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PRIVACY

U.K. Data Protection Regulator Smooths Way for Fund Managers to Transfer Data to the SEC

By Vincent Pitaro, *Hedge Fund Law Report*

The adoption of the E.U. General Data Protection Regulation (GDPR) created a quandary for European fund managers and other firms that are subject to SEC examination and recordkeeping requirements. If they responded to SEC requests for information during examinations, they ran the risk of violating the GDPR's strict controls on data transfers to non-E.U. countries. On the other hand, if they failed to respond to the SEC, they faced potential enforcement actions. In addition, the U.K. enacted its own version of the GDPR, which perpetuated the issue for U.K. fund managers and other firms post-Brexit.

The U.K. Information Commissioner's Office (ICO) recently resolved this issue for U.K. firms subject to SEC oversight, confirming that those firms may rely on the "public necessity" exception to the GDPR's data transfer prohibitions when complying with SEC information requests. This article analyzes the terms of – and rationale for – the relief, with additional commentary from Morrison & Foerster partner Annabel Gillham and counsel Robert S. Litt, who is co-chair of the firm's global risk and crisis management group.

See "GDPR Lives On in the U.K. Post-Brexit" (Mar. 4, 2021).

The Dilemma for SEC-Regulated U.K. Firms

U.K. firms that are registered with the SEC as investment advisers, as broker-dealers or in other capacities, as well as those that have securities or depositary receipts registered with the SEC and listed on U.S. exchanges (collectively, SEC-regulated U.K. firms), are subject to the duty to maintain appropriate books and records and to provide information to the SEC on request. SEC-registered U.K. investment advisers and broker-dealers are also subject to periodic SEC examinations, which often involve extensive requests for information about the firm and its business.

The GDPR, which took effect in May 2018, created a quandary for SEC-regulated U.K. firms. Compliance with SEC requests for information could run afoul of the GDPR's strict controls over transfers of data to non-E.U. countries.

At the same time SEC-regulated firms may be required to maintain and produce information about employees, clients and prospective clients, including, among other things, emails, notes and other written materials, all of which may contain data protected by the GDPR. Moreover, SEC examination requests typically

encompass "office policies, procedures, organisation structures, staff lists, director details[,] . . . employee disciplinary history, employment applications/questionnaires, employee personal trading records, financial transaction records, customer complaints, customer agreements, internal communications, and documents relating to service providers such as consultants and auditors," according to the ICO. Failure to maintain those records or to provide such documents and information to the SEC on request could be a violation of a firm's regulatory requirements, the ICO acknowledged.

To address that dilemma, in September 2020, the ICO issued an open letter (ICO Letter) to the Director of the SEC's Office of International Affairs, confirming that SEC-regulated U.K. firms may transfer data to the SEC in response to SEC requests in reliance on the GDPR's "public interest" exception to the general restriction on data transfers to non-E.U. countries, which is explained below. "The ICO Letter provides welcome guidance on the application of the derogation, under Article 49(1)(d) of the GDPR, which allows a transfer that is 'necessary for important reasons of public interest,'" Gillham told the Hedge Fund Law Report. Previously, transfers of personal information to the SEC in reliance on the derogation were not without risk. "It is now clear that the risk has been reduced to some extent, given that the ICO has confirmed the derogation is available for specific circumstances," she observed.

Nevertheless, "U.K. firms should still be mindful of the risks of any onward transfers by the SEC to U.S. service providers as part of their risk assessments, which may be subject to U.S. surveillance laws," Litt cautioned, "and should take into account supplemental measures that may be required following the decision of the Court of Justice of the European Union in the *Schrems II* case." Schrems II invalidated use of the Privacy Shield regime for cross-border data transfers and endorsed other measures for safeguarding those transfers. Of course, any onward data transfers by the SEC are likely to be to other U.S. government agencies, rather than to private-sector entities, he added.

See "Present and Former Regulators Discuss Current SEC and NFA Examination and Enforcement Environment (Part Two of Two)" (Jan. 23, 2020).

For more on the GDPR, see our two-part series: "Impact" (Feb. 21, 2019); and "Compliance" (Feb. 28, 2019); as well as our two-part series "What Are the GDPR's Implications for Alternative Investment Managers?": Part One (Apr. 26, 2018); and Part Two (May 10, 2018).

GDPR Provisions for Cross-Border Data Transfers

Prohibition on Transfers Without Appropriate Safeguards

In connection with its exit from the E.U., which took effect as of January 1, 2021, the U.K. enacted its own version of the GDPR. The analysis in the ICO Letter turns on the GDPR and E.U. guidance.

Chapter V of the GDPR, which governs transfers of data from the E.U. to third countries, provides:

> Any transfer of personal data which are undergoing processing or are intended for processing after transfer to a third country or to an international organisation shall take place only if, subject to the other provisions of this Regulation, the conditions laid down in this Chapter are complied with by the controller and processor, including for onward transfers of personal data from the third country or an international organisation to another third country or to another international organisation.

Transfer Tools that Enable Cross-Border Transfers

Chapter V also includes certain "transfer tools," pursuant to which a firm subject to the GDPR may transfer personal data outside the E.U.:

- Under Article 45, a firm may transfer personal data to a third country whose data protection regime is deemed by the E.U. to ensure an "adequate level of protection." To date, however, the U.S. has not received an adequacy determination.
- Under Article 46, it may transfer data when "appropriate safeguards" are in place, including so-called "standard contractual [data protection] clauses" and "binding corporate rules," which govern transfers within a group of affiliated enterprises engaged in joint economic activity.

To date, the E.U. has not issued a final set of standard contractual clauses (SCCs). The European Commission, which is now consulting on SCCs, is expected to formally issue SCCs in the next couple of months, Gillham noted. "The new E.U. SCCs will not be valid for restricted transfers from the UK. The ICO intends to consult on and publish U.K.-specific SCCs during 2021," she added.

"Historically, the U.S. has not been inclined to allow its internal enforcement agencies to be restricted by the laws of another country. U.K. firms are therefore well advised to look to implement a GDPR derogation (if possible), rather than relying on an Article 46 mechanism," Litt warned.

See our two-part series on drafting data privacy and security provisions in vendor agreements: "Assessing the Risks" (Apr. 1, 2021); and "Negotiating Critical Provisions and Responding to Incidents" (Apr. 8, 2021).

Public Interest Exception

The GDPR contemplates that, in certain circumstances "when balancing data protection and privacy rights against other human rights, it is necessary and proportionate for a transfer to take place without [the protection of Article 46 transfer tools]," according to the ICO. Those derogations from the general rule regarding transfers to non-E.U. countries, which are set forth in Article 49, must be "interpreted carefully" to ensure that the exceptions do not swallow the rule. Derogations must be considered on a case-by-case basis, "with careful thought and analysis," and should not be the basis for large scale and systematic transfers. "Records should be kept by firms making those transfers, to demonstrate their considerations," the ICO advised.

Of relevance to the ICO Letter, pursuant to Article 49(1)(d), a transfer may take place in the absence of an adequacy determination or other safeguards when "the transfer is necessary for important reasons of public interest."

Public Interest in Data Transfers to the SEC

The ICO expects that SEC-regulated U.K. firms and the SEC will work together to develop transfer tools that satisfy Article 46 of the GDPR. In the interim, in light of the SEC recordkeeping and examination regime, and the controls over information and documents provided by regulated firms to the SEC, the ICO has determined that SEC-regulated U.K. firms may transfer data to the SEC on the basis of the Article 49 derogation for "transfers necessary for important reasons of public interest."

The ICO Letter offers four primary reasons for concluding that such transfers are in the public interest.

1) SEC Regulatory Regime

SEC requests for information are a core component of its regulatory regime. The SEC may not share the information it receives from regulated firms except in connection with an enforcement proceeding; pursuant to a valid subpoena; and to other regulators that have a need for the information and provide appropriate confidentiality protections, the ICO acknowledged. It also noted that the Freedom of Information Act has controls to protect confidential information.

2) Overlapping U.S. and U.K. Regulatory Interests

There are "overlapping lines of public interest" between U.S. and U.K. regulation. The SEC; the U.K. Financial Conduct Authority (FCA); and the central banks and treasury departments of both nations are members of the Financial Stability Board (FSB). One of the FSB's key standards is the International Organisation of Securities Commissions "Objectives and Principles of Securities Regulations," which are consistent with the rules of both the SEC and the FCA, including those pertaining to examinations.

3) Prevention of Financial Crime

Compliance with the SEC regulatory regime by SEC-regulated U.K. firms is in the U.K. public interest because it helps to prevent commission of financial crime in the U.K, the ICO Letter explains. It also serves to prevent conduct in the U.S. that would be a crime in the U.K. The latter is among one of the objectives of the U.K. Financial Services and Markets Act 2000.

4) Duties of FCA-Regulated Firms

SEC-regulated U.K. firms that are also regulated by the FCA are required by the FCA Handbook to deal with all regulators – including overseas regulators – "in an open and cooperative way."

See "FCA and Bank of England Proposals Embrace Data-Driven Regulation" (Feb. 20, 2020).

Strict Necessity and Proportionality

The test for a derogation in the public interest is one of "strict necessity," but it also incorporates the concept of proportionality in balancing competing human rights, according to the ICO. In accordance with guidance from the European Data Protection Board, the ICO Letter sets forth the exact basis in E.U. and

U.K. law for the relevant public interest. The ICO has concluded that compliance with SEC requests for information will be both necessary and proportionate, provided that:

- SEC-regulated U.K. firms are "duly satisfied" that SEC requests for information "are within the scope of [its] regulatory powers and requirements, and keep a record of their considerations"; and
- SEC requests are not "large scale and systematic."

"If organizations are unsure regarding the scope of the request received by the SEC, we would encourage them to request clarification and take U.S. legal advice before producing the personal information. Organizations should be producing only the personal information that is necessary to comply with the SEC request," Gillham advised.

When responding to SEC requests, SEC-regulated U.K. firms must also ensure that they comply with their other obligations under the GDPR, including:

- additional requirements pertaining to "special category" or criminal records data;
- transparency duties, including providing appropriate privacy notices; and
- maintenance of appropriate records, including as to decisions about international data transfers.

Complaints Over Data Transfers to SEC

If the ICO receives a complaint from a U.K. data subject whose data was provided to the SEC by a SEC-regulated U.K. firm, the ICO will first ask the firm for comment on the complaint. "We would not find there to be a breach of the GDPR transfer rules if the firm provided evidence that it had carefully considered and appropriately applied the Art 49.1(d) 'public interest' derogation," the ICO advised. If it determines that there was a breach, it will take a "proportionate and pragmatic approach."

Extent of ICO Relief

In the event that it is not possible to put in place any Article 46 transfer tools, SEC-regulated U.K. firms may continue to rely on the "public interest" derogation on the terms outlined in the ICO Letter. The ICO may change its view "based on further findings or changes in circumstances," according to the ICO Letter.

The ICO pointed out that, in light of Brexit, its advice does not constitute pan-E.U. advice; it applies only to U.K. firms. "[T]he ICO is still widely respected as a reputable data protection authority in Europe. There is scope for other E.U. data protection authorities to follow the ICO's lead in this area, . . . but this may be more a question of politics than anything else," Gillham noted.

"It was interesting that the ICO took a specific stance in relation to sharing data with the [SEC] and didn't provide wider guidance in relation to U.K. organizations sharing information to comply with a U.S. regulatory request," Gillham observed. It appears that the SEC may have met with some resistance when asking SEC-regulated U.K. firms to provide personal information and, as a result, reached out to the ICO, she opined.