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Increased Regulatory Focus on Privacy and Cybersecurity for Private Funds in 2022

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2021 continued the trend of increased regulatory focus on privacy and cybersecurity for private investment funds in the U.S. and abroad. There are no signs of the trend leveling off any time soon.

One of the topics that captured our attention last year was the rise of ransomware. As previously shared, ransomware has evolved from merely encrypting files/disabling networks in solicitation of ransom, to sophisticated attacks penetrating data systems and debilitating entities. Thus, while money continues to be an obvious motivator for these attacks, increasingly so is the pursuit of intellectual property and data. Regulatory agencies have responded to combat the increase in attacks. For example, in October 2020, OFAC issued an Advisory declaring that any payment made to a sanctioned entity on OFAC's list would be a violation of federal sanctions regulations and the paying entity would be strictly liable. Importantly, this means that the intent of the victim, and the knowledge as to whether the entity is on OFAC's list, is no defense. While OFAC intends to decrease ransomware attack compliance through the issuance of its list of sanctioned entities, the nature of ransomware makes it difficult for the victim of an attack to be able to identify what entity is actually being paid. This ambiguity may cause victims of ransomware attacks to unintentionally violate OFAC's sanctions and be held strictly liable despite the publication of a list of sanctioned entities.

In the same vein of preventing breaches of privacy via cybersecurity efforts, in February 2022, the SEC proposed new rules under the Investment Advisers Act of 1940 (the "Advisers Act") and the Investment Company Act of 1940 (the "Investment Company Act") requiring registered investment advisers and funds to adopt and implement written cybersecurity policies and procedures reasonably designed to address such risks. One of the proposed rules requires advisers to report significant cybersecurity incidents affecting the adviser, or its fund or private fund clients, to the Commission. The Commission is also proposing amendments to various forms regarding the disclosure related to cybersecurity risks and incidents that affect advisers, funds, their clients, and their shareholders. The comment period ends on April 11, 2022, after which we can expect these new rules to take effect.

In the UK, the National Cyber Security Centre (NCSC) has recently published a reminder to organizations to take steps to protect their systems given the increased risk from and number of cyber threats. This reminder was reiterated by the ICO, the UK's data supervisory authority, following a reported uptick in cyber related data breaches in the UK of nearly 20% in the past two years. The UK's data protection legislation already provides that organizations should implement "*appropriate technical and organisational measures to ensure a level of security appropriate to the risk*" to protect personal data. When designing and assessing "appropriate" measures, organizations in the UK (including funds, sponsors and advisers) should also now take account of the specific guidance on ransomware recently published by the ICO.

We expect to see a continued focus on privacy and cybersecurity in the private funds space as regulators work to find ways to increase security and decrease the risk of loss due to new methods of attack. The Asset Management Litigation team will continue to stay on top of developments and will provide you with updates on these issues over the course of the year.

Read more of our Top Ten Regulatory and Litigation Risks for Private Funds in 2022.

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