2023 COMPLIANCE YEAR IN REVIEW

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The Busiest Year on Record for SEC Regulatory Changes

If 2023 could be condensed into one descriptive narrative, it would be that the U.S. Securities and Exchange Commission (SEC) concluded one of its most active years in proposed and adopted industry-altering regulatory rules for private fund managers that will greatly impact the way they conduct business – now and into the future.

What is truly interesting about this round of changes is that there was not one major crisis or scandal that set the ball rolling. Instead, the SEC's heightened rulemaking seems to be more about reshaping the U.S. financial markets that, for market participants, means increased obligations, technological infrastructure changes, enhanced regulatory awareness and much, much more. Silver's CEO, Fizza Khan, remarks on some of these topics in a February ***SilverVision post***.

With so many changes to keep track of and implement, the Silver Compliance Team has broken down the various revised and new rules affecting private fund managers into the following key topics:

- ***Adopted and Proposed Rules***
- ***Current State of Crypto***
- ***2024 Exam Priorities***
- ***New Marketing Rule: Implementation and Status***
- ***Privacy Laws***
- ***Record Keeping Enforcement Actions***

Adopted & Proposed Rules

SEC Adopts Rule to Increase Transparency into Short Selling and Amendment to CAT NMS Plan for Purposes of Short Sale Data Collection

Summary

Institutional investment managers that meet or exceed certain prescribed reporting thresholds will report on Form SHO certain short position and short activity data for equity securities. Under the amendment to the CAT NMS Plan, CAT reporting firms will indicate whether an order is a short sale effected by a market maker in connection with bona fide market making (BFMM) activities for which the BFMM exception in Rule 203(b)(2)(iii) of Regulation SHO is claimed.

Compliance Dates

The compliance date for Rule 13f-2 and Form SHO is January 1, 2025. The compliance date for public aggregated reporting, which follows three months after the compliance date of Rule 13f-2 and Form SHO, is April 1, 2025. The compliance date for the amendment to the CAT NMS Plan, which is 18 months after the effective date, is July 2, 2025.

Silver's Take

Investment advisers that carry large short positions in equity securities will be required, within two weeks after each month, to report those positions and related short sale activity to the SEC.

SEC Adopts Amendments to Rules Governing Beneficial Ownership Reporting

Summary

The amendments include shortening deadlines for initial and amended Schedule 13D and 13G filings; clarifying Schedule 13D disclosure requirements with respect to derivative securities; and requiring that Schedule 13D and 13G filings be made using structured, machine-readable data language.

Compliance Dates

Compliance with the revised Schedule 13G filing deadlines will be required beginning on September 30, 2024. Compliance with the structured data requirement for Schedules 13D and 13G will be required on December 18, 2024.

Silver's Take

Schedules 13D and 13G filing clients (generally PE fund managers and managers of large hedge funds, or hedge funds employing a microcap strategy) should be aware that filing deadlines have been shortened considerably.

SEC Proposes Reforms Relating to Investment Advisers Operating Exclusively Through the Internet

Summary

The Proposed Rule would require that advisers relying on the Internet Investment Adviser Exemption maintain an operational interactive website for ongoing advisory services to multiple clients. It would also eliminate the de minimis exception - which allows an adviser relying on the rule to advise clients through means other than its interactive website, so long as the adviser had fewer than 15 of these non-Internet clients during the preceding 12 months - requiring internet advisers to serve all clients exclusively through their website.

Silver's Take

The SEC has proposed reforms to the exemption that would effectively require all investment advice to be given using an interactive website, which could affect internet investment advisers who rely on the de minimis exemption, as that exemption may soon disappear.

SEC Proposes Enhanced Safeguarding Rule for Registered Investment Advisers

Summary

The Proposed Rule would expand the Custody Rule for investment advisers to cover all asset classes, with some key enhancements including requiring proper segregation and bankruptcy remoteness; written agreements with custodians; strengthening requirements for foreign financial institutions; and clarifying the Custody Rule's protections for discretionary trading. SEC Chair Gary Gensler also stated that most crypto assets are likely covered by the current Custody Rule and that investment advisers cannot rely on crypto platforms as qualified custodians as they often commingle assets.

Silver's Take

This Proposed Rule would expand assets that an adviser must custody with a qualified custodian to include assets such as privately issued securities, real estate and derivatives. The proposal would also expand the Custody Rule to cover all crypto assets, including those currently covered as funds and securities, as well as those that may not be considered funds or securities.

For more information on the implications of this new rule, please see the following thought leadership piece on this topic: ***"4 Key Takeaways from the SEC's Proposed "Safeguarding Rule"***

Enhanced Reporting of Proxy Votes by Registered Management Investment Companies

Summary

Proposed amendments to Form N-PX would enhance the information mutual funds, exchange-traded funds and certain other funds report about their proxy votes. The proposed amendments also would require institutional investment managers to disclose how they voted on executive compensation or so-called "say-on-pay" matters.

Compliance Dates

Investment advisers will be required to file their first reports on amended Form N-PX by August 31, 2024, with these reports covering the period of July 1, 2023, to June 30, 2024.

Silver's Take

The amendments would require funds and managers to tie the description of each voting matter to the issuer's form of proxy and to categorize each matter by type to help investors identify votes of interest and compare voting records; prescribe how funds and managers organize their reports and require them to use a structured data language to make the filings easier to analyze; and to disclose how their securities lending activity impacted their voting.

NFA Adopts Digital Asset Commodities Standards and Requirements

Summary

On March 29, 2023, the National Futures Association (NFA) announced NFA Compliance Rule 251: Requirements for Members and Associates Engaged in Activities Involving Digital Asset Commodities. The Rule generally prohibits false, misleading or manipulative practices by NFA members and associates transacting in "Digital Asset Commodities," which are defined solely as Bitcoin and Ether.

Compliance Dates

NFA Compliance Rule 251: Requirements for Members and Associates Engaged in Activities Involving Digital Asset Commodities became effective on May 31, 2023.

Silver's Take

Though this Rule gives the NFA jurisdiction to require specific standards of business conduct relating to digital assets, the Rule is fairly limited in that it largely prevents fraud and similar misconduct relating to Bitcoin and Ether.

SEC Proposes IA Outsourcing Oversight Framework

Summary

This Proposed Rule would establish an oversight framework for RIAs that are outsourcing a "Covered Function." This includes a service or function that: (1) is necessary to provide advisory services in compliance with the Federal securities laws; and (2) if not performed or performed negligently, would be reasonably likely to cause a material negative impact on the adviser's clients or on the adviser's ability to provide investment advisory services. Prior to retaining a service provider to carry out a covered function, an RIA must reasonably identify and determine through due diligence that it would be appropriate to outsource the covered function to the service provider, by considering: (i) the nature and scope of the covered function; (ii) potential risks resulting from the service provider performing the covered function, including how to mitigate and manage such risks; (iii) the service provider's competence, capacity and resources necessary to perform the covered function; (iv) the service provider's material subcontracting arrangements related to the covered function; (v) coordination with the service provider for Federal securities law compliance; (v) and the orderly termination of the performance of the covered function.

Furthermore, RIAs will have to create and retain records relating to their due diligence and monitoring, as well as disclose census-type information regarding these service providers on the Form ADV.

Silver's Take

Chairman Gensler supports this proposal because he thinks it would provide greater investor protections by requiring advisers to take steps to meet their fiduciary and legal obligations when outsourcing services through third parties. However, it is clear that this will put increased burdens on advisers, their third-party service providers and the ability to onboard outsourced functions in a nimble and seamless way.

SEC Adopts Amendments to Enhance Private Fund Reporting

Summary

The SEC adopted amendments to Form PF that require large hedge fund advisers and all private equity fund advisers to file current reports upon the occurrence of certain reporting events that could indicate significant stress at a fund or investment adviser. The amendments will become effective six months after publication of the adopting release in the Federal Register for current reporting, and one year after publication in the Federal Register for remaining amendments.

Compliance Dates

This rule is effective June 11, 2024, except for the amendments to Form PF sections 5 and 6 (referenced in 17 CFR 279.9) which are effective December 11, 2023. For the amended existing Form PF sections and amendments to 17 CFR 275.204(b)–1, the compliance date is June 11, 2024; for new Form PF sections 5 and 6, the compliance date was December 11, 2023.

Silver's Take

Form PF Filers will have additional regular and context-specific filing obligations. Specifically, large hedge fund advisers must file these reports as soon as practicable, but no later than 72 hours from the occurrence of the relevant event; and private equity fund advisers must file these reports on a quarterly basis within 60 days of the fiscal quarter end. Large private equity fund advisers are also required to report information on general partner and limited partner clawbacks on an annual basis, as well as additional information on their strategies and borrowings as a part of their annual filing.

For more information on the implications of this new rule, please see the following piece of thought leadership on this topic: ***"Form PF Changes and Its Impact on Private Fund Managers"***

SEC Adopts Private Fund Adviser Rules

Summary

On August 23, 2023, the SEC adopted sweeping changes to the Investment Advisers Act of 1940, as amended (Advisers Act) to enhance the regulation of private fund advisers and update the existing compliance rule that applies to all registered investment advisers. Commonly referred to as the Private Fund Adviser Rules within the industry, these much-anticipated reforms are designed to protect private fund investors by increasing transparency, competition and efficiency in the private funds market. While different than the proposed amendments that were announced by the SEC back in February 2022, the enacted rules include several quarterly reporting requirements with respect to performance, fees and expenses, increased transparency regarding side letters and other "preferential treatment" for fund investors and limitations on the ability of fund managers to obtain reimbursement from private funds clients. On the ESG side, managers who enter into side letters with ESG provisions, specifically those that allow certain investors specific reporting and information rights, should expect those provisions to be in scope of the Private Fund Adviser Rules and should be prepared to address them as part the rule's efforts to enhance transparency.

Compliance Dates

The compliance date for documenting Annual Compliance Reviews was November 13, 2023, for both large and small private fund advisers. The compliance date for Quarterly Statement Rules and the Private Fund Annual Aduit Rule is March 14, 2025, for both large and small private fund advisers. The compliance date for Secondary Transaction Requirements, Restricted Activities Rule and Preferential Treatment Rule for large private fund advisers is September 14, 2024, and March 14, 2025 for small private fund advisers. The compliance dates for Books and Records Requirements are tied to the effective dates of the Adopted Rule for which books and records are required.

Silver's Take

These new rules and amendments will have a material impact on private fund advisers, regardless of whether they are SEC-registered or relying on an exemption, as well as significantly increase compliance costs. Moreover, these rules and amendments change long-standing, negotiated market practices applicable to private fund advisers. Certain of the Rule's requirements have already come into effect in 2023, and while other requirements' implementation dates are relatively far off, advisers should begin to understand how the new and revised rules will affect their fundraising and operations, including how legacy status may apply.

For more information on the implications of these new rules, please see the following thought leadership piece on this topic: ***"The Private Fund Adviser Rules: What You Need to Know"***

SEC Adopts Rules on Cybersecurity Risk Management, Strategy, Governance and Incident Disclosure by Public Companies

Summary

The SEC adopted new rules requiring public companies to disclose material cybersecurity incidents and provide annual disclosures on cybersecurity risk management, strategy and governance. Public companies will now need to disclose any material cybersecurity incident on Form 8-K, along with its nature, scope, timing and impact, within four business days of determining its materiality. Public companies must also describe their processes for assessing and managing cybersecurity risks, the board of directors' oversight and management's role and expertise in assessing cybersecurity risks in their Form 10-K annual report. Analogous rules have been proposed for Broker Dealers and Investment Advisers, but they have not yet been adopted.

Compliance Dates

The compliance dates vary by the type of disclosure, with smaller reporting companies (SRCs) being afforded a longer compliance period for incident reporting:

1. With respect to the annual Form 10-K and Form 20-F cybersecurity disclosures, all registrants (including SRCs) must provide such disclosures beginning with their annual reports for fiscal years ending on or after December 15, 2023.

2. With respect to material cybersecurity incident disclosure on Form 8-K and Form 6-K, registrants that are not SRCs must begin complying by December 18, 2023. SRCs have an additional 180 days to comply, meaning that they must begin complying by June 15, 2024.

3. With respect to the structured data requirements (i.e., Inline XBRL tagging), all registrants (including SRCs) must begin tagging their cybersecurity disclosures in Form 10-K and Form 20-F in Inline XBRL for fiscal years ending on or after December 15, 2024, and all registrants (including SRCs) must begin tagging their material cybersecurity incident disclosures in Form 8-K and Form 6-K in Inline XBRL by December 18, 2024.

Silver's Take

While these rules on cybersecurity disclosures do not directly impact investment advisers, they may serve as a potential indicator of future regulatory trends, suggesting that advisers could face requirements to make similar disclosures in publicly available documents, such as Form ADV.

Current State of Crypto

For Silver's POV on this topic, please read our byline in the New York Law Journal *available here.*

Ripple Ruling on Crypto Rejected by Federal Judge in Terra Case (July 31, 2023)

Summary

In SEC v. Ripple Labs Inc., a U.S. District Court judge ruled that XRP itself is not necessarily a security, but its sale to institutional investors was, while its sale to retail investors was not (see summary of Ripple case below). In a separate case involving Terraform Labs, Judge Jed Rakoff rejected the distinction between public and institutional sales, declining to categorize coins sold directly to institutional investors as securities and those sold to retail investors as not. His opinion agrees with Ripple and others in the crypto industry that tokens themselves are not securities, but concludes that all the sales were securities offerings, examining the "totality of circumstances."

Silver's Take

This decision adds to the uncertainty over cryptocurrency regulation, challenging the idea that the manner of sale impacts whether a token is considered a security. The implications of the ruling on crypto exchanges remain unclear, particularly regarding whether tokens themselves are securities or if the issuances of tokens along with the totality of their circumstances are securities offerings.

Bittrex to Pay $24 Million to Settle with the SEC (August 10, 2023)

Summary

The SEC announced settlements with crypto trading platform Bittrex Inc. and its former CEO, William Shihara, for operating an unregistered securities exchange, broker and clearing agency. Bittrex's foreign affiliate, Bittrex Global GmbH, also settled for failing to register as a securities exchange. Overall, Bittrex, Shihara, and Bittrex Global agreed to combined penalties totaling $24 million, without admitting or denying the allegations.

Silver's Take

The SEC's complaint, filed in April 2023, accused Bittrex and Shihara of guiding crypto issuers to remove "problematic statements" from online platforms, which could have triggered regulatory scrutiny and indicated the digital assets were securities. However, as with Kraken and Coinbase (see summaries below), the SEC did not really allege any wrongdoing beyond failure to register, indicating that the SEC will continue to aggressively go after crypto exchanges even in the absence of fraudulent activity.

Crypto Industry Secures Early Victory in Legal Battle with Regulators (July 13, 2023)

Summary

In December 2020, the SEC commenced an action against Ripple Labs, Inc. and two of its senior leaders, Brad Garlinghouse and Chris Larsen, alleging that they engaged in the unlawful offer and sale of securities in connection with the sale of Ripple's XRP token. The District Court reached decisions on the parties' cross motions for summary judgment relating to four categories of sales of XRP, based on the Howey test:

- **Institutional Sales of XRP**
  (All Howey prongs satisfied = investment contract)
  Ripple, through wholly owned subsidiaries, sold XRP directly to institutional buyers and hedge funds pursuant to written contracts.

- **Programmatic Sales of XRP**
  (Not all Howey prongs satisfied = NOT an investment contract)
  Ripple sold XRP on digital asset exchanges "programmatically," where Ripple did not know who was buying the XRP, and the purchasers did not know who was selling it.

- **Other Distributions of XRP**
  (Not all Howey prongs satisfied = NOT an investment contract)
  Ripple distributed XRP as a form of payment for services, including to its employees, as a form of compensation. These distributions do not satisfy Howey's first prong that is an investment of money as part of the transaction.

- **Senior Leaders' Sales of XRP**
  (Not all Howey prongs satisfied = NOT an investment contract)
  Two senior leaders made XRP sales programmatically on various digital asset exchanges through blind bid/ask transactions.

Silver's Take

In an Order responding to a Motion for Summary Judgment, a District Court found:

- Sales of XRP by Ripple to institutional buyers who knew they were investing in Ripple were deemed to be securities contracts because they satisfied all three Howey prongs.

- Sales of XRP by Ripple and its senior leaders made anonymously on exchanges were deemed not to be securities contracts, because the third Howey prong could not be satisfied.

- Providing XRP in exchange for labor is not a securities contract, because the first Howey prong requires an investment of money.

Many people are latching on to the following single line of dicta, taking it out of context, and interpreting it to mean that the District Court has declared that XRP is not a security: "XRP, as a digital token, is not in and of itself a 'contract, transaction[,] or scheme' that embodies the Howey requirements of an investment contract."

In context, the District Court seems to be suggesting that the matter is not about whether or not XRP is a security in itself, but instead about how it is being sold and distributed. The text makes clear that an asset is not necessarily a security by nature, but it can become the subject of an investment contract depending on the circumstances of its transactions and the expectations of the parties involved. Just as assets like orange groves, as was the case in Howey, have been the subject of an investment contract, XRP can potentially be sold as an investment contract, regardless of its inherent features.

Judge Rules SEC Cannot Appeal Ripple Labs Decision (October 4, 2023)

Summary

The SEC dropped claims against Ripple Labs executives, Brad Garlinghouse and Chris Larson, regarding alleged violations of securities law. Then, U.S. District Judge Analisa Torres denied the SEC's request to appeal her decision on Ripple Labs, marking it as a significant blow to the regulator's crypto oversight. Torres previously concluded that Ripple's XRP sales on public exchanges were not securities, as buyers didn't anticipate profits based on Ripple's activities. The Ripple lawsuit is expected to proceed to trial on April 23, 2024.

Silver's Take

Judge Torres denied the SEC's request to appeal her specific interim decision concerning Ripple Labs, meaning the SEC cannot appeal that particular ruling at this stage. However, once the entire case concludes, the SEC will still have the right to appeal the decision of the District Court to the U.S. Court of Appeals.

New Hampshire Issuer of Crypto Asset Securities that Violated Registration Requirements Enjoined and Ordered to Pay Penalty (July 11, 2023)

Summary

Following a November 2022 summary judgment, a federal judge has ordered video sharing application provider LBRY, Inc. to pay a civil penalty of $111,000 for selling unregistered crypto asset securities and permanently enjoined LBRY from further violations of securities laws. LBRY, which announced they will begin winding down operations, sold "LBRY Credits" as crypto asset securities without filing a registration statement, denying investors necessary information according to the SEC.

Silver's Take

As with Kraken and Coinbase, the SEC did not allege any wrongdoing beyond failure to register, indicating that the SEC will continue to aggressively go after crypto issuers and exchanges even in the absence of fraudulent activity.

Come in and Register? These Firms Say They Found a SEC-Friendly Crypto Path (May 23, 2023)

Summary

Prometheum Capital and OTC Markets Group received approvals from FINRA to operate in the crypto securities market, signaling progress toward a compliant U.S. crypto infrastructure. Designed to comply with SEC regulations, Prometheum Capital aims to demonstrate that there is a way forward for crypto in the United States and that complaints about regulatory clarity are unfounded. While questions remain about which assets can be traded, the approved firms are preparing to handle digital assets that meet the definition of securities and comply with necessary disclosures and securities requirements.

Silver's Take

FINRA announced on May 23, 2023 that it approved its first broker-dealer with custody rights for digital assets securities, potentially opening the doors for similar opportunities.

SEC Files 13 Charges Against Binance Entities and Founder Changpeng Zhao (June 5, 2023)

Summary

In a 136-page complaint, the SEC alleges that Binance Holdings Ltd., which operates the world's largest crypto asset trading platform, two U.S.-based affiliates involved in operating a U.S. trading platform, and Changpeng Zhao, Binance's founder and controlling shareholder, engaged in a variety of securities law violations, including operating as an unregistered exchange, broker and clearing agency; engaging in unregistered offer and sale of crypto assets; failing to restrict U.S. investors from accessing Binance.com; and misleading Investors. While Changpeng Zhao recently settled with the DOJ, the SEC's case remains ongoing.

Silver's Take

Investment advisers using Binance have reevaluated their relationship with the platform as these charges not only call into question the safety of assets entrusted to Binance, but also the long-term viability of the platform itself. While the SEC is attempting to freeze and repatriate Binance's assets, the Complaint also indicates the SEC believes the following digital assets to be securities: SOL, ADA, MATIC, FIL, ATOM, SAND, MANA, ALGO, AXS and COTI.

SEC Charges Coinbase for Operating as an Unregistered Securities Exchange, Broker and Clearing Agency (March 29, 2023)

Summary

The SEC filed a complaint against Coinbase, alleging that it has operated as an unregistered exchange, broker, and clearing agency. Coinbase is also alleged to have engaged in an unregistered securities offering through its staking-as-a-service program.

Silver's Take

Like in the February settlement with Kraken and the Binance Complaint, the SEC has taken the position that staking-as-a-service constitutes an investment contract. Additionally, as with Kraken, and unlike Binance, the SEC did not allege any wrongdoing beyond failure to register, indicating that the SEC will continue going after crypto exchanges for operating as unregistered exchanges, brokers and clearing agencies. The SEC's actions are particularly significant as Binance, Coinbase and Kraken are the three largest exchanges. The Complaint also indicates the SEC believes the following digital assets to be securities: SOL, ADA, MATIC, FIL, SAND, AXS, CHZ, FLOW, ICP, NEAR, VGX, DASH and NEXO.

2024 Exam Priorities

Examinations Focused on Additional Areas of Adviser Marketing Rule

Summary

In a June 2023 Risk Alert, the Division of Examinations noted their focus on whether investment advisers violate the seven general prohibitions, such as including untrue statements, omitting material facts, unfair treatment of risks, misleading implications, unfair balance in performance results and including materially misleading information. Additional Marketing Rule emphasis areas include testimonials and endorsements, third-party ratings and Form ADV.

Silver's Take

Substantiation, performance advertising and books and records (including records relating to performance information) remain focus areas. Additionally, when drafting and updating the Form ADV, investments advisers should pay particularly close attention to Item 5.L of ADV Part 1A to ensure they are accurately reflecting their marketing activities.

Observations from Examinations of Newly-Registered Advisers

Summary

In a May 2023 Risk Alert, the SEC continued to focus on newly registered advisers as part of its risk-based examination program with Exams Staff observing issues with compliance policies and procedures, disclosure documents and filings, and marketing materials.

Silver's Take

Newly registered investment advisers should brace themselves for the possibility of an examination, with the focus likely being the standard review areas by Exams Staff. They should also pay particularly close attention to their marketing materials as this remains low hanging fruit.

SEC Division of Examinations Announces 2024 Priorities

Summary

The SEC published the 2024 Examination Priorities early this year, noting that that they will prioritize areas that pose emerging risks to investors or the markets in addition to core and perennial risk areas.

Silver's Take

Other than the fact that ESG is not mentioned this year, and AI is, priorities are consistent with those outlined in 2023.

For more information on the 2023 exam priorities, please see the following piece of thought leadership on this topic: ***"What You Need to Know About the SEC's 2023 Exam Priorities"***

New Marketing Rule: Implementation and Status

SEC Charges FinTech Investment Adviser Titan for Misrepresenting Hypothetical Performance of Investments and Other Violations (August 21, 2023)

Summary

Titan Global Capital Management USA LLC, a registered investment adviser that provides personalized investment advice to retail investors through a mobile app, agreed to pay over $1 million to the SEC to settle charges relating to misleading investors about performance metrics, crypto asset custody and inadequate policies and procedures.

Silver's Take

Although the fact pattern here is not particularly informative, this case does appear to be the first enforcement action involving either the new Marketing Rule or investment adviser digital asset custody issues. This case also highlights the ongoing importance of having proper disclosures in place and having policies and procedures and disclosures that are consistent with business practices.

SEC Staff Extends "Net" Performance Presentation Requirement to Case Studies (January 11, 2023)

Summary

The Marketing Rule requires that derived net performance be presented alongside any presentation of gross performance, which has led to some confusion, as industry practice has always been that this does not necessarily apply when presenting performance at the investment level. The Division of Investment Management issued an FAQ on January 11, 2023, requiring that net performance always be shown whenever gross performance is displayed, even when the performance relates to a single investment or group of investments.

Silver's Take

Calculating "derived net" (also called "regulatory net" or "imputed net") performance is complex and requires considering several factors, such as the inclusion of a high water mark, the assumption of sale order, adjustment for tax distortions and whether fund expenses should be spread across the entire portfolio or attached to specific investments. The lack of comprehensive instructions or guidance creates not only operational difficulties, but also concerns for advisers trying to avoid presenting misleading results and meeting the Marketing Rule's "fair and balanced" standards. Advisers should be prepared with comprehensive explanations of the calculations and assumptions used in computing "derived net" in anticipation of their next exam, as well as robust disclaimer language.

For more information, please listen to the following replay on this topic: ***"Replay of New Marketing Rule Panel Discussion"***

Privacy Laws

Connecticut and Colorado Privacy Laws Went into Effect on July 1, 2023

Summary

Both the Connecticut Data Privacy Act (CDPA) and Colorado Privacy Act (CPA) apply to organizations that "do business" in Connecticut and Colorado, respectively, or organizations that target products or services to state residents. For the CDPA or the CPA to apply, an organization must "process" the "personal data" of 100,000 or more of the state's residents in a given calendar year. Both the CDPA and the CPA expressly exempt financial services businesses that are subject to the Gramm-Leach-Bliley Act (GLBA) and its implementing regulations.

Silver's Take

Considering the 100,000-resident threshold and the GLBA exemption, it is very unlikely that many RIAs would fall under the purview of either the CDPA or CPA, but these laws should be considered to confirm potential impact.

Compliance Deadline Under California Consumer Privacy Act

Summary

The California Consumer Privacy Act (CCPA) applies to advisers with over $25 million in gross annual revenue in the prior calendar year who collect personal information from California residents. The CCPA requires these advisers to immediately notify California residents when their personal information is collected and inform them about their statutory privacy rights. Noncompliance penalties could be up to $2,500 per violation, with each impacted California consumer potentially being a separate "violation."

Compliance Date

In an unexpected turn of events, a California court postponed enforcement of the new California Consumer Privacy Act (CCPA) regulations until March 29, 2024. The court's final decision came at the eleventh hour on June 30, 2023, just one day prior to the scheduled enforcement start date of July 1, 2023.

Silver's Take

Advisers subject to the CCPA should update policies, develop specific privacy notifications, and update contracts with service providers.

SEC Proposes Changes to Reg S-P to Enhance Protection of Customer Information

Summary

Covered firms will be required to notify customers of breaches that might put their personal financial data at risk. The firms must adopt policies for an incident response program and provide notice to individuals whose sensitive customer information was, or is, reasonably likely to have been accessed or used without authorization. The proposed amendments will also broaden and align the scope of the safeguards and disposal rules to cover "customer information," extend the safeguards rule to transfer agents and conform to a statutory exception for privacy notice delivery.

Silver's Take

Investment advisers will potentially need to notify customers of certain types of data breaches.

Recordkeeping Enforcement Actions

SEC Charges 10 Firms with Widespread Recordkeeping Failures (September 29, 2023)

Summary

The SEC settled with 10 firms (five broker-dealers, three dually registered broker-dealers and investment advisers and two affiliated investment advisers) for recordkeeping failures related to off-channel communications on personal devices, resulting in penalties totaling $79 million.

Silver's Take

As was seen with J.P. Morgan in December 2021; 16 firms in September 2022; HSB and Scotia Capital in May; and the 11 firms that followed in August, off-channel communications continue to be an area of focus for the SEC and an easy target for enforcement actions. The only investment advisers involved in these actions so far have either been dual registrants or broker-dealer affiliates – none have been standalone advisers. Finally, this is the first instance of a party (Perella Weinberg Partners LP; Tudor, Pickering, Holt & Co. Securities LLC; and Perella Weinberg Partners Capital Management LP – all affiliated) self-reporting and receiving a civil penalty of $2.5 million - the most lenient penalty yet.

Trade Groups Push Back on SEC Recordkeeping "Sweep" (February 8, 2023)

Summary

In January of this year, ten investment and business industry trade groups responded to the SEC's request to access investment advisers' off-channel business communications, saying that the SEC is exceeding its authority.

Silver's Take

The SEC may attempt to turn employee noncompliance with internal policies and procedures into violations of the Advisers Act Rule 206(4)-7, despite the policies being broader than the statutory requirement. This would penalize advisers' efforts to promote compliance and incentivize firms to adopt narrow policies, while also being contrary to the plain text of the Advisers Act.

Additionally, collecting communications from personal devices can be invasive and may involve imaging the entire device, which can result in the collection of sensitive personal data, possibly without any indications of wrongdoing. Investment advisers should be aware of these privacy considerations when implementing electronic communications policies and procedures.

Conclusion

As you can see, and have likely experienced through the various changes required within your own businesses, it has been an interesting and busy year for the SEC, which means an interesting and busy year for both Silver and our clients. Please feel free to contact us at info@silverreg.com with any questions or concerns you may have regarding anything mentioned above and how these changes might impact your firm's compliance program.

To read Silver's ESG year-end report, please click here.

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