

Legal Update

NEW MASSACHUSETTS DATA SECURITY REGULATION; INVESTMENT MANAGERS AFFECTED

APRIL 2010

The Commonwealth of Massachusetts adopted a new regulation designed to protect its residents' "personal information." The regulation became effective as of March 1, 2010 (the "Effective Date"). The regulation applies to any person or company that possesses "personal information" of a Massachusetts resident (a "Resident") regardless of whether such person or company is located in Massachusetts. The regulation applies to both SEC registered and unregistered advisors that possess such information about Residents. This Update focuses on the impact of the regulation on investment managers of hedge funds and other private investment vehicles.

The regulation defines "personal information" as a Resident's first name (or initial) and last name together with such Resident's (1) social security number, (2) driver's license or state-issued identification card number, and/or (3) financial account or credit/debit card number (with or without a security code, password or the like to permit access to such account). The regulation covers personal information stored both in hard copy and electronically.

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If an investor in a fund is a Resident (or a managed account is established for a Resident), the investment manager of such fund will generally fall within the scope of the regulation because it will typically have “personal information” of such Resident. An investment manager will also generally fall within the scope of the regulation if it hires an employee or consultant who is a Resident.

The regulation requires any investment manager subject to the regulation to maintain a “comprehensive information security program” (“CISP”), which must contain administrative, technical, and physical safeguards that are appropriately tailored to such investment manager’s size and scope, its available resources, the amount of data it stores and the relative need for security of the personal information.

Among other things, the regulation requires any personal information transmitted over public or wireless networks or stored on laptops or other portable devices to be encrypted. Thus, if an investment manager or its agent sends a subscription agreement completed by or on behalf of a Resident or an investor statement (since such documents typically contain an investor’s full name and social security number) or any other documents with “personal information” to any person via e-mail, such documents must be encrypted.

Additionally, the regulation requires that persons or companies that possess personal information adopt procedures for their computer systems that provide for secure user authentication protocols (e.g., control of user IDs and other identifiers, using a secure method of assigning and selecting passwords, restricting access to active users, and blocking access after several unsuccessful attempts to gain access to the system) and secure access controls (e.g., restricting access to files containing personal information to those that need to know such information to perform their duties, assigning unique, non-vendor supplied IDs and passwords, encrypting sites, using appropriate firewalls, and using up-to-date system security agent software supported with up- to-date patches).

The regulation also requires an investment manager that is subject to the regulation to take reasonable steps to utilize third party service providers (e.g., administrators, accountants, marketers and attorneys) (“Service Providers”) that are capable of maintaining appropriate security measures to protect Residents’ personal information in a manner that complies with the regulation. Additionally, Service Providers must be required by contract to implement and maintain such security measures, and any contracts that were entered into prior to the Effective Date must be in compliance by March 1, 2012. It is advisable for investment managers to

comply with this requirement now (even if not currently subject to the regulation) since in the future they could fall within the purview of the regulation.

For further information regarding the regulation, and for assistance in developing a CISP, updating compliance manuals to satisfy the requirements of the regulation and/or negotiating or reviewing any agreements with Service Providers, please contact your regular Kleinberg Kaplan attorney.

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