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Tricks & Treats for Non-Profits Navigating Privacy & Cybersecurity Risks

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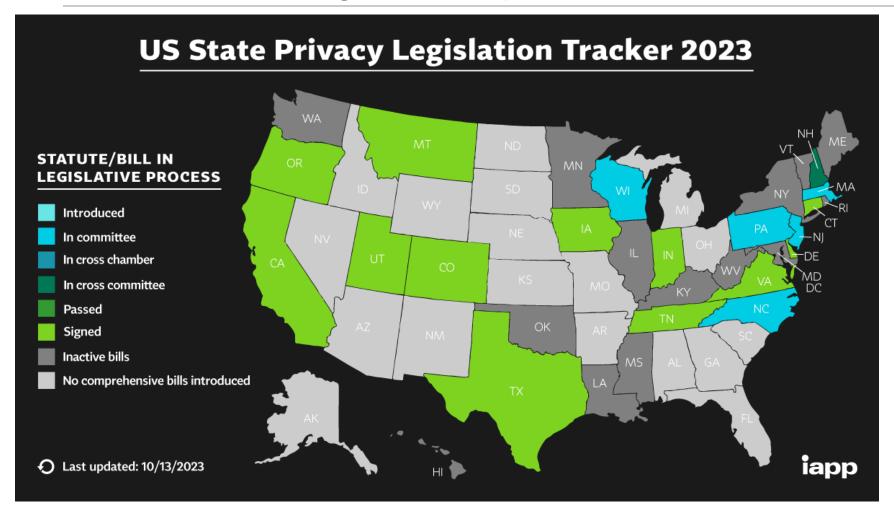
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US State Privacy Laws Update



US State Privacy Laws - Comprehensive

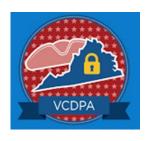
State	Effective Date	Applies to Nonprofits?
California (CCPA)	January 1, 2023	NOT GENERALLY*
Colorado (CPA)	July 1, 2023	YES
Virginia (VCDPA)	January 1, 2023	NOT GENERALLY*
Connecticut (CTDPA)	July 1, 2023	NO
Utah (UCPA)	December 31, 2023	NO
Tennessee (TIPA)	July 1, 2025	NO
Texas (TDPSA)	July 1, 2024	NO
Indiana (ICDPA)	January 1, 2026	NO
lowa (ICDPA)	January 1, 2025	NO
Montana (MCDPA)	October 1, 2024	NO
Oregon (OCPA)	July 1, 2024 July 1, 2025 (non-profits)	YES
Delaware (DPDPA)	January 1, 2025	YES
Nevada (NPICICA)	October 1, 2019	NO
Florida (Digital Bill of Rights)	July 1, 2024	NO

CA & VA Law: The Fine Print



California: The California Consumer Privacy Act (CCPA), as amended by the California Privacy Rights Act (CPRA)

- CCPA directly regulates "businesses" nonprofit generally does not qualify as a business, but it may if another business "controls" the nonprofit and the two entities share personal information and "common branding."
 - For example, if a corporation has a nonprofit arm or foundation, that nonprofit arm may qualify as a business under California law.
- A nonprofit may also qualify as a "service provider," "contractor," or "third party" under the CPRA and be subject to certain contractual requirements or other requirements to assist a business in its compliance with the law.



Virginia: The Virginia Consumer Data Protection Act (VCDPA)

- VCDPA exempts nonprofits organized under Virginia law, 501(c)(3), (6), and (12) organizations, political organizations, and subsidiaries or affiliates of utility providers.
- However, the VCDPA does not exempt all 501(c)(4) organizations (certain insurers providing information to authorized law enforcement are exempt).



CO, OR & DE: Privacy Law Thresholds



Conduct business or target state residents with products/services



Volume of consumer data

CO: 100K

OR: 100K

DE: 35K



Revenue from selling data

CO: 25K consumers + any revenue from data sales

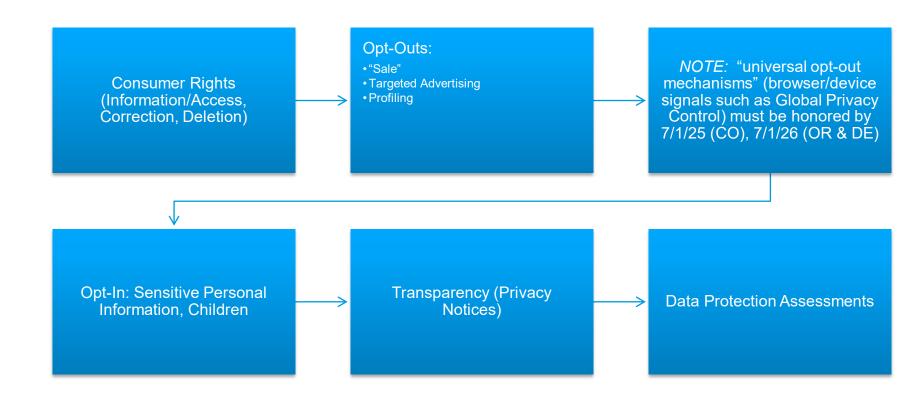
OR: 25K consumers + 25% revenue from data sales

DE: 10K consumers + 20% revenue from

data sales



If State Privacy Laws Apply...





WA, NV & CT: Health Data Privacy Laws



- Washington: My Health My Data Act
 - Effective March 31, 2024 (prohibition on geofencing goes into effect July 23, 2023)
 - Governs "consumer health data": defined broadly as "personal information that is linked or reasonably linkable to a consumer and that identifies the consumer's past, present or future physical or mental health status."
 - No minimum revenue or volume of data thresholds
 - No entity-level HIPAA exemption
 - No exemption for nonprofits



- Nevada: Nevada Consumer Health Data Privacy Law
 - Entity-level HIPAA exemption
 - No exemption for nonprofits



Connecticut: Consumer health data amendments to CTDPA (exempts nonprofits)



International Privacy Laws



- Europe: GDPR & UK Data Protection Act
 - Cross-border data transfer restrictions
 - US-EU Data Privacy Framework
- Brazil: LGPD
- · China:
 - Cybersecurity Law
 - Data Security Law
 - Personal Information Protection Law
 - Cross-border data transfer restrictions
- India: Personal Data Protection Act
 - Signed into law August 2023
 - Awaiting notice of effective date



Privacy Class Action Litigation

New applications of old privacy laws.....

- Video Privacy Protection Act (VPPA)
- Wiretapping Laws (CIPA, etc.)
 - Session Reply and Chatbot software
 - Now: Pixel tracking, email marketing analytics
- Illinois Biometric Information Privacy Act (BIPA)

Next up?

Failing to honor tracking choices (cookies, pixels, etc.)





Cyber Threat Landscape: Nonprofits a Target



- According to Nonprofit Tech for Good 2023
 Report, 27% of nonprofits have fallen prey to cyberattacks
- Risks (from Nonprofit Technology Enterprise Resource Report):
 - 68% nonprofits lack documented policies & procedures regarding cyberattacks
 - 71% allow staff to access org data via unsecured devices
 - Many lack adequate technical security controls and sufficient technical expertise
 - YET: Nonprofits often collect very sensitive data
- Nonprofits attractive target seen as low-hanging fruit

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Cyber Threat Landscape: Risk Trends



Social Engineering

Phishing → Malware injection

Spear Phishing → Fund transfers



Ransomware

Fewer victims are paying (85% Q1 2019 → 37% Q4 2022)

But average ransom payments have continued to trend up



Vendor breaches

2023 Cyentia Institute report found 98% of organizations worldwide have integrations with at least one third-party vendor that has been breached in the last two years



Cyber Threat Landscape: Al The Cyber Chess Queen



 Al enables deepfake social engineering techniques and automated malware that automatically adapts to avoid detection



 Al will help detect, evade or neutralize threats thanks to real-time anomaly detection, smart authentication and automated incident response







Cybersecurity Threat Mitigation

- Manage as a critical organizational risk: direct and frequent executive / board involvement
- Engage outside experts to assess risks and help design and implement risk mitigation strategies
- Make use of cloud services where it makes sense cloud shared responsibility model
- Focus on supply-chain risk
 - Implement / improve 360-degree vendor risk management
 - Plan for adequate due diligence timelines into product/service acquisition



Privacy Threat Mitigation

- Data mapping / inventories know what data you have and where it is
- Fully assess applicability of US and international laws
- Update privacy notices, especially regarding consumer rights
- Ensure processes and tools to manage consumer rights are in place and functioning as intended
- Audit tracking tech (cookies, pixels, tracking SDKs etc) used on websites, apps, email marketing and assess risks with legal counsel
 - Implement tracker governance processes



A Hopeful Note: Privacy Enhancing Technologies

Increasingly sophisticated cryptographic techniques and structural changes to how data is processed are available to increase privacy and security of data, such as:

- Better data obfuscation techniques (pseudonymization/anonymization; synthetic data)
- Heightened encryption tech
- "Differential privacy" (privacy-forward approach designed for interactive statistical queries made to a database)



Time to adopt PETs









Boo! Taking the Fear Out of Section 501(c)(4)



Jean Bertrand
Partner

October 31, 2023



Overview

- Private foundations have historically been used by wealthy individuals and families to engage in philanthropy. Private foundations provide the donor with a charitable deduction.
 - However, private foundations are subject to many restrictions and excise taxes
- Section 501(c)(4) social welfare organizations do not allow a charitable contribution deduction for income tax purposes
 - But they are not subject to the private foundation restrictions and excise taxes
- Many wealthy individuals cannot use the charitable deduction, so for them, section 501(c)(4)
 organizations compare favorably to private foundations
- In 2022, the founder of Patagonia contributed most of his stock to a section 501(c)(4) organization.
- Section 2036(a) may limit the ability of a donor to a section 501(c)(4) organization to select grant recipients; however, there are work-arounds.



Historical Use of Private Foundations

- Private foundations have many benefits:
 - Donations are eligible for an income tax deduction
 - Donations are not subject to the gift tax
 - Donations are excludible from donor's estate
 - Nonrecognition of gain on donations of appreciated assets
 - The income of a private foundation is generally tax-exempt (except for UBTI/UDFI and the annual 1.39% excise tax)



Historical Use of Private Foundations (cont'd)

- However, there are drawbacks to operating a private foundation. Private foundations are subject to a long list of restrictions and excise taxes:
 - Limitation on excess business holdings
 - Expenditure responsibility requirements
 - 1.39% tax on investment income
 - -5% annual distribution requirement
 - Jeopardizing investments tax
 - Strict self-dealing rules
 - Assets must be used exclusively for charitable purposes
 - Prohibition on participating in political campaigns
 - Lobbying is a taxable expenditure (effectively prohibits lobbying)
 - Requirement that donors be disclosed to the public



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An Alternative to Private Foundations - 501(c)(4) Organizations

- An alternative vehicle to a private foundation is a section 501(c)(4) social welfare organization
- Section 501(c)(4) organizations are tax-exempt (except for UBTI/UDFI) and can engage in all of the same activities in which a private foundation can engage (and more) but are subject to many fewer restrictions
- They are **NOT** subject to:
 - Limitation on excess business holdings
 - Expenditure responsibility requirements
 - -1.39% tax on investment income
 - -5% annual distribution requirement
 - Jeopardizing investments tax
 - Self-dealing rules (instead they are subject to more lenient "excess benefit transaction rules")



Section 501(c)(4) Organizations

- Like a private foundation, a section 501(c)(4) organization must *not* be organized for profit, and no part of its net earnings may inure to the benefit of any private shareholder or individual
- A section 501(c)(4) organization must be operated exclusively for the promotion of social welfare
- To operate "exclusively" for the promotion of social welfare, an organization must engage "primarily" in promoting in some way the common good and general welfare of the people of the community (e.g., for the purpose of bringing about civic betterments and social improvements)



- No definition of "primarily", prior IRS guidance suggested that if 60% of an organization's time and expenditures were for social welfare, the organization would qualify for a safe harbor
- Campaign participation social welfare does not include participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office, but since social welfare must be an organization's primary activity, a section 501(c)(4) can engage in political campaign activity so long as these activities are not its *primary* activity
- Unlimited lobbying can engage in an unlimited amount of lobbying as long as it's in furtherance of social welfare purposes
- Anonymity donors do not have to be disclosed to the public



- Practical aspects
 - An organization must file an IRS Form 8976 notifying the IRS of its intention to operate as a section 501(c)(4) organization within 60 days after the date the organization is formed
 - No requirement to file an application (on IRS Form 1024-A) with the IRS for recognition of tax-exempt status in order to be tax-exempt
 - Although many organizations do file with the IRS for certainty
 - Required to file an annual tax return on IRS Form 990. Failure to file for three consecutive years will result in loss of tax-exemption.



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- Estate tax consequences
 - A bequest to a section 501(c)(4) does not qualify for an estate tax deduction under section 2055(a)(2)
 - In addition, section 2036(a) provides that the value of a decedent's gross estate includes:
 - the value of any property the decedent transferred (other than in a bona fide sale for adequate and full consideration) and
 - <u>retained the right for life</u> (or any period not ascertainable without reference to his or her death or for any period that does not in fact end before his or her death), either alone or in conjunction with any person, <u>to designate the persons that will possess or</u> <u>enjoy the property or income from the property</u>
 - Thus, if a donor, directly or indirectly, has the right throughout the donor's life to select section 501(c)(4) organization's grant recipients, the donor's estate would include the donation
 - What about family members?



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- To address the section 2036(a) estate tax issue:
 - The donor could remove itself from grantmaking and not be a member, director or officer of the organization with the authority to select grant recipients
 - The donor's will and the foundation organizational documents could provide that upon his/her death all remaining assets of the section 501(c)(4) organization will be transferred to section 501(c)(3) organizations
 - While the assets of the section 501(c)(4) organization would be included in the donor's estate, the donor should get a charitable donation deduction for the transfer of the assets to the section 501(c)(3) organizations

October 31, 2023

where We Rection 501(s) (4) Organizations the Senor cannot use a charitable deduction for income tax purposes or where the private foundation rules are particularly onerous

- Very wealthy individuals holding publicly traded stock often have no taxable income and therefore cannot use a charitable deduction
- Fund managers that receive "carried interest" in investment partnerships have a zero basis in their partnership interests for tax purposes. The managers wouldn't be entitled to a charitable deduction if they donated their carried interest to a section 501(c)(3) organization
- Non-US individuals who want to set up a US charity cannot benefit from a charitable deduction for income tax purposes
- Private foundations cannot normally hold more than 20% of the voting stock of an active business; therefore, donors of active businesses that want the business to be held longterm by a tax-exempt organization (rather than sold) use section 501(c)(4) organizations

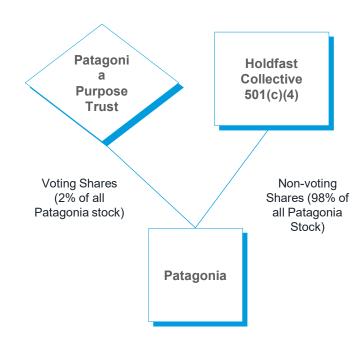


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The Patagonia Transaction

- In 2022, Yvon Chouinard and his family transferred 98% of the Patagonia shares to a section 501(c)(4) organization and 2% of the shares (100% of the vote) to a purpose trust
- The transfer to the Patagonia Purpose Trust was subject to a \$17.5 million gift tax
- The family members did not receive an income tax deduction with respect to the transfer
- The stock was estimated to have a value of \$3 billion
- The transfer to the Holdfast Collective was not subject to gift tax or capital gains tax
- Patagonia will remain a for-profit corporation
- Chouinard family members still serve on the Patagonia board of directors
- The family will "guide" the purpose trust by electing and overseeing its leadership
- The family will "guide" the philanthropic work performed by the Holdfast Collective

Current Ownership Structure





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Protecting the Treats: Compensation and Benefits Developments

Seth Safra Partner

October 31, 2023

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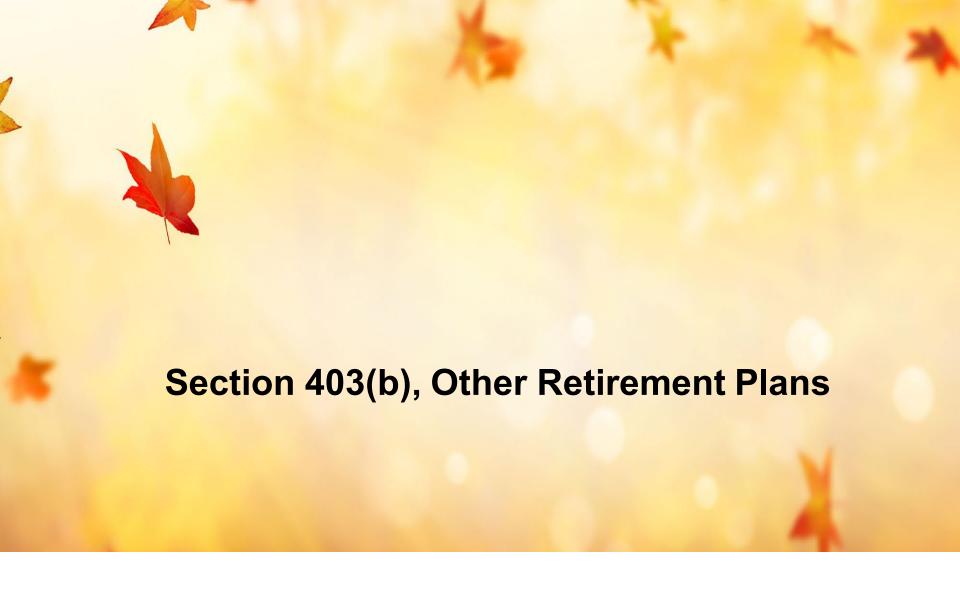
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Compensation and Benefits Developments

- Section 403(b), Other Retirement Plans
 - IRS determination letter opportunity
 - SECURE 2.0
- ERISA Fiduciary Update
- Health Benefits
 - Mental health parity
 - Price transparency







IRS Determination Letter Opportunity

- Pre-approved plans vs. "individually designed" plans
- Until now, IRS did not review individually designed plans
- New program (Rev. Proc. 2022-40)
 - Started June 1, 2023
 - Timing by EIN

EIN Ends With	Apply On or After
1, 2, 3	June 1, 2023
4, 5, 6	June 1, 2024
7, 8, 9, 0	June 1, 2025

- Limited opportunity: initial qualification, plan termination
- Benefit of IRS letter: protection against disqualification for form defect
- Advantageous to treat "on or after" as "one-year window"



SECURE 2.0 Highlights for Non-Profits

Required

- Catch-ups must be Roth
 - If prior year compensation was > \$145k (indexed); deadline extended to 2026
- Must include "long-term part-timers" (≥ 500 hours in a year starting after 12/31/22)

Optional:

- Required Minimum Distributions
 - Age increases from 72-73 (optional)
 - Minimum distributions not required for Roth amounts after 2023
- Hardship withdrawals permitted from earnings (to align with 401(k) rule)
- Small benefit cashout limit increases from \$5,000 to \$7,000 (starting in 2024)



SECURE 2.0 Highlights for Non-Profits (cont.)

Optional (cont.)

- Match on student loan repayments (starting in 2024)
- Emergency Savings Accounts (starting in 2024)
- Increase to catch-up limit, starting in 2025
 - Only for age 61, 62, or 63; regular catch-up limit increases by 50%
- Option to receive match or non-elective contribution on Roth basis
- Expansion of distribution options for disaster relief, other special circumstances
- CITs in 403(b) plans (securities law issues need to be ironed out)



SECURE 2.0 Highlights: Administrative Changes

- Overpayment recovery
 - No longer required to recover most inadvertent payments
 - New limitations and restrictions on ability to recover
- Requirement to provide paper statements in certain cases (starting in 2026)
 - DC plan: paper benefit statement at least once per year
 - DB plan: paper benefit statement at least once every three years
 - Participants may opt out of these paper statements; but can't default to electronic
- Enhancements to pension plan funding notices (starting for 2024 plan year)







ERISA Fiduciary Litigation

- Lawsuits continue against DC plans
 - Defendants include hospitals, universities, other non-profits
 - Suits have started reaching smaller plans
 - Allegations based on fees, fund selection
 - Active vs. passive; risk level; diversification
 - 403(b) fee structure, legacy recordkeepers/funds are a target
 - Cybersecurity and use of participant data
 - Are brokerage windows next?
- Some courts have dismissed cases based on inadequate pleading
- Many courts are still allowing cases to proceed

Liberal pleading standard + time/cost to defend = \$ to settle



Common Allegations of Imprudence

- Offering actively managed funds vs. passive (index) funds
- Offering anything but the cheapest share class available
- Offering too many investment options
- Investment fees and/or performance vs. benchmark or cherry-picked alternative
- Offering affiliated investment funds
- Offering money market funds vs. stable value
- Excessive recordkeeping fees:
 - Revenue sharing model or higher flat amount than alleged market norm
 - Inefficiency of having >1 record keeper



DOL Guidance

- ESG
 - Current DOL wants to encourage
 - But still must apply risk/return analysis, like any other investment
- Private equity: permitted, but DOL is skeptical
- Cryptocurrency: DOL objects . . . with a jab against brokerage windows
- Privacy and data security
 - Critical issue for engaging, monitoring service providers
 - Educate participants on risks and responsibilities
- Proposed rule on who is an investment fiduciary (imminent)







Mental Health Parity

- Plan must have parity between mental health/substance use disorder (MHSUD) and medical/surgical (M/S)
 - Annual and lifetime limits
 - Financial requirements, "quantitative limitations"
 - Non-quantitative treatment limitations ("NQTL"), e.g.:
 - Medical management standards
 - Prescription drug formulary design
 - Standards for provider admission to network, including reimbursement rates
 - Method for determining "usual, customary, and reasonable" charges
 - "Fail first" or "step therapy" protocols
 - Restrictions based on geographic location, facility type, provider specialty
- Each plan must have "comparative analysis" to document compliance
 - DOL: majority of comparative analyses are deficient



Mental Health Parity: Proposed Rule

Focus on NQTL:

Replace general "no more stringent" test with three-parts:

1. No More Restrictive

- No NQTL for MH/SUD may be more restrictive than the "predominant" NQTL for "substantially all" M/S benefits in same class
- "predominant" = most common
- "substantially all" means ≥ 2/3

2. Design and Application

 Standards for designing and applying NQTLs for MH/SUD in a class can't be applied more stringently than for M/S in same class

3. Data Evaluation

- Must collect and evaluate data to assess impact of NQTL on access to MH/SUD benefits
- Material difference in outcomes suggests non-compliance
- Per se test for network composition

Classes: (1) inpatient IN, (2) inpatient OON, (3) outpatient IN, (4) outpatient OON, (5) emergency, (6) prescription drug

- More detail for comparative analysis, fiduciary must certify
- Expanded list of NQTL examples
- Non-compliance can lead to DOL order not to apply the NQTL



Price Transparency: Plans Must Post Machine Readable Files

- Rule: Health plans must post three machine-readable files, updated monthly:
 - In-network rates (expressed as dollar amounts)
 - Allowed amounts for out-of-network items and services
 - Negotiated rates and historical net prices for covered prescription drugs

Prescription drug machine-readable file

- Enforcement was delayed due to overlap with separate prescription drug reporting requirement
- October 2023: Agencies rescinded the delay; so must post prescription drug data
- Additional enforcement guidance to come

In-network rate machine-readable file

- Agencies initially provided enforcement exception to the "dollar amount" requirement where payment arrangement can't easily be boiled down to dollars per item/service
 - Example: Arrangement that pays % of billed charges
- October 2023: Agencies rescinded the exception;
 but will exercise enforcement discretion on a case-by-case basis





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