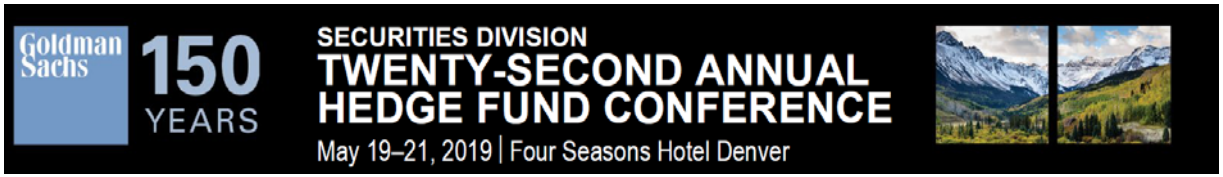


# The CALIFORNIA CONSUMER PRIVACY ACT:

## The Coming Wave of State Data Privacy Regulation for Hedge Fund Advisers

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The California Consumer Privacy Act ("CCPA") is a broad consumer privacy law that is effective as of January 1, 2020, and will apply to most large investment advisers. The CCPA is the most sweeping and comprehensive privacy and data protection law in the US and has been compared to the European Union's GDPR - although in some ways, including the information subject to the CCPA, the CCPA is an even more far reaching law. Among other things, the CCPA requires that consumers be informed of the categories of information that is collected about them, allows consumers to obtain copies of their information, allows consumers to request their information be deleted, and allows consumers to opt out of having their data sold or shared. The law is enforced by the California Attorney General and through the creation of a private right of action. For businesses subject to the CCPA, the implementation of the mechanisms necessary to comply with the law is a significant undertaking.

The challenge of complying with the CCPA is compounded by the fact that the CCPA remains a work in progress. The initial bill was rushed through the legislature and was almost immediately amended to correct obvious errors and internal inconsistencies. However, the amendment process is far from over and there have been approximately ten bills introduced in the California legislature that, if passed, would make further meaningful revisions to the law. In addition, the California Attorney General is required to promulgate regulations implementing the CCPA, and at present that process is not required to be completed until July 1, 2020.

For registered investment advisers, there is an important exemption from many of the CCPA's requirements for information that is subject to the Gramm Leach Bliley Act ("GLB") and its implementing regulations. For registered investment advisers, the implementing regulations are those of the Securities and Exchange Commission's Regulation S-P. Thus, if the personal information collected by an adviser is subject to Regulation S-P and GLB, then the CCPA does not apply to that information. The critical analysis for an

adviser, therefore, is whether it obtains any personal information that is not already covered by Regulation S-P and GLB. For many private fund advisers it is likely that the personal information collected is already subject to Regulation S-P and therefore – at least as the law is presently worded – they will be exempt from the bulk of the CCPA's requirements.

However, the CCPA's private right of action for damages from a data breach will remain applicable to an adviser even if otherwise exempt from the CCPA due to the GLB exemption. A requirement for such a private lawsuit is that the breach result from a "violation of the duty to implement and maintain reasonable security procedures and practices appropriate to the nature of the information . . ." Thus, an adviser fully complying with SEC Regulation S-P and Regulation S-ID, which require an adviser to have data protection policies in place, should have a built-in defense to private lawsuits under the CCPA.

Stepping back, California is likely the first of what will turn out to be many states adopting consumer privacy legislation. Currently there are at least ten other states considering some form of legislation, and some of those laws have no exemption for information subject to GLB. There has also been movement at the federal level toward adoption of a national privacy law - which if passed, may or may not pre-empt some or all of the various state laws. Advisers need to keep tabs on this dynamic and changing area of law to determine if they are subject to any requirements beyond those of GLB and the SEC's regulations. With the effective date of the CCPA only six months away, it is a good time to review the types of personal information that the adviser collects, the personal information it shares with third parties, and the policies adopted to safeguard that information and respond to security breaches. Knowing what information an adviser has, how it is used, and how it is protected is a pre-requisite to determining the applicability of the CCPA as well as any laws that are adopted in other states, and the basis to change or strengthen data protections to protect against actions by the SEC under Regulations S-P or S-ID and private and regulatory state actions.

## The CCPA

- Adopted quickly in June 2018 to avoid an even more restrictive ballot initiative.
- The Act contained errors and internal inconsistencies, some of which were addressed in an amendment two months later.
- At present there are approximately 10 amendments pending in the California legislature.
- The California Attorney General is to adopt implementing regulations by July 1, 2020.

## Other States

- Consumer privacy laws are being considered in several states including Hawaii, Maryland, Massachusetts, Mississippi, New Jersey, Nevada, New Mexico, New York, North Dakota, Rhode Island, and Washington.

## Federal Legislation

- Hearings held in both Senate and House.
- Important issues are the scope of federal legislation and preemption of state laws.

## Entities Subject to the CCPA

For-profit businesses that do business in California and that:

(i) have annual gross revenues in excess of $25 million;
(ii) annually buys, receives for a commercial purpose, sells or shares the personal information of 50,000 or more consumers, households or devices; or
(iii) derives 50 percent or more of its annual revenues from selling consumers' personal information.

Any entity that controls or is controlled by such a business and that shares common branding with the business is also subject to the CCPA.

## Persons Whose Information Is Protected

Consumers: natural persons residing in California

## What Information Is Protected

Information that identifies, relates to, describes, is capable of being associated with, or could reasonably be linked, directly or indirectly, with a particular consumer or household.

## The definition of "personal information" protected under the CCPA includes:

- "identifiers" such as alias, postal address, unique personal identifier, online identifier Internet Protocol address, email address, account name, social security number, driver's license number, and passport number.
- Records of personal property, products or services purchased, obtained, or considered, or other purchasing or consuming histories or tendencies.
- Biometric information.
- Internet or other electronic network activity information, including, but not limited to, browsing history, search history, and information regarding a consumer's interaction with an Internet Web site, application, or advertisement.
- Geolocation data.
- Audio, electronic, visual, thermal, olfactory, or similar information.
- Professional, employment, and education information.
- Inferences drawn from any of the information identified in this subdivision to create a profile about a consumer reflecting the consumer's preferences, characteristics, psychological trends, preferences, predispositions, behavior, attitudes, intelligence, abilities, and aptitudes.

## What the CCPA Requires

- Disclosure of the categories of information collected and purpose at the time of collection.
- The right to request categories of information collected about the consumer within the prior 12 months, categories of the sources of personal information collected, why it is collected, and categories of third parties with whom the information is shared.
- The right to request to know if their personal information is sold or disclosed to a third party, and the category of third party to whom it is sold or disclosed.
- The right to have copies of the information collected.
- The right to request the deletion of personal information.
- The right to "opt out" of the sale of personal information.
- Prohibition on discriminating against consumers who restrict the use of their information.

## The Gramm Leach Bliley Act Exemption

The CCPA "shall not apply to personal information collected, processed, sold, or disclosed pursuant to the federal Gramm-Leach-Bliley Act, and implementing regulations."

GLB's Definition of Personal Information is "personally identifiable financial information" that is (i) provided by a consumer to a financial institution; (ii) resulting from any transaction with the consumer or any service performed for the consumer; or (iii) otherwise obtained by the financial institution.

SEC Regulation S-P's definition of Personal Information is any information "(i) a consumer provides to you to obtain a financial product or service from you; (ii) about a consumer resulting from any transaction involving a financial product or service between you and a consumer; or (iii) you otherwise obtain about a consumer in connection with providing a financial product or service to that consumer."

Most, if not all, information collected about investors by a typical private fund adviser will fall under the definitions in GLB and Regulation S-P, and therefore exempt the information from the CCPA. This is a critical assessment for a registered adviser to make. Some information that may not fall under the exemption are employee information, data collected by portfolio companies (for venture and PE advisers), and investment research activities such as data scraping and surveys.

## The CCPA's Private Right of Action

Even if exempt from the main provisions of the CCPA due to the GLB exemption, a private lawsuit may be brought for a data breach where "nonencrypted or nonredacted personal information. . . is subject to an unauthorized access and exfiltration, theft, or disclosure as a result of the business's violation of the duty to implement and maintain reasonable security procedures and practices appropriate to the nature of the information to protect the personal information . . . "

It is therefore important to implement and maintain reasonable security procedures. Regulation S-P and Regulation S-ID generally require procedures to protect personal information. Although what "reasonable procedures" are is not defined, strict and full compliance with S-P and S-ID should provide a basis for a defense to a private claim under CCPA. Ensuring strict compliance with S-P and S-ID also dovetails with the SEC's continuing current focus on data privacy in examinations and enforcement actions.

## Recent SEC materials relating to Regulations S-P and S-ID

SEC Office of Compliance Inspections and Examinations: *Investment Adviser and Broker-Dealer Compliance Issues Related to Regulation S-P - Privacy Notices and Safeguard Policies* (April 16, 2019)

Rundown of the most common S-P compliance issues encountered in SEC examinations.

*In the Matter of Voya Financial Advisors, Inc.*, SEC IA Release No. 5048 (September 26, 2018).

Although involving a dual registered broker-dealer/investment adviser, and not an adviser to a hedge fund, the SEC enforcement case is notable for a few aspects relevant to hedge fund advisers. First, it was the first case brought under regulation S-ID (the Identity Theft Red Flags Rule). Second, although framed in terms of adequate policies and procedure, to an extent the SEC was opining on the adequacy of the protective measures taken by the registrant and the adequacy (and speed) of the response to a cyber intrusion. Therefore, and although hedge fund advisers are less vulnerable to cyber intrusions as compared to separate account advisers, fund advisers can expect the SEC's examiners to begin looking at the adequacy of cyber protection policies on a more substantive basis and also to the possibility of an enforcement action if a successful intrusion occurs.

## Steps to Take Now

- Monitor the legislative amendments to the CCPA and the California Attorney General's forthcoming regulations.
- Perform a detailed data inventory to determine what information is collected about individuals throughout the organization, electronic and physical, and where it is stored.
- Assess the applicability of the CCPA's Gramm Leach Bliley exemption.
- Analyze how and with whom any personal information is shared with third parties, including service providers.
- Assess the appropriateness and strength of policies, safeguards, and breach response plans in light of types of information collected and the requirements of Regulations S-P and S-ID.
- Assess adequacy of current privacy disclosures.
- Consider appropriate training for employees.

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