



Legal Risk Management Tip **May 2008**

NEWLY PROPOSED CHANGES TO REGULATION S-P

The SEC's proposed amendments to Regulation S-P include a new exception to the Privacy Notice and opt-out requirements that may allow limited information sharing when representatives move from one firm to another (SEC Release 34-57427). In its release, the SEC recognizes that representatives may develop close relationships of trust and confidence with their clients. With this in mind, the SEC designed an exception to allow for:

- Limited information sharing;
- Establishment of an orderly framework under which client information could be shared; and
- Supervision of the transfer of such information.

With this design, the proposed exception may help to facilitate the efficient transfer of customer information, which in turn will allow for customers to continue their relationship with their existing representative with more ease should a representative associate with a new firm. However, the proposal also imposes certain restrictions to ensure that customer information is properly protected.

For investment advisers and broker-dealers, this new exception may impact the firm by increasing its responsibilities to promote investor choice and supervise the protections associated with the efficient transfer of client contact information.

WHAT INFORMATION MAY BE SHARED AND WHY?

Under the exception, the limited customer information to be disclosed will likely help the representative but shield the customer against potential identity theft. Consequently, the permitted information that may be shared is limited to:

- The customer's name;
- A general description of the type of account and products held by the customer; and
- The customer's contact information (such as address, telephone number and e-mail).

Specifically, the release prohibits the sharing of a customer's account number, Social Security number or securities positions.

The SEC acknowledges that this type of information sharing is important to promote investor choice and the efficient transfer of customer accounts. However, as currently proposed, the exception permits the representative's former firm to control whether or not any of the applicable customer information will be shared. Consequently, should the firm opt to not share limited customer information, the former representative may be forced to get explicit customer consent, or implicit consent through notice and opt-out procedures, prior to transferring any such information.

IMPLICATIONS OF THE NEW INFORMATION DISCLOSURE EXCEPTION

Assuming the SEC adopts the proposed changes to Regulation S-P, the exception permitting disclosure of limited client contact information raise several practical considerations that firms should consider before utilizing the exception.

1. Firms that utilize the exception will face uncertain implications if any non-allowable information is transferred.
2. The departing representative could be in violation of Regulation S-P if he/she takes unauthorized customer information.
3. The firm will need to implement a supervisory program for the customer information transfer process.
4. The exception does not apply when representatives transfer to or from banks, state-registered advisers, or other types of financial institutions not subject to SEC regulations.

As your firm continues its annual review by testing its internal controls relating to privacy safeguards for confidential client information, consider the tenants the new proposed amendments to Regulation S-P. It is important to consider the proposal's impact now in order to plan for enhancements to your compliance program in the future. For more information, please contact us at (619) 298-2880.

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