

ESSAY

MANAGING CYBER RISKS

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I. INTRODUCTION

Cybersecurity concerns are an ever-increasing threat.¹ The rising cost, frequency, and severity of data breaches² now dominate risk management discussions.³ Over the last ten years, more than 4,000 known data breaches have shocked, debilitated, and even (temporarily) paralyzed markets.⁴ Commentators estimate that potentially billions of records containing confidential or sensitive data have been compromised.⁵ Experts suggest that data breaches cost the global economy more than \$400 billion dollars of losses annually.⁶ Heads of state around the world have committed to enhance cybersecurity, to protect intellectual property and confidential or sensitive data, and to aggressively

¹ See Tom C.W. Lin, *Financial Weapons of War*, 100 MINN. L. REV. 1377, 1381 (2016) (discussing financial infrastructure as a “new theater of war”); Matthew Goldstein, *Brokerage Firms Worry About Breaches by Hackers, Not Terrorists*, DEALBOOK, N.Y. TIMES (Feb. 3, 2015, 11:54 AM), http://dealbook.nytimes.com/2015/02/03/brokerage-firms-most-worried-about-hackers-and-rogue-employees-finra-report-sa-ys/?_r=0 (discussing the threat of hacking faced by financial firms); Sam Jones, *Cyber Security: Business Is in the Front Line*, FIN. TIMES (Apr. 29, 2014, 10:35 AM), <http://www.ft.com/intl/cms/s/0/11b41ac4-c3cb-11e3-a8e0-00144feabcd0.html#axzz3hFamiepE> (noting an increase of data breaches by 63% in 2013); see also David E. Sanger & Julie Hirschfeld Davis, *Hacking Linked to China Exposes Millions of U.S. Workers*, N.Y. TIMES (June 4, 2015), <http://www.nytimes.com/2015/06/05/us/breach-in-a-federal-computer-system-exposes-personnel-data.html> (reporting that a large breach of federal employees’ data originated in China).

² Data breaches occur when cybercriminals hack into businesses or corporations to steal confidential information such as credit and debit card numbers, e-mail addresses, and phone numbers. E.g., Rachael M. Peters, *So You’ve Been Notified, Now What? The Problem with Current Data-Breach Notification Laws*, 56 ARIZ. L. REV. 1171, 1173 (2014) (discussing sizable data breaches at Target, Home Depot, and JPMorgan Chase).

³ See *infra* Part II.B.2.

⁴ *Protecting Consumer Information: Can Data Breaches Be Prevented?* Hearing Before the H. Subcomm. on Commerce, Mfg., and Trade, 113th Cong. 1–2 (2014) (statement of Lisa Madigan, Att’y Gen. of Illinois), <http://energycommerce.house.gov/hearing/protecting-consumer-information-can-data-breaches-be-prevented>.

⁵ See CTR. FOR STRATEGIC & INT'L STUDIES, NET LOSSES: ESTIMATING THE GLOBAL COST OF CYBERCRIME 3 (2014), <http://mcafee.com/US/resources/reports/np-economic-impact-cybercrime2.pdf> (“The cost of cybercrime includes the effect of hundreds of millions of people having their personal information stolen—incidents in the last year include more than 40 million people in the US, 54 million in Turkey, 20 million in Korea, 16 million in Germany, and more than 20 million in China. One estimate puts the total at more than 800 million individual records in 2013.”).

⁶ *Id.* at 2.

prosecute cybercriminals.⁷ Private sector efforts to mitigate the effects of cyberattacks reflect similar goals.⁸ As cyberattacks multiply, governments, corporations, and citizens scramble to mount a successful defense against cyber-intrusions. The size, sophistication, and diversity of styles of the cyberattacks renders these activities among the most perilous of emerging risk management concerns.

President Obama recently announced that cybersecurity is “one of the most serious economic and national security challenges we face as a nation.”⁹ By the admission of the President, however, the United States is woefully underprepared to address the threat of cyberattacks.¹⁰ For the government and certain critical industries, cybersecurity risk management concerns may have catastrophic consequences. By targeting these industries, hackers may disrupt business operations,¹¹ gain access to or manipulate sensitive or confidential data,¹² or simply steal intellectual property¹³ or tangible assets.¹⁴

⁷ See Press Release, Office of the Press Sec'y, The White House, Excerpts of the President's State of the Union Address (Jan. 20, 2015), <http://www.whitehouse.gov/the-president/2015/01/20/excerpts-president-s-state-union-address> (providing President Obama's statement that “[n]o foreign nation, no hacker, should be able to shut down our networks, steal our trade secrets or invade the privacy of American families, especially our kids” (internal quotations omitted)); Nicholas Watt et al., *David Cameron Pledges Anti-Terror Law for Internet After Paris Attacks*, THE GUARDIAN (Jan. 12, 2015, 5:04 PM), <http://www.theguardian.com/uk-news/2015/jan/12/david-cameron-pledges-anti-terror-law-internet-paris-attacks-nick-clegg> (“The Prime Minister said a future Conservative government would aim to deny terrorists ‘safe space’ to communicate online”); Mark Rutte, Prime Minister of N.Z., Speech at the Hague Global Conference on Cyber Space (Apr. 16, 2015), <https://www.government.nl/topics/cybercrime/documents/speeches/2015/04/16/speech-by-prime-minister-mark-rutte-at-the-opening-of-the-gccs-2015> (“We need to invest in security so that legitimate [Internet] users will benefit and criminals will think twice.”).

⁸ See *infra* Part II.B.

⁹ Barack Obama, President of the U.S., Remarks by the President at the Cybersecurity and Consumer Protection Summit (Feb. 13, 2015), <https://www.whitehouse.gov/the-press-office/2015/02/13/remarks-president-cybersecurity-and-consumer-protection-summit>.

¹⁰ *Id.*

¹¹ See, e.g., Jay P. Kesan & Carol M. Hayes, *Mitigative Counterstriking: Self-Defense and Deterrence in Cyberspace*, 25 HARV. J.L. & TECH. 429, 445–46 (2012) (“Cyberattacks’ indirect effects are generally larger than their direct effects because the attackers focus on causing disruption after the attacks”).

¹² See, e.g., Matthew Goldstein & Nicole Perlroth, *Authorities Closing in on Hackers Who Stole Data from JPMorgan Chase*, DEALBOOK, N.Y. TIMES (Mar. 15, 2015), <http://www.nyti>

Cyberattacks capture national and international attention because of their pervasive effects. For example, in December 2013, Target announced that the discount retailer company had suffered a data breach.¹⁵ The hackers who orchestrated the crime obtained the confidential credit and debit card information of more than 40 million customers.¹⁶ As investigations ensued, Target continued to adjust its estimate of the number of records accessed, ultimately reporting that hackers captured the personal data of as many as 110 million customers.¹⁷ In 2014, in a data breach involving a similar method of deception, hackers invaded home improvement retailer Home Depot's records and acquired 56 million customers'

mes.com/2015/03/16/business/dealbook/authorities-closing-in-on-hackers-who-stole-data-from-jpmorgan-chase.html ("[H]ackers gain[ed] access to email addresses and phone numbers for 83 million households and small businesses . . ."); Jones, *supra* note 1 ("[C]riminally-motivated cyber breaches are not just related to cyber theft, but can increasingly involve market manipulation. One international lawyer says he is aware of attacks that targeted his and other similar law firms to mine information on merger and acquisition activity in London and New York.").

¹³ See, e.g., *Fighting China's Hackers: Is It Time to Retaliate Against Cyber-Thieves?*, ECONOMIST (May 25, 2013), <http://www.economist.com/news/united-states/21578405-it-time-retaliate-against-cyber-thieves-fighting-chinas-hackers> ("American officials . . . report that intellectual property (IP) is being stolen on an unprecedented scale, and that passive defenses no longer work.").

¹⁴ See, e.g., David E. Sanger & Nicole Perlroth, *Bank Hackers Steal Millions via Malware*, N.Y. TIMES (Feb. 14, 2015), <http://www.nytimes.com/2015/02/15/world/bank-hackers-steal-millions-via-malware.html> (describing how hackers forced an ATM to dispense cash); Ian Wylie, *Danger in the Digital Age: The Internet of Vulnerable Things*, FIN. TIMES (Apr. 26, 2015, 11:59 PM), <http://www.ft.com/cms/s/0/fc2570f0-cef4-11e4-b761-00144feab7de.html#axzz3r0dmZUid> ("Less well understood are the growing cyber threats to physical assets, as the online world merges with the real one.").

¹⁵ See Rachel Abrams, *Target Puts Data Breach Costs at \$148 Million, and Forecasts Profit Drop*, N.Y. TIMES (Aug. 5, 2014), <http://www.nytimes.com/2014/08/06/business/target-puts-data-breach-costs-at-148-million.html> (discussing how hackers stole Target customers' credit card and other personal information in a data breach).

¹⁶ Elizabeth A. Harris & Nicole Perlroth, *For Target, the Breach Numbers Grow*, N.Y. TIMES (Jan. 10, 2014), <http://www.nytimes.com/2014/01/11/business/target-breach-affected-70-million-customers.html>.

¹⁷ Harris & Perlroth, *supra* note 16; see also Nicole Perlroth, *Target Stuck in the Cat-and-Mouse Game of Credit Theft*, N.Y. TIMES (Dec. 19, 2013), <http://www.nytimes.com/2013/12/20/technology/target-stolen-shopper-data.html> ("Target said that from Nov. 27 to Dec. 5 hackers stole customer names, credit or debit card numbers, expiration dates and three-digit security codes . . .").

credit and debit account information and 53 million customers' e-mail addresses.¹⁸

In both the Target and Home Depot data breaches, malicious software (malware) infected the business's cash register system enabling hackers to view, record, and alter data.¹⁹ One risk from such a breach of customers' credit and debit card information and personal data is that hackers may make counterfeit cards and commit fraud.²⁰ Research firm Aite estimates that the costs of counterfeit fraud reached \$1.35 billion in 2008 and accounted for 15.7% of the total \$8.6 billion in credit and debit card fraud in the same year.²¹

These large-scale data breaches are not unique to chain retailers. While cyberattacks against retailers are troubling, hackers' efforts to breach the firewalls of financial institutions and exchanges at the center of international commercial enterprise—financial institutions—could threaten to destabilize global economic systems.

The architecture of modern markets makes financial institutions critical to global commerce and to the operations of local, state, national, and foreign governments.²² The universe of

¹⁸ Shelly Banjo, *Home Depot Hackers Exposed 53 Million Email Addresses*, WALL ST. J. (Nov. 6, 2014, 8:03 PM), <http://www.wsj.com/articles/home-depot-hackers-used-password-stole-n-from-vendor-1415309282>; see also Maggie McGrath, *Home Depot Confirms Data Breach, Investigating Transactions from April Onward*, FORBES (Sept. 8, 2014, 5:32 PM), <http://www.forbes.com/sites/maggiemcgrath/2014/09/08/home-depot-confirms-data-breach-investigating-transactions-from-april-onward/> (discussing Home Depot's payment data systems breach).

¹⁹ See Banjo, *supra* note 18 ("The hackers evaded detection in part because they moved around Home Depot's systems during regular daytime business hours and designed the malware to collect data, take steps to transmit it to an outside system and erase its traces"); Andrea Peterson, *Secret Service Estimates Type of Malware that Led to Target Breach Is Affecting Over 1,000 U.S. Businesses*, WASH. POST (Aug. 22, 2014), <https://www.washingtonpost.com/news/the-switch/wp/2014/08/22/secret-service-estimates-type-of-malware-that-led-to-target-breach-is-affecting-over-1000-u-s-businesses/> ("The malware remotely exploits businesses' administrator accounts and steals consumer's [sic] payment data, such as their credit and debit card numbers.").

²⁰ For a general discussion of the concept of risk, see *infra* Part II.A.

²¹ FED. RESERVE SYS., THE 2013 FEDERAL RESERVE PAYMENTS STUDY: RECENT AND LONG-TERM PAYMENT TRENDS IN THE UNITED STATES: 2003–2012, at 41 tbl.3.3.1, 42 tbl.3.3.2 (2013), https://www.frbservices.org/files/communications/pdf/research/2013_payments_study_summary.pdf.

²² See *infra* Part III.A.

financial institutions is broad. It includes conventional depository banks, as well as securities, commodities, and derivatives platforms or exchanges; investment banks, hedge, pension, and mutual funds; brokerage firms; and, in some cases, insurance companies. Pursuant to federal regulation and consistent with their business models, large financial institutions acquire, collect, and retain significant volumes of personal information. Possession of and control over this sensitive data makes financial institutions and retailers highly attractive targets for hackers.²³

Shocking examples of breaches at financial institutions underscore these concerns. In 2013, hackers penetrated network systems at both Citibank and JP Morgan Chase.²⁴ Consequently, hackers accessed the data related to tens of thousands of customer accounts. While the threat to individual financial institutions is alarming, the significance of the largest financial institutions in the global economy, the interconnectedness of these businesses, and their shared dependence on technology create a new body of systemic risk concerns.²⁵ If hackers successfully disrupt the sources of securities and commodities exchange platforms or the transaction network of the payment and banking system, the devastation and damage would trigger a chain of negative

²³ See Doug Carroll, *Banks Admit Growing Cyberattack Risks*, USA TODAY (Aug. 28, 2014, 4:06 PM), <http://www.usatoday.com/story/money/business/2014/08/28/banks-growing-cyber-security-risks/14741653/> (highlighting financial firms' responses to cybercrime risks); Jones, *supra* note 1 ("As many of the world's largest companies are beginning to realise, the threat to their margins, their brands and even their continued existence from cyberattacks is no longer an abstract risk they can ignore."); R. Andrew Patty II, *Credit Card Issuers' Claims Arising From Large-Scale Data Breaches*, 28 J. TAX'N FIN. INST. 5, 5 (2015) ("[L]arge collections and streams of information in the possession or control of major retailers and other merchants associated with specific financial accounts held at card-issuing financial institutions have proven to be tempting targets for bad actors who are seeking pecuniary gain or striving to sabotage infrastructure for political or ideological reasons.").

²⁴ Randall Smith & Alison Tudor, *Citi, Confirming Breach, to Issue Tens of Thousands of New Cards*, WALL ST. J. (June 9, 2011, 6:22 PM), <http://www.wsj.com/articles/SB10001424052702304259304576374713184158184>; Emily Glazer & Danny Yadron, *J.P. Morgan Says About 76 Million Households Affected by Cyber Breach*, WALL ST. J. (Oct. 2, 2014, 9:32 PM), <http://www.wsj.com/articles/j-p-morgan-says-about-76-million-households-affected-by-cyber-breach-1412283372>.

²⁵ See generally Lawrence G. Baxter, *Betting Big: Value, Caution and Accountability In an Era of Large Banks and Complex Finance*, 31 REV. BANKING & FIN. L. 765 (2012) (discussing the costs and benefits of large-scale financial institutions).

consequences for businesses, governments, and individuals around the world.

Cyber risks are evolving and this metamorphosis requires a prompt regulatory response. Unlike liquidity, credit, market, and other types of financial market risks, cyber risks threaten to trigger a series of losses far more debilitating than a run on any individual financial institution. Cyber risks, by their nature, reflect a sophisticated and complex concern. Cyber risks threaten disruptive attacks against interconnected and systemically important banking and non-banking financial institutions. Even a temporary disruption in banking, payment, and financial instruments trading platforms may destabilize markets. The consequences of a well-targeted cyberattack cast a shadow that may reach institutions and individuals all over the country and possibly in many countries around the world.

It is possible that concerns regarding cyber threats and financial markets are overstated. While cyberattacks have yet to undermine the national economy, hackers continue to develop new methods of penetrating proprietary systems. The Carbanak cyberattack in 2013 evinces the imminent nature and high probability of this new front and establishes that we are on the edge of a new digital frontier.²⁶

In late 2013, the Carbanak cybergang unleashed a cyberattack on more than one hundred financial institutions across thirty different countries.²⁷ Over a period of several months, Chinese and European hackers remotely programmed automatic teller machines (ATMs) to dispense cash and transfer millions of dollars in funds from customers' accounts in Europe, the United States, and Japan.²⁸ Hackers gained control over the internal operational systems of the individual financial institutions by baiting bank employees with e-mails that appeared to be from colleagues, urging the employees to download malware.²⁹ For nearly two

²⁶ Sanger & Perlroth, *supra* note 14 ("[T]he 'Carbanak cybergang,' named for the malware it deployed, represents an increase in the sophistication of cyberattacks on financial firms.").

²⁷ See *id.* ("[T]he scope of the attack . . . could make it one of the largest bank thefts ever.").

²⁸ *Id.*

²⁹ *Id.*

years, the hackers used software to monitor employees' daily routines, captured videos and screenshots, and reviewed and recorded video feeds.³⁰ Hackers later used the intelligence they gathered to access the banking institutions' systems and impersonate employees while the malware remotely triggered ATMs to dispense cash and to transfer funds.³¹

Data breaches that result in fraud and theft create noteworthy risks for financial institutions and many scholars and commentators have explored these issues. This Essay suggests that the most significant cyber threats facing financial institutions loom under-explored and under-theorized. Cyber threats against financial intermediaries that link systemically important financial institutions create systemic risk concerns. Financial institutions are critically dependent on technology to conduct their business and their role in the domestic and international economy suggest that disastrous consequences may follow if the operations of these channels of commerce experience disruption.

In 2011, one of the largest international securities exchanges, NASDAQ, confirmed that its computer network was hacked and confidential documents were accessed.³² The brazen penetration of this venerable exchange, which provides a securities platform impacting market prices and economic stability around the world, shocked market participants. Theories regarding the hackers' motivations range from presumptions that the intruders were seeking nonpublic inside information to whispers of terrorism, theft, or wire fraud. The intentions that prompted the hackers to attack the exchange's network are far less troubling than the mere fact that their efforts were successful.

Adopting the perspective that cyber risks may engender catastrophic loses, Congress adopted the Cybersecurity Information Sharing Act of 2015 (CISA).³³ The Act designates a

³⁰ *Id.*

³¹ *Id.*

³² Devlin Barrett et al., *Nasdaq Confirms Breach in Network*, WALL ST. J. (Feb. 7, 2011, 12:01 AM), <http://www.wsj.com/articles/SB10001424052748703989504576128632568802332>.

³³ H.R. 2029, 114th Cong., div. N., tit. I §§ 101–111 (enacted). See also Orin Kerr, Op., *How Does the Cybersecurity Act of 2015 Change the Internet Surveillance Laws?*, VOLOKH CONSPIRACY, WASH. POST (Dec. 24, 2015), <https://www.washingtonpost.com/news/volokhconsp/>

method for federal and state governments, as well as private entities, to voluntarily exchange information regarding cybersecurity threats, seeks to prevent and mitigate cyberattacks, and establishes a process for real-time sharing and receipt of cybersecurity threat information.³⁴

This Essay approaches cyber risks as systemic risks. It presents an outline of principles governing the development of cyber risk regulation by normatively and descriptively examining the evolution of cyber regulation in financial markets and identifying promising opportunities to thwart hackers and others who seek to disrupt securities and commodities exchanges, banking institutions, and payment systems. Both endogenous and exogenous cyber threats reveal weak internal controls, crumbling firewalls, or failures to build redundant protective systems. Because these businesses are publicly traded companies competing in capital markets to attract investors, it is unlikely that these institutions will be motivated to reveal risk exposures if the sole reward is protecting the public good.

This Essay examines these questions and proposed responses. Part II of this Essay examines the theory of risk management concerns and argues that cybersecurity concerns constitute the newest risk management frontier. Part III examines the contours and definitions of terms at the center of the cybersecurity risk management crisis in the financial services industry and explains the cybersecurity concerns that plague financial institutions. Part III also surveys proposed solutions designed to address cybersecurity concerns at large, systemically important financial institutions. Part IV examines the contours of the CISA and argues that information sharing is a critical component to successfully defend against cyberattacks aimed at systemically important financial institutions and financial intermediaries. Information sharing alone, however, is an incomplete solution. This Essay evaluates the contributions of industry-initiated and

iracy/wp/2015/12/24/how-does-the-cybersecurity-act-of-2015-change-the-internet-surveillance-laws/ (describing the recently adopted provision of the Omnibus Appropriations Act aimed at cybersecurity surveillance—the Cybersecurity Act of 2015).

³⁴ See *infra* Part IV.A.

federal agency-proposed alternatives to the growing cyber risks that threaten domestic and international financial institutions.

II. UNDERSTANDING, MANAGING, AND MITIGATING SYSTEMIC RISKS

Financial market regulation and literature exploring regulation frequently implore market participants to take action to reduce the likelihood that “systemic risks” will materialize. The notion of systemic risk animates discussions regarding the causes of the recent financial crisis and justifications for the imposition of regulation designed to prevent future crises. Notwithstanding the use of this popular term, there is no widely accepted or uniform definition of systemic risk. Unable to define systemic risk, scholars, commentators, and regulators struggle to develop well-tailored regulation to manage and mitigate systemic risk. Part II.A identifies several commonly occurring risks in financial markets. Part II.B argues that the definition of systemic risk is evolving, creating challenges for regulators attempting to manage or mitigate systemic risk.

A. IDENTIFYING RISKS

The term risk is used colloquially to suggest that an action or decision may lead to a negative outcome.³⁵ In truth, risk taking may lead to either a positive or negative outcome.³⁶ Risk simply describes an element of uncertainty or the chance for a range of possible outcomes.³⁷

³⁵ Cf. GEOFFREY PARSONS MILLER, THE LAW OF GOVERNANCE, RISK MANAGEMENT, AND COMPLIANCE 535 (2014) (“The traditional notion conceives of risk as the chance of something bad happening The more modern approach, however, sees the chance of something bad happening as only one aspect of risk. A more general understanding would also include the chance of something good happening. Risk in this sense is measured by the dispersal of outcomes rather than simply the chance of a bad one.”).

³⁶ *Id.*

³⁷ See Roger Miller & Donald Lessard, *Evolving Strategy: Risk Management and the Shaping of Large Engineering Projects* 4 (MIT Sloan Sch. of Mgmt., Working Paper No. 4639-07, 2007), <http://ssrn.com/abstract=96260> (“Risk is the possibility that events, their resulting impacts, and their dynamic interactions will turn out differently than anticipated. Risk is typically viewed as something that can be described in statistical terms, while

Financial markets and financial institutions face various classes of risk including credit, liquidity, interest rate, and market risk.³⁸ Lending arrangements give rise to credit risks or concerns that a debtor may fail to repay an outstanding debt obligation. There are several types of contractual arrangements that create credit risk. When a creditor, such as a local community bank, extends a loan to a borrower to buy a home, the possibility that the borrower will not repay the outstanding principal or interest obligation creates a credit risk.³⁹ Credit risks are an immutable characteristic of lending arrangements and arise in contracts involving a diverse spectrum of borrowers.⁴⁰

Liquidity risks involve the potential that the debt obligations of an enterprise may exceed the assets of the business.⁴¹ Consider, for example, the activities of a conventional depository bank that maintains savings account deposits and issues home loans. The bank may face a liquidity crisis if all savings accountholders run to the bank demanding return of their deposits at a time when the bank has issued their deposits to borrowers seeking home loans. The residential mortgages may have terms of ten, twenty, or thirty

uncertainty is viewed as something that applies to situations in which potential outcomes and causal forces are not fully understood.”).

³⁸ ANTHONY SAUNDERS & MARCIA MILLON CORNETT, FINANCIAL MARKETS AND INSTITUTIONS 576 tbl.19-1 (5th ed. 2012). Credit risk, for example, is “the risk that promised cash flows . . . may not be paid in full.” *Id.* Liquidity risk may result from unexpected liability that forces a firm “to liquidate assets in a very short period of time and at low prices.” *Id.* Interest rate risk is “incurred . . . when the maturities of [a firm’s] assets and liabilities are mismatched and interest rates are volatile.” *Id.* Financial institutions face these and several other risks. *See, e.g., id.* (defining risks in financial institution). Because the attributes of the business models of financial institutions vary, the risks described here may present differently for each type of financial institution.

³⁹ See Heath Price Tarbert, Comment, *Are International Capital Adequacy Rules Adequate? The Basel Accord and Beyond*, 148 U. PA. L. REV. 1771, 1775 (2000) (“The bank’s role as a financial intermediary involves many specific risks, of which the most predominant is credit risk—that a borrower will default on a loan.”); Kristin N. Johnson, *Governing Financial Markets: Regulating Conflicts*, 88 WASH. L. REV. 185, 206 (2013).

⁴⁰ See Kristin N. Johnson, *Addressing Gaps in the Dodd-Frank Act: Directors’ Risk Management Oversight Obligations*, 45 U. MICH. J.L. REFORM 55, 64 (2011) (“Large, complex financial institutions originate loans to many types of borrowers including corporations with operations around the world; other banks, thrifts, and more sophisticated financial institutions; hedge funds; and private equity firms.”).

⁴¹ FDIC RMS MANUAL OF EXAMINATION POLICIES, LIQUIDITY AND FUNDS MANAGEMENT § 6.1-2 (2015).

years. In this situation, the bank could not return savers' deposits until borrowers repay residential mortgages. The business model of conventional depository banks creates an asset-liability mismatch.⁴² If customers make a run on the bank and the bank must dispose of assets at fire sale prices, the bank may suffer substantial financial losses.⁴³

Another common type of financial risk—interest rate risk—is intimately related to liquidity risk.⁴⁴ Interest rates reflect the price at which banks agree to lend to borrowers, including other financial institutions.⁴⁵ Interest rates enable lenders to limit exposure when matching short-term assets and long-term liabilities.⁴⁶ Interest rates and asset trading prices comprise a broader category of risks—market risks. This category of risk arises from sudden changes in the prices of frequently traded assets or pricing benchmarks.⁴⁷ Firms engaged in the purchase and sale of securities, commodities, raw materials, and various manufacturing industries all navigate the challenges of market risk.⁴⁸ The active equity and debt securities or commodities

⁴² When a financial institution does not possess the necessary cash to satisfy a withdrawer request, the institution “may have to sell some of their less liquid assets to meet the [demands].” SAUNDERS & CORNETT, *supra* note 38, at 579.

⁴³ See *id.* (providing examples of financial institutions that experienced severe distress after a “run” by depositors on cash deposits).

⁴⁴ Interest rate risk can occur when financial institutions “mismatch[] the maturities of its assets and liabilities as part of its asset transformation function.” *Id.* at 580. Longer maturity assets pose increased risk for financial institutions because interest rates can change from year to year. OFFICE OF INVESTOR EDUC. & ADVOCACY, SEC. & EXCH. COMM’N, SEC PUB. NO. 151, INVESTOR BULL.: INTEREST RATE RISK—WHEN INTEREST RATES GO UP, PRICES OF FIXED-RATE BONDS FALL 4 (2013), http://www.sec.gov/investor/alerts/ib_interestrate.pdf. Interest rate risk encompasses the following: refinancing risk, a type of interest rate risk where the “the cost of refinancing can be more than the return earned on asset investments”; reinvestment risk, “[t]he risk that the returns on funds to be reinvested will fall below the cost of funds”; and price risk, “the risk that the price of the security will change when interest rates change.” SAUNDERS & CORNETT, *supra* note 38, at 581–82.

⁴⁵ *Lending Rates*, BANK OF CAN. (Oct. 2011), http://www.bankofcanada.ca/wp-content/uploads/2010111/lending_rates.pdf (explaining how banks set interest rates).

⁴⁶ SAUNDERS & CORNETT, *supra* note 38, at 580.

⁴⁷ *Id.* at 582. See generally BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, AMENDMENT TO THE CAPITAL ACCORD TO INCORPORATE MARKET RISKS (2005), <http://www.bis.org/publ/bcbs119.pdf> (providing for the measurement of market risk).

⁴⁸ Johnson, *supra* note 40, at 63–64.

trading desks of financial institutions expose these businesses to significant market risk.⁴⁹

B. WHY ARE SYSTEMIC RISKS SPECIAL?

Recent turmoil in financial markets⁵⁰ casts a spotlight on the perils of risk management failures in financial markets. Commentators, regulators, and financial market participants express concerns that a single shock or series of shocks may trigger a daisy chain of losses and lead to the insolvency of one or more systemically important financial institutions.⁵¹ Scholars and commentators describe the risk of a series of financial institution failures as systemic risk. Yet, systemic risk is not a term of art with a simple, precise, user-friendly definition. Interpretations differ regarding the types of threats that constitute systemic risk. Notwithstanding popular use of the term, the existing literature

⁴⁹ SAUNDERS & CORNETT, *supra* note 38, at 583. The named examples of risks are generally self-explanatory. For a careful and valuable examination of reputational risk and the theory of misconduct risk, see Christina Parajon Skinner, *Misconduct Risk*, 84 FORDHAM L. REV. 1559 (2016). It bears mentioning, however, that the sovereign risk described here refers to “[t]he risk that repayments from foreign borrowers may be interrupted because of interference from foreign governments.” SAUNDERS & CORNETT, *supra* note 38, at 588. Unlike loans to domestic corporations, where there are available remedies for default, loans to foreign subsidiaries may not be paid back because “the government of the country in which the corporation is headquartered may prohibit or limit debt repayments due to foreign currency shortages and adverse political events.” *Id.* If a foreign country is unable or unwilling to repay their debt, the loaning financial institution “has little if any recourse to local bankruptcy courts or to an international civil claims court.” *Id.* at 589. Insolvency can result in the failure of a significant financial institution, which could disrupt the domestic and global economy and even trigger a domino effect of global losses. *See, e.g., id.* (describing the failure of two major financial institutions, Washington Mutual and Citigroup, due to insolvency).

⁵⁰ See, e.g., FIN. CRISIS INQUIRY COMM’N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES, at xv (2011), http://fcic-static.law.stanford.edu/cdn_media/fci_c-reports/fcic_final_report_conclusions.pdf (“As this report goes to print, there are more than 26 million Americans who are out of work, cannot find full-time work, or have given up looking for work. About four million families have lost their homes to foreclosure and another four and a half million have slipped into the foreclosure process or are seriously behind on their mortgage payments. Nearly \$11 trillion in household wealth has vanished, with retirement accounts and life savings swept away.”).

⁵¹ See, e.g., Steven L. Schwarcz, *Systemic Risk*, 97 GEO. L.J. 193, 204 (2008) (defining systemic risk).

leaves important questions regarding the specific details of systemic risk unresolved.

1. *Understanding Systemic Risks.* Interpreted literally, systemic risk refers to concerns that threaten the stability of an organizational system. In the context of financial markets, the “system” refers to the financial institutions, payment systems, and trading platforms and exchanges that comprise the foundation of the domestic and global economy. Clarifying the meaning of the “risks” that threaten financial market stability is, however, more complicated.

While there is no consensus on a definition of “systemic risk” and scholars and regulators’ accounts of the events that engender systemic risks differ, descriptions of systemic risk possess some common elements. It is widely agreed that systemic risk refers to “a trigger event, such as an economic shock or institutional failure, [that] causes a chain of bad economic consequences—sometimes referred to as a domino effect.”⁵²

Yet, it is unclear how substantial volatility must be to register as systemically significant. Is the metric for volatility tied to whether fluctuating prices have significant adverse effects on the real economy? Or should the focus be on whether volatility may lead to a disruption and not a crisis? E. Gerald Corrigan, a former Federal Reserve President, proposes that focusing on the impact of risks—whether risks lead to a mere disruption and not a prolonged period of slow growth—helps us evaluate when risks ought to be classified as systemic.⁵³

This Essay adopts the perspective that one must evaluate the probability that a risk will materialize and the magnitude of the impact of risk that transforms the threat into a systemic risk.

⁵² *Id.* at 198. Professor Steven Schwarcz instructs that “[t]hese consequences could include (a chain of) financial instruction and/or market failures . . . [or] [l]ess dramatically . . . (a chain of) significant losses to financial institutions . . . [and] can deprive society of capital and increase its cost . . . or decrease[] its availability.” *Id.*

⁵³ *Hedge Funds and Systemic Risks in the Financial Markets: Hearing Before the H. Comm. on Fin. Servs.,* 110th Cong. 8 (2007) (statement of E. Gerald Corrigan, Managing Dir., Goldman Sachs & Co.) (“[S]ystemic risk of a financial nature is . . . a financial shock that brings with it the reality or the clear and present danger of inflicting significant damage of the financial system and the real economy.”).

This approach captures the elements of systemic risk that scholars commonly accept and goes further to encompass Frederic Mishkin's proposition that systemic risk is "the likelihood of a sudden, usually unexpected, event that disrupts information in financial markets, making them unable to channel funds to those parties with the most productive investment opportunities."⁵⁴ As the Federal Reserve has explained, systemic risks arise when important financial institutions, such as payment systems, experience disruptions that trigger a domino effect of consequences. According to the Federal Reserve,

[S]ystemic risk may occur if an institution participating on a private large-dollar payments network were unable or unwilling to settle its net debit position. If such a settlement failure occurred, the institution's creditors on that network might also be unable to settle their commitments. Serious repercussions could, as a result, spread to other participants in the private network, to other depository institutions not participating in the network, and to the nonfinancial economy generally. A Reserve Bank could be exposed to indirect risk if Federal Reserve policies did not address this systemic risk.⁵⁵

Exploring the methods of mitigating and managing systemic risks further clarifies the contours of systemic risks.

2. *A Brief Survey of Risk Management Approaches.* Risk management is a central pillar in financial market stability and a

⁵⁴ Frederic S. Mishkin, *Comment on Systemic Risk*, 7 RES. FIN. SVCS. PRIV. & PUB. POL'Y 31, 32 (1995) ("Systemic risk is the likelihood of a sudden, usually unexpected, event that disrupts information in financial markets, making them unable to effectively channel funds to those parties with the most productive investment opportunities.").

⁵⁵ Policy Statement on Payments System Risk, 66 Fed. Reg. 30,199, 30,200 (Bd. of Governors of the Fed. Reserve Sys., 2001).

key element in financial market regulation.⁵⁶ Scholars describe efforts to identify, assess, or mitigate outcomes that could lead to losses as risk management strategies.⁵⁷ Successful risk management strategies may engender a multitude of benefits and are as diverse as the businesses and industries that adopt them. To manage risks, business may rely on a wealth of endogenous tools, such as enterprise risk management (ERM) strategies⁵⁸ or corporate governance structures, and exogenous solutions, such as minimum capital ratios or living wills.⁵⁹ Risk management thus “involves organizational processes that generally include risk identifying, measuring, and mitigating procedures.”⁶⁰ Risk management is, “at its most fundamental level...about identifying bad outcomes that could occur in an uncertain future and taking deliberate action to shift the odds in a firm’s favor.”⁶¹

Modern risk management theory began at the turn of the twentieth century when Louis Bachelier pioneered a model of

⁵⁶ See generally Pierre Duguay, Dep'y Governor, Bank of Can., Remarks to the Risk Management Association, Toronto Chapter, Toronto, Ontario (Jan. 8, 2009) (explaining the importance of risk management strategies to achieve financial stability).

⁵⁷ E.g., Nizan G. Packin, *It's (Not) All About the Money: Using Behavioral Economics to Improve Regulation of Risk Management Financial Institutions*, 1 U. PA. J. BUS. L. 419, 434 (2012) (“Risk managers...attempt to reduce the likelihood of negative outcomes.”); Johnson, *supra* note 40, at 61 (“[M]ethods developed to measure, mitigate, or manage risk generally focus on estimating the probability and magnitude of risks that lead to losses.”); Miller & Lessard, *supra* note 37, at 8 (describing several risk management techniques).

⁵⁸ See Kristin N. Johnson, *Macroprudential Regulation: A Sustainable Approach to Regulating Financial Markets*, 2013 U. ILL. L. REV. 881, 899 (describing the complexity of the risk management strategies businesses adopt, including ERMs, which “attempt to comprehensively measure risks”).

⁵⁹ See Victoria McGrane & James Sterngold, *Fed Sets Tough New Capital Rule for Big Banks*, WALL ST. J. (Dec. 9, 2014, 8:43 PM), <http://www.wsj.com/article/fed-proposes-extra-capital-requirement-for-8-biggest-u-s-banks-1481507> (noting regulatory imposition of “fatter capital cushions...to make the financial system less risky”); Ryan Tracy & Victoria McGrane, *Big U.S. Banks Refile ‘Living Wills’ After Regulatory Rebuke*, WALL ST. J. (July 6, 2015, 10:53 PM), <http://www.wsj.com/articles/big-us-banks-refile-living-wills-after-regulatory-rebuke-1436212747> (reporting that, among others, JP Morgan Chase & Co. re-submitted plans for reorganization to help mitigate damage in the event of financial failure). See generally RENÉ STULZ, RISK MANAGEMENT AND DERIVATIVES (2003) (providing insight into the way businesses can maximize corporate value through various risk management techniques).

⁶⁰ Johnson, *supra* note 40, at 63.

⁶¹ Robert Weber, *A Theory for Deliberation-Oriented Stress Testing Regulation*, 98 MINN. L. REV. 2236, 2251 (2014) (citing DAN BORGE, THE BOOK OF RISK 4 (2001)).

Brownian motion to analyze fluctuations in the prices of financial assets.⁶² In 1939, the American Finance Association met for the first time, and in 1942, they published their first journal, *American Finance*.⁶³ The decades that followed ushered in a period of innovation in risk management.⁶⁴ Mathematicians and physicists embraced their celebrated role among financial institutions and developed asset pricing models such as the Black-Scholes options pricing formula and the Noble prize-winning Capital Asset Pricing Model.⁶⁵ Both models enjoyed tremendous popularity.

Beginning in the early 1970s with the collapse of the Bretton Woods system, financial product engineers began to design newly styled currency derivatives products.⁶⁶ Financial product engineers posited that these derivatives, currency futures, and options and interest rate swaps would reduce risk exposure and facilitate hedging.⁶⁷

During the 1980s and 1990s, market participants engineered and encouraged the development of hedging products including default and credit risk management tools.⁶⁸ In the late 1980s, the Basel Committee on Banking Supervision initiated a series of discussions among the central banking authorities of the nations with the largest economies in the world; the discussions led several countries to implement the 1988 Basel Accord—a body of regulations designed to manage risks in the banking industry.⁶⁹

⁶² GEORGES DIONNE, RISK MANAGEMENT: HISTORY, DEFINITION AND CRITIQUE 6 (2013), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2231635.

⁶³ *Id.*; see also *About the Association*, AM. FIN. ASS'N, <http://www.afajof.org/details/page/3710241/About-the-Association.html> (last visited Sept. 20, 2015).

⁶⁴ DIONNE, *supra* note 62, at 7.

⁶⁵ Press Release, Royal Swedish Acad. of Scis., The Prize in Economics 1990 (Oct. 16, 1990), http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1990/press.html; PHILLIPE JORION, VALUE AT RISK 417–18 (3d ed. 2007) (describing CAPM).

⁶⁶ Shinhua Liu, *Currency Derivatives and Exchange Rate Forecastability*, 63 FIN. ANALYST J. 72, 72 (2007).

⁶⁷ See Arthur E. Wilmarth, Jr., *The Transformation of the U.S. Financial Services Industry, 1975–2000: Competition, Consolidation, and Increased Risks*, 2002 U. ILL. L. REV. 215, 332–33 (noting how the availability of new financial “tools” such as derivatives led to increased hedging by financial institutions).

⁶⁸ DIONNE, *supra* note 62, at 8.

⁶⁹ *Id.*

Depository banks subject to federal capital adequacy standards⁷⁰ adopted these risk-mitigating strategies because they reduced the appearance of the banks' risk exposure, enabling them to engage in a broader array of commercial activities.⁷¹

The 1980s and 1990s also saw American investment banks introduce formal risk management departments.⁷² Two of the most widely celebrated internal risk management models to emerge from this movement in the mid-1990s were RiskMetrics (a market risk management tool) and CreditMetrics⁷³ (a credit risk management tool).

Many financial institutions currently rely on value-at-risk (VAR) methodologies. VAR enables portfolio managers to avoid exceeding risk tolerance guidelines by estimating the worst expected loss over a given time period at a given confidence level under presumed market conditions.⁷⁴ VAR enables portfolio managers to assess the risks of loss associated with undertaking a certain risk.⁷⁵

Finally, stress testing offers another regularly cited risk management strategy.⁷⁶ Financial institutions use stress tests to determine their capacity to manage certain types of risks or shocks.⁷⁷ A stress test enables financial market participants to evaluate how best to respond to "severe, yet plausible, stressed

⁷⁰ See Uniform Financial Institutions Rating System, 62 Fed. Reg. 752, 752 (notice of adoption of policy statement Jan. 6, 1997) (providing a rating system by which to monitor the financial soundness and risk-taking of depository institutions using six key composite rating factors: Capital adequacy; asset quality management capability; earnings level and quality; liquidity adequacy; and market risk sensitivity).

⁷¹ See Allen C. Puwalski, *Derivatives Risk in Commercial Banking*, posting in *An Update on Emerging Issues in Banking*, FDIC (Mar. 26, 2003), <http://www.fdic.gov/bank/analytical/fyi/2003/02603fyi.html> ("The ability of participants in the financial markets to adjust specific risk exposures enhances the efficiency of capital flows by allowing companies to conduct business activities without amassing certain risks that would otherwise attend that business.").

⁷² DIONNE, *supra* note 62, at 8.

⁷³ *Id.*

⁷⁴ MILLER, *supra* note 35, at 563 (defining VAR as an estimate of "the maximum expected loss a firm will face within a specified probability level (known as the 'confidence level') over a particular time period (known as the 'time horizon')").

⁷⁵ Weber, *supra* note 61, at 2254.

⁷⁶ See *id.* at 2238–39 (explaining how financial systems could benefit from stress testing).

⁷⁷ *Id.* at 2238.

market conditions such as low economic output, high unemployment, stock market crashes, liquidity shortages, high default rates, and failures of large counterparties.”⁷⁸ Employing stress tests reveals triggers and weak links that may cause extraordinary losses.⁷⁹

U.S. and foreign regulators increasingly emphasize the value of stress testing.⁸⁰ Regulators believe that stress tests will (1) facilitate efforts to promote risk oversight; (2) encourage quantitative skepticism within bank risk management departments; and (3) align corporate governance practices among management in industries where externalities endanger significant populations such as, the nuclear power industry or the air traffic control industry.⁸¹

C. SYSTEMIC RISK MITIGATION

Examination of the commonly identified risks in financial markets and a comparison of these types of risk with systemic risks illustrate the rationale for treating systemic risks as unique and carefully regulating these concerns. Credit and capital markets serve as a critical infrastructure resource in international financial markets.⁸² Assets flow across territorial boundaries with

⁷⁸ *Id.* at 2238–39.

⁷⁹ *Id.* at 2239.

⁸⁰ See *id.* (“What is new, however, is the zeal with which lawmakers and regulators have looked to stress testing as a regulatory technique.”).

⁸¹ See *id.* at 2301–02 (noting three themes regulators should focus on when dealing with regulated firms and the implementation of stress tests).

⁸² See John C. Coffee, Jr., *Extraterritorial Financial Regulation: Why E.T. Can’t Come Home*, 99 CORNELL L. REV. 1259, 1269–70, 1269 n.33 (2014) (noting the relevance of “commons” literature to the regulation of financial institutions (citing Kristin N. Johnson, *Things Fall Apart: Regulating the Credit Default Swap Commons*, 82 U. COLO. L. REV. 167, 174 (2011))). Coffee, Johnson, and Steven Schwarcz are among a pioneering group of scholars exploring the application of Garrett Hardin’s tragedy of the commons to international financial markets. *Id.*; see also Iman Anabtawi & Steven L. Schwarcz, *Regulating Ex Post: How Law Can Address the Inevitability of Financial Failure*, 92 TEX. L. REV. 75, 90 (2013) (acknowledging that financial markets can suffer from “a type of tragedy of the commons in which finite capital resources are exploited”); Steven L. Schwarcz, *Protecting Financial Markets: Lessons from the Subprime Mortgage Meltdown*, 93 MINN. L. REV. 373, 386 (2008) (comparing the exploitation of scarce resources in a tragedy of the commons to the exploitation of scarce resources in a financial system). The innovative

ease as market participants simultaneously transact with counterparties in any number of countries around the world.⁸³ An international network of exchanges and clearinghouses enable financial market participants to execute many of the world's most significant transactions, transferring cash, securities, commodities, and other assets across national borders in seconds.⁸⁴ Technological innovations in international banking, payment, and settlement systems increasingly facilitate cross-border transactions.⁸⁵ Advancing technology will increasingly ensure that financial market transactions are uninhibited by conventional boundaries.

The development of infrastructural resources, such as international banks, bank holding companies, securities and commodities exchanges, and clearinghouses facilitates the execution of cross-border transactions.⁸⁶ These institutions also provide critical benefits, enhance market efficiency, permit more accurate price discovery, and promote greater portfolio diversification.⁸⁷ The engineering of these critical market actors

application of the tragedy of the commons parable to financial markets offers alternative solutions to regulatory questions prompted by cross-border transactions or financial market sectors characterized by market participants executing transactions through trading institutions operating in multiple jurisdictions.

⁸³ See JAMES MANYIKA ET AL., MCKINSEY GLOBAL INST., GLOBAL FLOWS IN A DIGITAL AGE: HOW TRADE, FINANCE, PEOPLE, AND DATA CONNECT THE WORLD ECONOMY 23, 61 (2014) (discussing the increasingly international nature of commercial transactions).

⁸⁴ See Chris Brummer, *Post-American Securities Regulation*, 98 CAL. L. REV. 327, 346 (2010) (discussing how “innovations like the Internet” have drastically improved the rapidity and accuracy of international sales transactions).

⁸⁵ MANYIKA ET AL., *supra* note 83, at 37 (“[W]e see huge growth in the digital portions of flows of goods and services—a process we call digitization.”).

⁸⁶ See Stavros Gadinis & Howell E. Jackson, *Markets as Regulators: A Survey*, 80 S. CAL. L. REV. 1239, 1257–58, 1298 (2007) (concluding that many stock exchanges are “expanding their operations across national borders”).

⁸⁷ See Jeremy C. Kress, *Credit Default Swaps, Clearinghouses, and Systemic Risk: Why Centralized Counterparties Must Have Access to Central Bank Liquidity*, 48 HARV. J. ON LEGIS. 49, 65 (2011) (“The benefits of [clearinghouses] include loss mutualization and credit risk homogenization, multilateral netting, and information aggregation.”); Jerry W. Markham & Daniel J. Harty, *For Whom the Bell Tolls: The Demise of Exchange Trading Floors and the Growth of ECNs*, 33 J. CORP. L. 865, 882 (2008) (stating that the transparency of modern stock exchanges “provides a price discovery mechanism”); Johnson, *supra* note 39, at 189, 209 (noting that self-regulatory organizations, including financial institutions such as the British Banker’s Association, “frequently adopt and implement

and payment, trade, and settlement businesses, however, has also engendered endemic problems.

Regulatory efforts in the wake of the recent financial crisis reveal a fundamental concern growing in tandem with the burgeoning and deeply interconnected relationships among international financial market participants and financial institutions. No single international financial market regulator exercises the authority to address the lack of effective regulation in international financial markets. While funds and assets flow across national borders with ease, jurisdictional limitations circumscribe the scope of national regulators' authority.⁸⁸

Conventional wisdom suggests that nations may regulate activities within their borders. But when transactions in one nation create market consequences in another nation, regulators, in limited cases, will impose restraints on the foreign actors engaging in the activity that affects their domestic markets.⁸⁹ Generally, however, each nation regulates the market participants domiciled, and the transactions executed, within its territorial boundaries.⁹⁰

From this background, one should note that a dearth of information regarding domestic or foreign market participants in any market or the failure of regulators to collect and share information in a timely manner stymies efforts to quell systemic

industry standards that enhance efficiency and organization," and that complex financial instruments, such as credit derivative agreements, help diversify investor portfolios).

⁸⁸ See Pierre-Hugues Verdier, *Transnational Regulatory Networks and Their Limits*, 34 YALE J. INT'L L. 113, 114 (2009) (finding that although numerous institutions began regulating international economic interactions, "economic regulation in crucial areas such as competition, securities, and banking remains first and foremost a domestic phenomenon").

⁸⁹ E.g., Robert W. Staiger & Alan O. Sykes, *International Trade and Domestic Regulation* 44 (Stan. U. Pub. L. & Legal Theory Research Paper Series, Paper No. 1504913, 2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1504913 (illustrating how a country can regulate foreign actors who impose negative externalities on international markets by banning the importation of the foreign actor's harmful product and shifting the foreign producer's externalities from the domestic market).

⁹⁰ See Gary B. Born, *A Reappraisal of the Extraterritorial Reach of U.S. Law*, 24 L. & POL'Y INT'L BUS. 1, 10–16 (1992) (discussing traditional notions of the extraterritorial application of national law, particularly in the context of the American notion of extraterritoriality).

risks. Second, a revolution in risk management practice and technology has characterized the most recent era in financial market innovation. Effective regulation of financial market participants or financial market intermediaries requires careful consideration of appropriate risk management technology. Risk management technology should occupy a central role in the development of any international regulatory approach.

When financial institutions (whether conventional depository banking institutions, investment banks, or some type of lending syndicate) act as creditors, each carefully screens borrowers to ascertain their creditworthiness.⁹¹ Portfolio diversification, or the strategic allocation of credit risks across the spectrum of borrowers, offers another risk mitigation strategy.⁹² Finally, lenders require the payment of interest in connection with most lending arrangements; higher interest rates offset increased credit risk.⁹³

These few examples of risks and risk mitigation strategies illustrate the challenges that financial institutions face in their efforts to execute business strategies. The list is not static. Financial institutions must continuously adapt to address emerging risks.

Efforts to regulate systemic risk pose indisputably unique challenges. First, mitigating systemic risk requires properly identifying the sources of systemic risk. Second, regulation must be well-tailored to mitigate the threat of systemic risks. Finally, engineering effective regulation involves ensuring competent oversight and enforcement.

III. EMERGING SYSTEMIC RISK CONCERNs: CYBERSECURITY THREATS

While a well-identified body of risks, including credit, market, interest rate, and liquidity risk, has long been the subject of risk management experts, a new class of risk promises to test our most

⁹¹ SAUNDERS & CORNETT, *supra* note 38, at 579.

⁹² *Id.*

⁹³ *Id.* at 578.

valuable risk management strategies. This Part examines the burgeoning universe of risks growing from our dependence on cyberspace. These underexplored cyber risks are indisputably the next frontier of risk management concerns.

A. DEFINING CYBERSECURITY THREATS

Notwithstanding the popularity of concepts such as “cyber-incident,” “cybercrime,” and “cyberattack,” there are no universally adopted definitions for these terms. Generally, a cyber-incident refers to an unauthorized effort to access confidential or sensitive data.⁹⁴ A cybercrime is “any crime that is facilitated or committed using a computer, network, or hardware device,”⁹⁵ meaning cybercrimes are cyber-incidents involving acts prohibited by law. The cyber-activities that most trouble financial market risk management experts are neither cyber-incidents nor cybercrimes. These categories of cyber-activities are over- and under-inclusive to describe the cyberthreats that plague financial markets. Examining descriptions of cyberattacks provides a more useful point of departure. Identifying the activities that constitute cyberattacks, however, is more difficult and markedly more controversial.

Government and activist coalitions use the term cyberattack to describe undesirable cyber intrusions. The United States military, more specifically the Joint Chiefs of Staff, describes a cyberattack as:

A hostile act using computer or related networks or systems, and intended to disrupt and/or destroy an adversary’s critical cyber systems, assets, or functions.

⁹⁴ See, e.g., *Report Cyber Incidents*, DEP’T OF HOMELAND SEC. (July 20, 2015), <http://dhs.gov/how-do-i/report-cyber-incidents> (defining cyber incident).

⁹⁵ Sarah Gordon & Richard Ford, *On the Definition and Classification of Cybercrime*, 2 J. COMPUTER VIROLOGY 13, 14 (2006); see also Convention on Cybercrime, pml., Nov. 23, 2001, C.E.T.S. No. 185 (entered into force July 1, 2004), <http://conventions.coe.int/Treaty/en/Treaties/Html/185.htm> (targeting an “action directed against the confidentiality, integrity and availability of computer systems, networks and computer data as well as the misuse of such systems, networks and data”).

The intended effects of cyberattack are not necessarily limited to the targeted computer systems or data themselves—for instance, attacks on computer systems which are intended to degrade or destroy infrastructure or C2 capability. A cyberattack may use intermediate delivery vehicles including peripheral devices, electronic transmitters, embedded code, or human operators. The activation or effect of a cyberattack may be widely separated temporally and geographically from the delivery.⁹⁶

This approach limits references to cyberattacks to acts intended to harm cyber systems.

Some commentators base their characterization of cyber intrusions on the motivations of the actors who engage in a cyberattack. Authors of *The Law of Cyber-Attack* adopt a narrow definition, explaining that a cyberattack consists of “any action taken to undermine the functions of a computer network for a political or national security purpose.”⁹⁷ This approach encompasses hacking, bombing, cutting, and infecting, and states that “to be a cyber-attack [an action] must aim to undermine or disrupt the function of a computer network,” thereby defining cyberattack “according to its objective.”⁹⁸ The devices employed to undermine or compromise a computer network may include worms, viruses, or Trojan horses.⁹⁹ This definition is narrowly focused on the threats posed by cyber-technologies, which are motivated by political or national security rationales.¹⁰⁰

Five common depictions of cyberattacks clarify the methods and rationale for these intrusions.¹⁰¹ “Lone wolf” attacks are often

⁹⁶ Memorandum from Gen. James E. Cartwright, Vice Chairman of the Joint Chiefs of Staff, U.S. Marine Corps., for the Chiefs of the Military Servs., Commanders of the Combatant Commands, Dirs. of the Joint Staff Directories 5 (2010).

⁹⁷ Oona A. Hathaway et al., *The Law of Cyber-Attack*, 100 CAL. L. REV. 817, 826 (2012).

⁹⁸ *Id.* at 826–27.

⁹⁹ *Id.* at 828 (quoting Vida M. Antolin-Jenkins, *Defining the Parameters of Cyberwar Operations: Looking for Law in All the Wrong Places?*, 51 NAVAL L. REV. 132, 139 (2005)).

¹⁰⁰ Hathaway et al., *supra* note 97, at 826.

¹⁰¹ Jones, *supra* note 1.

executed by “gifted teenagers” who want to compromise international networks for the rush of successfully intruding in a proprietary space (fun) or for bragging rights (fame).¹⁰² “Lone wolf” attacks are some of the most “difficult cyberattacks to detect and combat.”¹⁰³ Second are “hacktivists” attacks, which are conducted by individuals who are motivated to attack for political or moral reasons (furthering a cause).¹⁰⁴

A third type of cyberattack involves “fraud and criminal activity,” usually executed by someone who wishes to gain access to customer information for their own advantage (fraud).¹⁰⁵ These hackers tend to target banks and retailers due to the large amount of customer information they possess.¹⁰⁶ A fourth type of cyberattack, known as “industrial espionage,” usually involves a lone wolf targeting financial assets (funneling funds).¹⁰⁷ These attacks are often highly complex.¹⁰⁸ “Cyber warfare,” a fifth type of cyberattack, describes a cyberattack against a nation state (furthering a military or political campaign).¹⁰⁹ These are the least common of all cyberattacks, but could be the most destructive, even for the most developed countries.¹¹⁰

These definitional distinctions reflect different understandings of the elements of cyberattacks and the problems that these intrusions create.

B. CYBER RISKS AND FINANCIAL INSTITUTIONS

Who might initiate a cyberattack on a large, systemically important financial institution? Hackers (including activists who want to reveal weaknesses in cybersecurity risk management practices or disrupt a firm’s operations), foreigners engaged in

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

corporate or traditional espionage, and terrorists¹¹¹ wreak havoc by penetrating firm firewalls, accessing confidential information, manipulating accounts,¹¹² and disrupting key platforms in the international financial monetary system.¹¹³ Historically, cybersecurity policies have aimed to protect “investor and firm information from compromise,” meaning loss of data confidentiality, integrity, or availability.¹¹⁴ While data protection continues to be an important area of cyber risk concern, cyberattacks that threaten the networks that link financial institutions, exchange and clearinghouse platforms, and payment systems comprise the new cybersecurity frontier.

Investment banks, broker-dealers, and securities and commodities exchange platforms strategically endeavor to anticipate and defend against cyberattacks. The Financial Industry Regulatory Authority (FINRA) reports that the “frequency and sophistication of these attacks is increasing and individual broker-dealers, and the industry as a whole, must make responding to these threats a high priority.”¹¹⁵

The cybersecurity concerns that financial institutions face threaten the stability of financial markets, the loss of billions of

¹¹¹ FIN. INDUS. REGULATORY AUTH., REPORT ON CYBERSECURITY PRACTICES 1 (2015), http://www.finra.org/sites/default/files/p602363%20Report%20on%20Cybersecurity%20Practices_0.pdf.

¹¹² See *id.* (discussing the threat of “hackers penetrating systems for the purpose of account manipulation”).

¹¹³ See Katherine T. Smith et al., *Case Studies of Cybercrime and Its Impact on Marketing Activity and Shareholder Value*, 2011 ACAD. MKTG. STUD. J. (forthcoming), <http://ssrn.com/abstract=1724815> (“A challenge facing e-business or cyber-business is that it is vulnerable to e-crime, also called cybercrime. Cybercrime can totally disrupt a company’s marketing activities. Cybercrime costs publicly traded companies billions of dollars annually in stolen assets, lost business, and damaged reputations. Cybercrime costs the U.S. economy over \$100 billion per year. Cash can be stolen, literally with the push of a button. If a company website goes down, customers will take their business elsewhere. In addition to the direct losses associated with cybercrime, a company that falls prey to cyber criminals may lose the confidence of customers who worry about the security of their business transactions. As a result, a company can lose future business if it is perceived to be vulnerable to cybercrime. Such vulnerability may even lead to a decrease in the market value of the company, due to legitimate concerns of financial analysts, investors, and creditors.” (internal citations omitted)).

¹¹⁴ FIN. INDUS. REGULATORY AUTH., *supra* note 111, at 3.

¹¹⁵ *Id.*

dollars, and breaches of private data related to the banking, savings, and commercial accounts and wire-transfers or transactions of millions of clients, including businesses, governments, municipalities, non-profit organizations, and individuals. As the New York State Department of Financial Services noted, “[c]yber hacking is a potentially existential threat to our financial markets....”¹¹⁶ Regulators note that cybersecurity threats may “wreak serious havoc on the financial lives of consumers.”¹¹⁷

Financial and banking institutions are thus concerned about both internal and external cyber security threats, and both internal and external infiltration testing is needed to determine how secure a firm is against these potential threats.¹¹⁸ These institutions naturally vary in how they rank various threats due to the nature of the firm and their business model.¹¹⁹ “For example, online brokerage firms and retail brokerages are more likely to rank the risk of hackers as their top priority risk” whereas “[f]irms that engage in algorithmic trading were more likely to rank insider risks more highly.”¹²⁰ Similarly, large brokerage firms were more likely to rank “risks from nation states or hacktivist groups” higher than other firms.¹²¹

Technology plays a significant role in financial firms’ ability to execute transactions, intensifying financial institutions’ vulnerability to cyberattacks.¹²² Firms relying on the Internet to manage communications with clients; employees and clients’ accessing information on firm websites using mobile devices; and firms’ employees, clients, and regulators distributing information

¹¹⁶ Press Release, N.Y. Dep’t of Fin. Servs., NYDFS Issues Examination Guidance to Banks Outlining New Targeted Cyber Security Preparedness Assessments (Dec. 10, 2014), <http://www.dfs.ny.gov/about/press/pr1412101.htm>.

¹¹⁷ *Id.*

¹¹⁸ FIN. INDUS. REGULATORY AUTH., *supra* note 111, at 14, 22.

¹¹⁹ *Id.* at 5.

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² *Id.* at 1.

through e-mail communications, offer various opportunities for cyberattacks.¹²³

Regulators characterize the highest priority cybersecurity risks as endogenous threats (concerns that insiders may compromise firm or client data),¹²⁴ exogenous threats (concerns that hackers will attack confidential firm data),¹²⁵ and operational risks.¹²⁶ Endogenous risks include employees' or other users' unauthorized access to firm systems and databases and their harvesting of sensitive or confidential data.¹²⁷ Exogenous risks include the threats posed by interfacing with vendors or other third-party systems.¹²⁸ While the three legs of this risk management triangle are equally significant, the first two categories of risk—endogenous and exogenous risks—are the most pervasive.¹²⁹

These systemically important firms must understand the kinds of threats they face, what is most likely to be targeted for attack, who is likely to attack, what their vulnerabilities are, and how to best prepare for and protect against these threats. FINRA states that metrics are a “critical cyber security management tool,” and is concerned that some firms only use metrics minimally, thereby limiting their knowledge of how effective their cyber security procedures are.¹³⁰ In its survey of firm practices, FINRA noted that “over 80 percent of firms had established cybersecurity risk assessment programs . . . a number of which draw on the COBIT 5 and ISO/IEC 27001 frameworks,” and others modeled their risk

¹²³ *Id.*

¹²⁴ *Id.* at 4.

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ *Id.* at 4, 17. Other endogenous cybersecurity concerns include firms inadvertently granting new hires inappropriate access, employees accruing privileges by being promoted to a higher position with potentially greater access to information, and misuse of credentials when a thief steals an employee's credentials. *Id.* at 17.

¹²⁸ *Id.* at 26.

¹²⁹ *Id.* at 4; see also Justin Baer, *Morgan Stanley Fires Employee Over Client-Data Leak*, WALL ST. J. (Jan. 5, 2015, 10:03 PM), <http://www.wsj.com/articles/morgan-stanley-terminates-employee-for-stealing-data-1420474557> (discussing how Morgan Stanley fired one of its financial advisers accused of “stealing account data on about 350,000 clients and posting some of that information for sale online in potentially the largest data theft at a wealth-management firm”).

¹³⁰ FIN. INDUS. REGULATORY AUTH., *supra* note 111, at 11.

domains on the Federal Financial Institutions Examination Council (FFIEC) handbook.¹³¹ However, FINRA is concerned that the remaining firms were either just starting to establish a cybersecurity risk assessment program or had no program in place.¹³²

Firms have expressed additional concerns about information sharing, which must comply with regulatory requirements, including antitrust regulation.¹³³ The Federal Trade Commission and the Department of Justice, however, issued a policy statement explaining that sharing “cyber threat information is not likely to raise antitrust concerns and can help secure the nation’s networks of information and resources.”¹³⁴ FINRA noted that firms use cybersecurity threat information and intelligence in many ways, including collecting and analyzing data related to threats and vulnerabilities that the firms can then “incorporate in their technical infrastructure, e.g., by adjusting firewall settings to block certain IP addresses, installing patches to fix vulnerabilities in software, or updating anti-virus and anti-malware software to capture newly identified instances of viruses or malware.”¹³⁵

According to FINRA, “[a] risk management-based approach to cybersecurity permits firms to tailor their approach to the individual circumstances and the changing threats each firm faces” and can “inform firms’ thinking at a programmatic as well as individual control level.”¹³⁶ While financial and banking institutions must be vigilant regarding cybersecurity, they can take some comfort in the fact that “most successful attacks take advantage of fairly basic control weaknesses.”¹³⁷ If the right policies are implemented and updated periodically, cyber criminals will have a much harder time accessing firms’ confidential

¹³¹ *Id.* at 14.

¹³² *Id.*

¹³³ *Id.* at 36.

¹³⁴ Press Release, Fed. Trade Comm’n, FTC, DOJ Issue Antitrust Policy Statement on Sharing Cybersecurity Information (Apr. 10, 2014), <https://www.ftc.gov/news-events/press-releases/2014/08/ftc-doj-issue-antitrust-policy-statement-sharing-cybersecurity>.

¹³⁵ FIN. INDUS. REGULATORY AUTH., *supra* note 111, at 36.

¹³⁶ *Id.*

¹³⁷ *Id.*

information. Proper internal control policies, common wisdom argues, will disarm attackers seeking to access firms' confidential information. Risk assessments and information sharing can help these entities identify and prioritize the potential cyberattacks they could face and the steps they need to take to try to prevent these attacks,¹³⁸ as well as measures for mitigation and containment for when a breach occurs.¹³⁹

IV. REGULATING CYBERSPACE

Charting a course for appropriately addressing cyber risks requires exploring a number of solutions. Examining these solutions reveals critical opportunities to mitigate endogenous cyber risks. This Part reveals that reliance on conventional solutions is a passive defense to cyberattacks. This Part demonstrates the necessity of dynamic strategies and collaboration among businesses and government.

Cyberspace is governed by a patchwork of state, federal, and international regulations. Our fragmented regulatory framework, characterized by industry-specific legislation, leaves significant gaps in the oversight of cyberspace. No uniform international law currently exists to govern cyberspace and to specifically regulate cyberattacks, though entities including the United Nations, NATO, the Council of Europe, and the Shanghai Cooperation Organization have made some efforts to regulate cyberattacks.¹⁴⁰

¹³⁸ *Id.*

¹³⁹ *Id.* at 24.

¹⁴⁰ Hathaway et al., *supra* note 97, at 860 ("There has been only limited U.N. action on the issue of cyber-security. The U.N. General Assembly has passed several related resolutions. These resolutions, however, are vague and have not required any specific action by U.N. members." (footnotes omitted)); *id.* at 861–62 ("NATO recently began to address the threat of cyber-attacks. NATO did little in response to the 2007 cyber-attack on Estonia, laying bare that it 'lacked both coherent cyber doctrine and comprehensive cyber strategy.' On the heels of that attack, NATO held its first meeting—the 2008 Bucharest Summit—to formally address cyber-attacks. This summit prompted the creation of two new NATO divisions focused on cyber-attacks: the Cyber Defence Management Authority and the Cooperative Cyber Defence Centre of Excellence." (footnotes omitted)); *id.* at 862–63 ("The Council of Europe has taken the most direct and concrete approach to regulating a subset of the cyber-security problem—in particular, cyber-crime—of any international organization to date. As the first international treaty on crimes committed using the

A. TOWARD TRANSPARENCY AND INFORMATION SHARING

Congress has recently enacted or amended several significant cybersecurity regulations, including the Computer Fraud and Abuse Act,¹⁴¹ the E-Government Act of 2002,¹⁴² the Cybersecurity Research and Development Act of 2002,¹⁴³ the Federal Information Security Management Act of 2002,¹⁴⁴ the Cyber Security Enhancement Act of 2002,¹⁴⁵ the Cybersecurity Enhancement Act of 2014,¹⁴⁶ and the National Cybersecurity Protection Act of 2014.¹⁴⁷ These legislative steps are laudable for their efforts to introduce criminal laws that address fraud involving devices, computers, or e-mail; malicious interference with communications lines, stations, or systems; electronic communication interception; illicit access to electronic communications and records; and recording of dialing, routing, addressing, and signaling information. Currently, no single piece of federal legislation exists that addresses cybersecurity threats and issues.¹⁴⁸ The fragmented approach to addressing cyber risks creates opportunities for regulatory arbitrage. Moreover, none of these efforts effectively addresses mounting concerns that cyber risks

Internet and other computer networks, the 2001 Council of Europe Convention on Cybercrime ('Cybercrime Convention') promulgated 'a common criminal policy aimed at the protection of society against cybercrime,' primarily through legislation and international cooperation. The United States ratified the Convention in 2006." (footnotes omitted)); *id.* at 865 ("The Shanghai Cooperation Organization, an intergovernmental mutual security organization founded in 2001 by China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan, and Uzbekistan, has taken significant preliminary steps toward cooperation in the cybersecurity area. In its Yekaterinburg Declaration of June 16, 2009, '[t]he SCO member states stress[ed] the significance of the issue of ensuring international information security as one of the key elements of the common system of international security.' The Organization presents a possible center of gravity in international legal action on cyber-attacks." (alteration in original) (footnotes omitted)).

¹⁴¹ 18 U.S.C. § 1030 (2012).

¹⁴² Pub. L. No. 107-347, 116 Stat. 2899.

¹⁴³ Cyber Security Research and Development Act, Pub. L. No. 107-305, 116 Stat. 2367.

¹⁴⁴ Pub. L. No. 107-347, § 301-05, 116 Stat. 2946, 2946-61.

¹⁴⁵ Pub. L. No. 107-296, § 225, 116 Stat. 2156.

¹⁴⁶ Pub. L. No. 113-274, 128 Stat. 2971.

¹⁴⁷ Pub. L. No. 113-282, 128 Stat. 3066.

¹⁴⁸ See Hathaway et al., *supra* note 97, at 877 ("U.S. domestic law, though potentially a powerful tool for battling cyber-attacks, has not yet addressed the challenge directly, and what remedies exist are in many cases restricted by jurisdictional limits.").

may disrupt interconnected systems such as securities and commodities trading systems, banking systems, or payment systems. Leaving these systems vulnerable creates systemic risk concerns.

The most recently minted statute in the litany of cyber regulations—the Cybersecurity Information Sharing Act of 2015 (CISA)¹⁴⁹—demonstrates significant promise to address systemic cyber threats. Adopted on December 18, 2015, the CISA “[p]romotes and encourages the private sector and the United States government to rapidly and responsibly exchange cyber threat information.”¹⁵⁰ Notwithstanding the promise of the CISA, concerns regarding the absence of privacy protections raise important questions regarding the implementation of the Act.

1. *The Cybersecurity Information Sharing Act of 2015.* The CISA aims to protect “information systems or information that is stored on, processed by, or transiting an information system The statute expressly declares its intent to protect information systems and information warehoused in these systems from cybersecurity threat attacks.”¹⁵¹ To this end, the statute creates a voluntary cybersecurity information sharing exchange designed to encourage public and private sector actors to share cyber threat information.¹⁵²

The CISA invites private entities to gather and share relevant cybersecurity threat information with federal agencies or private entities without concerns that such acts violate antitrust regulations or create liability.¹⁵³ Cybersecurity threats are defined in the statute as actions “that may result in an unauthorized effort to adversely impact the security, availability, confidentiality, or integrity of an information system or information that is stored on, processed by, or transiting an information system.”¹⁵⁴ Title I—“Cybersecurity Information Sharing”—permits private entities to

¹⁴⁹ H.R. 2029, 114th Cong., div. N, tit. I §§ 101–111 (2015) (enacted).

¹⁵⁰ *Cybersecurity Legislation Watch*, ISACA, <http://www.isaca.org/cyber/pages/cybersecuritylegislation.aspx> (last visited Feb. 10, 2016).

¹⁵¹ H.R. 2029, div. N, tit. I, § 102(4).

¹⁵² See generally *id.* tit. I (describing the new information sharing exchange).

¹⁵³ See *id.* (setting up regulations to encourage information sharing).

¹⁵⁴ *Id.* § 102(5)(A).

monitor their networks and engage in defensive measures¹⁵⁵ to protect their own information systems and networks from cybersecurity attacks.¹⁵⁶ Upon identifying cybersecurity threats, private entities may share information regarding cyber threat indicators, which include:

- (A) malicious reconnaissance, including anomalous patterns of communications that appear to be transmitted for the purpose of gathering technical information related to a cybersecurity threat or security vulnerability; (B) a method of defeating a security control or exploitation of a security vulnerability; (C) a security vulnerability, including anomalous activity that appears to indicate the existence of a security vulnerability; (D) a method of causing a user with legitimate access to an information system or information that is stored on, processed by, or transiting an information system to unwittingly enable the defeat of a security control or exploitation of a security vulnerability; (E) malicious cyber command and control; (F) the actual or potential harm caused by an incident, including a description of the information exfiltrated as a result of a particular cybersecurity threat; (G) any other attribute of a cybersecurity threat, if disclosure of such attribute is not otherwise prohibited by law; or (H) any combination thereof.¹⁵⁷

The CISA includes a number of privacy protections. For example, upon identifying a cyber threat indicator or a defensive measure, private entities must remove any “personal information of a specific individual or information that identifies a specific individual” from the data before sharing that information.¹⁵⁸ In

¹⁵⁵ The statute defines a defensive measure as “an action, device, procedure, signature, technique, or other measure . . . that detects, prevents, or mitigates a known or suspected cybersecurity threat or security vulnerability.” *Id.* § 102(7)(A).

¹⁵⁶ *Id.*

¹⁵⁷ *Id.* § 102(6)(A)–(H).

¹⁵⁸ *Id.* § 104(d)(2)(A)–(B).

addition to implementing screening and redacting policies, participants can only use the information obtained through this information sharing process for the limited purposes identified in the statute, which include: identifying cyber threats or their sources; identifying potential security vulnerabilities; and responding to, preventing, or mitigating specific threats such as serious bodily harm, or a serious economic harm, including a terrorist act or a use of a weapon of mass destruction.¹⁵⁹

Titles II, III, and IV of the CISA create a number of new cybersecurity-related requirements, including a reporting requirement for government agencies, in order to promote internal defenses against cyberattacks and improve federal network security;¹⁶⁰ inviting federal efforts to coordinate with industry and other stakeholders to develop capabilities that support and rapidly advance the development, adoption, and implementation of automated mechanisms for the sharing of cyber threat indicators and defensive measures;¹⁶¹ promoting the development of best practices for cybersecurity;¹⁶² requiring a government study on mobile device security;¹⁶³ and allowing apprehension and prosecution of international cyber criminals, even if they do not have any assets within the United States' jurisdiction.¹⁶⁴

2. *Weaknesses of the CISA.* Critics of the Cybersecurity Information Sharing Act contend that the statute grants broad powers of surveillance and fails to incorporate appropriate privacy protections. Market participants express concern regarding the government's ability to safeguard proprietary and confidential

¹⁵⁹ *Id.* § 105(d)(5)(A).

¹⁶⁰ *Id.* div. N, tits. I–III. Title III is called “Federal Cybersecurity Workforce Assessment,” and states that the federal government must evaluate the current state of its cybersecurity workforce and identify critical needs for information technology, cybersecurity, or other cyber-related workforce. *Id.* tit. III, § 304(a)(1). The government must submit progress reports in compliance with this section. *Id.* § 304(a)(2).

¹⁶¹ *Id.* tit. I, § 105; *see id.* § 102(7)(a) (defining a defensive measure as “an action, device, procedure, signature, technique, or other measure . . . that detects, prevents, or mitigates a known or suspected cybersecurity threat or security vulnerability”).

¹⁶² *Id.* § 404(c), § 206(c)(2).

¹⁶³ *Id.* § 401.

¹⁶⁴ *Id.* div. N, tit. IV, § 403.

information.¹⁶⁵ Government warehousing of shared data is only as safe as the government's capacity to prevent cyber intrusions. After recent cyberattacks breaching government agency defenses, many express concerns that shared information may be more vulnerable in the hands of government agencies.

Privacy advocates' concerns regarding secondary transfer of data may be one of the most hotly debated issues. Once information is shared with one agency of the federal government, the agency may transfer the shared information to the National Security Agency or the Federal Bureau of Investigation.¹⁶⁶ With great alarm, critics of the bill proclaim that the bill allows extensive monitoring of web-based activities, empowers government officials and agencies to occupy a central role in gathering confidential and proprietary information, and creates too few limitations on law enforcement's subsequent use of the information.¹⁶⁷

These critics argue that the expansive definitions of "cyber threat indicator" and "cybersecurity threat" and the surveillance and liability protections afforded in the CISA give the government and private companies too much latitude in what types of information they gather and how they gather it.¹⁶⁸ Others say the law is redundant of other information-sharing practices like

¹⁶⁵ John D. McKinnon, *Congress Poised to Pass Cybersecurity Measure*, WALL ST. J. (Dec. 16, 2015), <http://www.wsj.com/articles/congress-poised-to-pass-cybersecurity-measure-1450284622>; see also Press Release, Open Tech. Inst., *Omnibus Funding Bill is a Privacy and Cybersecurity Failure* (Dec. 16, 2015), <https://www.newamerica.org/oti/omnibus-funding-bill-is-a-privacy-and-cybersecurity-failure/> (quoting Robyn Greene, Policy Counsel at New America's Open Technology Institute, who said, "[t]he new, renamed version of CISA sets up a near free-for-all for the NSA and FBI to ramp up surveillance and investigation of Americans, and could seriously undermine data security and cybersecurity in general. If the excess of personal information that may be shared under this bill is targeted by malicious and nation state hackers—and there's no reason to think it won't be—this may well turn out to be the Intelligence Community's next major boondoggle.").

¹⁶⁶ Press Release, Open Tech. Inst., *supra* note 165.

¹⁶⁷ Letter from Civil Soc'y Orgs., to Member of Congress (Dec. 17, 2015), <http://www.constitutionproject.org/wp-content/uploads/2015/12/Coalition-Letter-Opposing-Cybersecurity-in-Omnibus.pdf>.

¹⁶⁸ Jessica Beyer, *The Cybersecurity Information Sharing Act (CISA)*, HENRY M. JACKSON SCH. INT'L STUD., U. WASH. (Oct. 30, 2015), <https://jsis.washington.edu/news/the-cybersecurity-information-sharing-act-cisa/>.

Information Sharing and Analysis Centers (ISACs) and the Department of Homeland Security's Enhanced Cybersecurity Services.¹⁶⁹ These critics argue that Congress and the Obama administration have not addressed if or why these other information-sharing practices are deficient.¹⁷⁰ A few have even compared the CISA to the USA Patriot Act, stating that both laws are expensive that reflect legislative approaches with ideas that had previously been rejected by Congress and then quickly passed in a subsequent session before many would have had a chance to read through the entire bill.¹⁷¹ Important technology firms, including Google, Facebook, and Yahoo oppose various elements of the legislation and have expressed their intent not to participate in the information sharing program.¹⁷²

Still others argue that the statute expands the power of the federal government in undesirable ways. For example, under Title I of the CISA, the Director of National Intelligence will lead the charge in developing "procedures to facilitate and promote . . . timely sharing of classified cyber threat indicators and defensive measures . . . and information relating to cybersecurity

¹⁶⁹ Mark Jaycox & Lee Tien, *Obama's Computer Security Solution is a Mishmash of Old, Outdated Policy Solutions*, ELECTRONIC FRONTIER FOUND. (Jan. 16, 2015), <https://www.eff.org/deeplinks/2015/01/obamas-computer-security-solution-mish-mash-old-outdated-policy-solutions>. See, e.g., DEPT OF HOMELAND SEC., *Enhanced Cybersecurity Services*, <http://www.dhs.gov/sites/default/files/publications/ECS%20Fact%20Sheet%2007.30.15.pdf> (last visited Feb. 22, 2016).

¹⁷⁰ Jaycox & Tien, *supra* note 169.

¹⁷¹ Jenna McLaughlin, *Hasty, Fearful Passage of Cybersecurity Bill Recalls Patriot Act*, THE INTERCEPT (Dec. 19, 2015, 11:05 AM), <https://theintercept.com/2015/12/19/hasty-fearful-passage-of-cybersecurity-bill-recalls-patriot-act/>.

¹⁷² John D. McKinnon, *Lawmakers, White House Near Cybersecurity Agreement*, WALL ST. J. (Dec. 15, 2015, 5:39 PM), <http://www.wsj.com/articles/lawmakers-white-house-near-cyber-security-agreement-1450219168?cb=logged0.01276299450546503>; see also Damian Paletta & Daisuke Wakabayashi, *Apple Piles On as Senate Debates Cyber Bill*, WALL ST. J. (Oct. 21, 2015, 11:46 AM), <http://www.wsj.com/articles/apple-piles-on-as-senate-debates-cyber-bill-1445442387> (reporting that Apple did not support the Cybersecurity Information Sharing Act and Apple's statement, "[t]he trust of our customers means everything to us and we don't believe security should come at the expense of their privacy"); Cory Bennett, *Major Tech Group Comes Out Against Cyber Bill*, THE HILL (Oct. 15, 2015, 12:34 PM), <http://thehill.com/policy/cybersecurity/257029-major-tech-group-opposes-cyber-bill> (listing Sprint, T-Mobile, Amazon, eBay, Netflix, Microsoft, Facebook, Google, Apple and Yahoo as opponents of the CISA).

threats”¹⁷³ with relevant federal entities,¹⁷⁴ non-federal entities,¹⁷⁵ or the public if appropriate.¹⁷⁶ As critics have indicated, existing legislation grants the President broad powers in times of national emergency, which include the threat of a major cybersecurity incident.¹⁷⁷

After the September 11th terrorist attacks, public concerns over executive power escalated with regard to the President’s authority to conduct surveillance within the United States,¹⁷⁸ including President Bush’s controversial authorization enabling the NSA “to intercept international electronic communications between persons in the United States . . .”¹⁷⁹ The continuing expansion of executive and federal authority should be subject, these critics argue, to appropriate limitations.

Finally, the defensive measures authorization provision in the CISA does not address measures that adversely impact third-party networks or data. Consistent with the congressional establishment of a voluntary sharing framework, the legislation disclaims any intention of creating a duty to share cyber threat indicators or defensive measures or a duty to warn or act based on the receipt of such indicators or measures.¹⁸⁰ Congressional critics have already introduced a bill to repeal the CISA.¹⁸¹

B. ALTERNATIVE INITIATIVES

While the CISA may mitigate certain cyber threats, voluntary information sharing alone will not overcome the possibility of

¹⁷³ Cybersecurity Information Sharing Act of 2015, H.R. 2029, 114th Cong., div. N, tit. I, § 103(a)(1)–(2) (enacted).

¹⁷⁴ See *id.* § 102(8) (defining Federal entity as “a department or agency of the United States or any component of such department or agency”).

¹⁷⁵ See *id.* § 102(14)(A) (defining non-Federal entity as “any private entity, non-Federal government agency or department, or State, tribal, or local government (including a political subdivision, department, or component thereof”).

¹⁷⁶ *Id.* § 103(a).

¹⁷⁷ David W. Opderbeck, *Cybersecurity and Executive Power*, 89 WASH. U. L. REV. 795, 813 (2012).

¹⁷⁸ *Id.* at 822.

¹⁷⁹ *Id.* at 826.

¹⁸⁰ H.R. 2029, 114th Cong., div. N, tit. I, § 106(c)(1)(B).

¹⁸¹ H.R. 4350, 114th Cong. § 1 (2016).

systemic cyber risks. Fortunately, regulatory efforts by FINRA, the Securities Exchange Commission, and the National Institute of Science and Technology (NIST) supplement the CISA's efforts and introduce important best practices and mandatory cybersecurity guidelines. Twice in recent years, FINRA surveyed over two hundred financial firms to gain insight into the contours of financial market participants' cybersecurity practices.¹⁸² The surveys revealed three critical cyber security threats for financial firms, including: hackers penetrating firm systems; insiders compromising firm or client data; and operational risks materializing.¹⁸³ To counter these concerns, FINRA outlined a body of best practices.

Some of the FINRA's proposed best practices are trite and non-controversial. For example, to combat cybersecurity attacks created when an insider such as an employee downloads malware,¹⁸⁴ FINRA proposes that effective employee training on cybersecurity issues is vital to a firm's cybersecurity program.¹⁸⁵ Other best practices techniques introduce more aggressive efforts and acknowledge that third-party relationships create significant risk for cyberattacks. The FINRA guidelines propose (1) development of a defense-in-depth strategy by layering several independent security controls throughout their IT system; (2) limiting users' and employees' access to the firm's data and systems; (3) encrypting data to protect data confidentiality and information integrity; (4) having third-parties attempt to penetrate the firm's system to test any potential cybersecurity weaknesses; and (5) increasing surveillance of third-party vendors whose security standards might not meet those of the firm.¹⁸⁶

While these practices may be helpful in overcoming weaknesses in cyber security risk mitigation, FINRA's guidelines are completely voluntary and simply amount to helpful suggestions for

¹⁸² FIN. INDUS. REGULATORY AUTH., *supra* note 111, at 3.

¹⁸³ *Id.* at 4.

¹⁸⁴ *Id.* at 31.

¹⁸⁵ *Id.*

¹⁸⁶ *Id.* at 16–27.

firms to develop or improve their cybersecurity procedures.¹⁸⁷ While it may be true that “there is no one-size-fits-all solution to address cyber threats,”¹⁸⁸ FINRA acknowledges that “[a] sound governance framework with strong leadership is essential” to managing and mitigating cyberattacks.¹⁸⁹ In other words, internal governance structures cannot wait for industry-led or government-proposed initiatives. Board members and senior-level managers must seek out and implement cybersecurity risk mitigation measures.

Taking an approach consistent with the Commission’s reliance on disclosure-based regulation,¹⁹⁰ the SEC’s Division of Corporation Finance recently published guidance providing that companies registering securities for sale to the public and those subject to periodic reporting requirements should indicate potential cyber risks they face, any cyber incidents that have transpired, and whether they outsource material cyber-functions and any relevant insurance coverage.¹⁹¹ The SEC posits that disclosure of cybersecurity risks “must adequately describe the nature of the material risks and specify how each risk affects the registrant.”¹⁹² Registrants should tailor their disclosure to their particular circumstances, detailed enough that investors know the nature of the cyber risks that the company faces.¹⁹³

Registered company managers should also discuss and analyze cybersecurity risks and incidents that are part of an event or trend that is “reasonably likely to have a material effect on the registrant’s results of operations, liquidity, or financial condition or would cause reported financial information not to be necessarily indicative of future operating results or financial condition.”¹⁹⁴

¹⁸⁷ *Id.* at 2.

¹⁸⁸ *Id.* at 38.

¹⁸⁹ *Id.* at 1.

¹⁹⁰ Michael D. Guttentag, *An Argument for Imposing Disclosure Requirements on Public Companies*, 124 FLA. ST. U. L. REV. 123, 124–25 (2004) (“Disclosure requirements are the primary tool the federal government uses to regulate public companies.”).

¹⁹¹ DIV. OF CORP. FIN., SEC. & EXCH. COMM’N, CF DISCLOSURE GUIDANCE: TOPIC NO. 2, CYBERSECURITY (2011), <https://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic2.htm>.

¹⁹² *Id.*

¹⁹³ *Id.*

¹⁹⁴ *Id.*

Registrants should discuss possible outcomes and expected costs of potential cyber threats.¹⁹⁵ If a cyber incident occurs, registrants must provide disclosure of losses that are reasonably possible and should aim to mitigate losses.¹⁹⁶ Additionally, registrants are required to disclose their assessments of the effectiveness of their disclosures, controls and internal oversight procedures.¹⁹⁷

The SEC's reliance on transparency fails to offer a valuable tool for risk mitigation.¹⁹⁸ Disclosure is an *ex post* declaration of events that have already transpired and offers limited guidance for firms seeking to prevent losses.¹⁹⁹ Creating disclosure obligations may serve to alert the investing public to cyber risks.²⁰⁰ This approach also creates, however, challenges for registered companies seeking to raise capital from the investing public. Registered companies must determine when a cyber threat is sufficiently material to require disclosure.²⁰¹ Certainly, the disclosure of *every* cyber risk is not useful to investors and simply serves to inundate markets with information.²⁰² Determining the magnitude of the impact of evolving cyber threats, however, will prove challenging for firms. Evaluating disclosure regarding firms' preparedness for cyberattacks will initially pose an industry-wide conundrum:

¹⁹⁵ *Id.*

¹⁹⁶ *Id.*

¹⁹⁷ *Id.*

¹⁹⁸ Cf. Joel Bronstein, *The Balance Between Informing Investors and Protecting Companies: A Look at the Division of Corporate Finance's Recent Guidelines on Cybersecurity Disclosure Requirements*, 13 N.C. J.L. & TECH. ONLINE 257, 259 (2012) (noting that the guidelines force companies into a catch-22; they either expose themselves to further cyberattacks or risk failing to meet disclosure requirements).

¹⁹⁹ See BLACK'S LAW DICTIONARY 497 (8th ed. 2004) (defining disclosure as "[t]he act or process of making known something that was previously unknown; a revaluation of facts").

²⁰⁰ See Sam Young, Note, *Contemplating Corporate Disclosure Obligations Arising From Cybersecurity Breaches*, 38 J. CORP. L. 659, 663–64 (2013) (noting the potential impact that a cyberattack would "have on investors or potential investors in a public company").

²⁰¹ See Deloitte, *CISOs Welcome SEC Cyber Security Disclosure Guidance But Struggle to Respond*, C10 JOURNAL, WALL ST. J. (Aug. 29, 2012, 12:01 AM), <http://deloitte.wsj.com/cio/2012/08/29/cisos-welcome-sec-cyber-security-disclosure-guidance-but-struggle-to-respond/> ("[C]ompanies are wondering what cyber risks they need to disclose and how they can disclose them without exposing their vulnerabilities and inviting cyber criminals to attack them.").

²⁰² See TSC Indus. v. Northway, Inc., 426 U.S. 438, 448–49 (1976) (noting that disclosure of too much information could, if "trivial information," "bury" investors and prevent informed decisionmaking).

Disclosing too little information creates liability risks but disclosing too much damages capital raising efforts.²⁰³

Finally, a public-private initiative may represent the most valuable path toward cyber risk mitigation.²⁰⁴ In February 2013, President Barack Obama signed an Executive Order authorizing NIST to develop a Framework for Improving Critical Infrastructure Cybersecurity to address cyber risks.²⁰⁵ Similar to FINRA's best practices, the NIST framework is not mandatory, though, many have enthusiastically embraced the guidelines as the appropriate standard for financial markets. The framework is designed specifically to protect critical infrastructure, or resources that provide vital national, physical, or virtual systems and assets whose destruction "would have a debilitating impact on cybersecurity, national economic security, national public health or safety, or any combination of those matters."²⁰⁶ The framework consists of three parts—the Framework Core, the Framework

²⁰³ See Roland L. Trope & Sara Jane Hughes, *The SEC Staff's "Cybersecurity Disclosure" Guidance: Will It Help Investors or Cyber-thieves More?*, BUS. L. TODAY, Dec. 2011, at 4, <http://www.americanbar.org/content/dam/aba/publications/blt/2011/12/sec-cybersecurity-2011-12.authcheckdam.pdf> (explaining the Hobbesian choice created by the SEC's guidance; businesses will either discuss too little or too much).

²⁰⁴ See INTELLIGENCE & NAT'L SEC. ALLIANCE, ADDRESSING CYBER-SECURITY THROUGH PUBLIC PRIVATE PARTNERSHIP: AN ANALYSIS OF EXISTING MODELS 3 (2009) ("Since the nation's cyber infrastructure is not government owned, a partnership of government, corporate and private stakeholders is required to secure the internet.").

²⁰⁵ See Sari Greene, *Cybersecurity is an Executive Responsibility: Preparing for Upcoming Cybersecurity Examinations*, MAINE BANKER, Mar.–Apr. 2015, at 5, <http://learn.sagedatasecure.com/hubfs/docs/cybersecurity-is-an-executive-responsibility.pdf?t=1443532531801> ("While not mandatory, there is an expectation that financial institutions will adopt the NIST Cybersecurity Framework as a way to measure cybersecurity readiness and resilience, as well as to create a cybersecurity roadmap."); Paul A. Ferrillo, *Understanding and Implementing the NIST Cybersecurity Framework*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REGULATION (Aug. 25, 2014), <http://corpgov.law.harvard.edu/2014/08/25/understanding-and-implementing-the-nist-cybersecurity-framework/> (quoting Graham Scott, *Interview: Greg Touhill, DHS, USA on Cybersecurity*, GLOBAL GOV'T FORUM (July 28, 2014), <http://www.globalgovernmentforum.com/brigadier-general-greg-touhill-cybersecurity-department-of-homeland-security-interview/> ("Though 'voluntary,' it cannot be overstated that the [NIST] Framework is 'a National Standard' developed with input from industry experts, collaborators and businesses with years of cyber experience.")).

²⁰⁶ NAT'L INST. OF SCI. AND TECH., FRAMEWORK FOR IMPROVING CRITICAL INFRASTRUCTURE CYBERSECURITY 37 (2014), <http://www.nist.gov/cyberframework/upload/cybersecurity-framework-021214.pdf>.

Profile, and the Framework Implementation Tiers—and “focuses on using business drivers to guide cybersecurity activities and considering cybersecurity risks as part of the organization’s risk management processes.”²⁰⁷ Similar to FINRA’s guidelines,²⁰⁸ this framework is not a one-size-fits-all approach for managing cyber threats.²⁰⁹ Firms will vary in implementing the framework depending on their unique threats and vulnerabilities.²¹⁰

The Framework Core provides industry standards, guidelines, and practices for cybersecurity activities and desired outcomes for all levels within a company by using five key functions: identify, protect, detect, respond, and recover.²¹¹ Identify refers to developing a procedure to identify and manage cyber threats.²¹² Protect refers to ensuring delivery of critical infrastructure services.²¹³ Detect refers to promptly identifying that a cybersecurity incident has occurred.²¹⁴ Respond refers to taking action after detecting a cybersecurity incident.²¹⁵ Recover refers to resilience and restoring capabilities or services that were harmed because of a cybersecurity incident.²¹⁶

The NIST framework Profile applies the Framework Core to a particular scenario in order to reach outcomes based on business needs that a company has selected from the framework categories and subcategories.²¹⁷ Companies should have a Current Profile (showing the cybersecurity outcomes the company is currently achieving) and a Target Profile (showing the desired cybersecurity risk management goals and outcomes).²¹⁸ Comparing these two profiles can help identify gaps in a company’s cybersecurity risk management procedures and thus help the company to close those

²⁰⁷ *Id.* at 1.

²⁰⁸ See *supra* notes 186–89 and accompanying text.

²⁰⁹ NAT’L INST. OF SCI. AND TECH., *supra* note 206, at 2.

²¹⁰ *Id.*

²¹¹ *Id.* at 4.

²¹² *Id.* at 8.

²¹³ *Id.*

²¹⁴ *Id.*

²¹⁵ *Id.* at 8–9.

²¹⁶ *Id.* at 9.

²¹⁷ *Id.* at 5.

²¹⁸ *Id.* at 11.

gaps.²¹⁹ The NIST Framework Implementation Tiers describe how a company views cybersecurity risks and what measures the company has implemented to manage and combat those risks.²²⁰ There are four tiers within this section of the framework: (1) Partial; (2) Risk Informed; (3) Repeatable; and (4) Adaptive.²²¹ Companies are encouraged to progress to higher tiers “when such a change would reduce cybersecurity risk and be cost effective.”²²²

These three parts work together to facilitate risk management and information sharing. The framework describes risk management as “the ongoing process of identifying, assessing, and responding to risk,”²²³ specifically cybersecurity risks.²²⁴ The framework should start and end at the executive level. Executives should communicate the priorities, available resources, and the overall risk tolerance of the entire business. At the most senior business level, decisions should reflect a general risk management process and collaboration across operations to communicate business needs and create a Profile. The operations division of the business must then perform an impact assessment based on the information received. This information should be reported up to the executive level. Finally, the executive level must discuss what changes to make regarding risk management and how to make those changes based on that outcome.²²⁵

Companies can implement the NIST framework by following seven easy-to-follow steps to establish or improve their cybersecurity programs.²²⁶ Step one—“Prioritize and Scope”—requires identifying business objectives and priorities to make strategic decisions about implementing or improving a cybersecurity program.²²⁷ Step two—“Orient”—invites businesses to identify systems, assets, regulatory requirements and an overall

²¹⁹ *Id.*

²²⁰ *Id.* at 5.

²²¹ *Id.* at 10–11.

²²² *Id.* at 9.

²²³ *Id.* at 5.

²²⁴ *Id.*

²²⁵ *Id.* at 12.

²²⁶ *Id.* at 13–14.

²²⁷ *Id.* at 14.

approach to risk based on the scope of the cybersecurity program determined in step one.²²⁸ Step three—“Create a Current Profile”—means showing which Category and Subcategory outcomes from the Framework Core are already being achieved.²²⁹ Step four—“Conduct a Risk Assessment”—means determining the likelihood of a cybersecurity incident occurring and the potential impact that incident could have on the company.²³⁰ Step five—“Create a Target Profile”—means focusing on the Framework Categories and Subcategories that fit the company’s desired cybersecurity outcomes.²³¹ Step six—“Determine, Analyze, and Prioritize Gaps”—means comparing the Current and Target Profiles to determine any gaps and create a plan to address those gaps.²³² Step seven—“Implement Action Plan”—means taking action in response to the gaps identified in Step six and monitoring current cybersecurity practices against the Target Profile.²³³

The NIST framework, however, does have some shortcomings. While it “offers worthwhile standards for improving cybersecurity, it does not fully address several critical areas.”²³⁴ For example, it does not address data privacy issues or standards; it does not address the need to implement measures to identify a company’s unique threats, motivations, and capabilities; and it does not discuss a company’s statutory, contractual, or regulatory cybersecurity requirements.²³⁵

²²⁸ *Id.*

²²⁹ *Id.*

²³⁰ *Id.*

²³¹ *Id.*

²³² *Id.*

²³³ *Id.*

²³⁴ PRICEWATERHOUSECOOPERS LLP, WHY YOU SHOULD ADOPT THE NIST CYBERSECURITY FRAMEWORK 6 (2014), <https://www.pwc.com/us/en/increasing-it-effectiveness/publications/assets/adopt-the-nist.pdf>.

²³⁵ *Id.*

V. CONCLUSION

Cyberattacks are a central, pervasive, and endemic threat, which will grow exponentially in coming years.²³⁶ As President Obama observed, cyberattacks threaten to “sabotage our power grid, our financial institutions, and our air traffic control systems.”²³⁷ These information structures “serve as the backbone of our national economy.”²³⁸ Simply stated, we must acknowledge the critical natures of cyber risks and the threat such risks impose on “economic value creation, exchange, and transfer.”²³⁹

This Essay questions the existing emphasis on risk management solutions that focus on information and agency failures. Over the last four decades, parallel to the development and increasing sophistication of regulation and financial market engineering, risk management strategies have evolved. Traditional risk management solutions have relied on independently developed, implemented, and enforced risk management practices. This Essay dismisses the conventional approaches to risk management in international financial markets. Rather than focusing on solutions applicable to individual risk management issues, this Essay surveys solutions to identify strengths and limitations of existing regulatory options

²³⁶ Martin Giles, *Defending the Digital Frontier*, ECONOMIST (July 12, 2014), <http://www.economist.com/news/special-report/21606416-companies-markets-andcountires-are-increasingly-under-attack-cyber-criminals> (“Data breaches are becoming ever bigger and more common. Last year over 800 [million] records were lost, mainly through such attacks Among the most prominent recent victims has been Target, whose chief executive, Gregg Steinhafel, stood down from his job in May, a few months after the giant American retailer revealed that online intruders had stolen millions of digital records about its customers, including credit- and debit-card details. Other well-known firms such as Adobe, a tech company, and eBay, an online marketplace, have also been hit.”); *see also* FIN. INDUS. REGULATORY AUTH., *supra* note 111, at 38 (encouraging businesses to recognize and combat growing cybersecurity threats).

²³⁷ Barack Obama, President of the United States, Remarks by the President in the State of the Union Address (Feb. 12, 2013).

²³⁸ Yogesh Malhotra, Risk, Uncertainty, and, Profit for the Cyber Era: Model Risk Management of Cyber Insurance Models Using Quantitative Finance and Advanced Analytics 12 (Jan. 2015) (unpublished thesis, State University of New York), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2553547.

²³⁹ *Id.* at 1–12.

and emphasizes developing a comprehensive understanding of cyber risks and cyber risk management.

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