



May 12, 2008

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-9303

Re: Proposed Amendments to Regulation S-P
SEC File No. S7-06-08

Dear Ms. Morris:

The National Association of Independent Brokers-Dealers, Inc. (NAIBD) was formed in 1979 to positively impact rules, regulations, and legislation by facilitating a consistent, productive relationship between industry professionals and regulatory organizations. The organization is national in scope and direction with 350+ Broker-Dealer and Industry Associate Members.

Through its advocacy of industry issues on behalf of independent broker-dealers and their associated personnel, NAIBD formulates responses to FINRA and SEC requests for comment and has been influential on issues related to FINRA governance and consolidation, rule proposals, and industry best practices.

The National Association of Independent Broker-Dealers supports the spirit of amendments proposed by the Securities and Exchange Commission and appreciates the instruction and guidance regarding SEC expectations for the enhancement of firm safeguards of non-public information. Notwithstanding this, the NAIBD is concerned that the rules proposed by the SEC appear to be closely modeled to similar rules adopted by the Department of the Treasury and the Federal Reserve System; rules formulated and intended primarily for firms with custody of customer assets.

Unlike firms in the jurisdiction of those agencies, many broker-dealers and investment advisers that would be subject to the SEC's proposed amendments do not provide custodial services for customer assets and therefore pose significantly less risk related to a security breach. Further, many of these same firms are already subject to similar regulations, such as state consumer protection guidelines. These factors considered NAIBD finds the amendments as proposed would be unduly burdensome for

small firms to meet the substantial technical standard of protection that, in turn, would not provide substantially greater security for investors.

NAIBD conducted a survey of its membership¹ to determine the affect of the amendments to Regulation S-P on its smaller firm members. The survey resulted in the following summary of facts, information and statistics:

On amendments to technical standards for protections of non-public information:

- More than 95% of broker-dealers participating in the survey reported that they believe the security policies and procedures they have currently in place are adequate to ensure safeguards for customer information and are in compliance with requirements of other agencies.
- More than 95% of firms reported that they have adequate policies in place for the appropriate disposal of customer information.
- More than 77% of firms reported using third party service providers that have access to private customer information.
- Less than 10% of the survey participants reported ever experiencing loss, damage or inconvenience to the firm or its customers due to a security breach of a third party service provider.
- Less than 10% reported ever experiencing an incident where client information was compromised.
- While more than 85% of firms agreed that notifying an individual of a security breach is an important part of the regulation, many respondents questioned the necessity of notifying the SEC unless it is determined that help is needed to investigate the incident at a higher level. Comments indicate that a better policy may be to allow firms to develop breach policies and procedures independently, subject to SEC review and assessment.
- 90% of respondents reported that the firm cost to implement the proposed amendments would present either a significant or minor financial burden. The general feeling was that the cumulative effect of these additional expenses would put a strain on overall profitability for most broker-dealer so as to make the effort unfeasible. Two respondents remarked that the proposed amendments would create such a financial burden as to necessitate considering closing the business.
- There was a great deal of feedback regarding specific criteria that should be developed to exempt certain (smaller) firms from the proposed changes, as

¹ The survey results have been compiled in report format and are available upon request to lisaroth@naibd.com.

well as amend breach notification procedures, as detailed in our following comments.

On proposed amendments that would permit limited sharing upon the transfer of a RR from one broker-dealer to another:

- Several responding members felt that the amendments as proposed do not adequately address the unique situations of the independent business model where information, documents and locations are controlled at the rep or branch level and not at the broker-dealer level. Smaller, independent broker-dealers tend to share the view that customers are considered clients of the representatives – not the firm.
- Given that reps often times change broker-dealers but do not change office locations, one respondent submitted a question as to how logistically the restricted transfer of customer information would be enforced.
- Survey participants were nearly evenly split (52% vs. 47%) in support of the adequacy of the proposed level of information that may be transferred when reps change firms.

In consideration of the survey results and associated comments and based on the review and consideration of its Member Advocacy Committee, the NAIBD respectfully requests that the SEC review and revise the proposed amendments to reflect the following concerns, requests and/or recommendations:

- Provide exceptions from the technical requirements for small firms that do not carry customer assets;
- Permit small firms to rely on custodial firms for relevant portions of their programs such that there be no need to duplicate efforts with respect to any customer account or relationship;
- Relieve firms of limited size and resources from the requirement to employ an appropriately qualified information security coordinator;
- Provide ‘model programs’ and templates for small firms to support the implementation and testing of an appropriate program;
- Narrow the scope of the reporting requirement to include only those breaches that include sensitive customer data;
- Expand the scope of shared customer data permissible upon departure of a rep from one firm to another.

(A) Information Security Program Requirements

The following information is provided in support of the summary of requests enumerated above:

National Association of Independent Broker-Dealers
16835 West Bernardo Drive, Suite 120
San Diego, CA 92127

Revise Cost Estimates for Designating a Program Coordinator; Allow for Program Coordinator to be a Non-Employee

Section 248.30(a)(3)(i), as proposed, would require firms to designate an employee to coordinate the information security program. NAIBD urges the SEC to recognize that the universe of firms subject to these rules include thousands of firms with fewer than 25 employees. It is most likely that firms of this limited size do not currently employ an individual who possesses the appropriate skills and background to meet the requirements of the role. Under the rule as proposed, these firms would be forced to either hire an appropriately qualified individual or appoint the responsibility to an existing employee that may be underqualified. It would be reasonable to expect that such an employee would find it necessary to engage then manage a third party consultant to meet these requirements.

In this regard, as our survey revealed, most small firms lack the resources to address this component of the proposed amendments even at the level estimated by the SEC. The projected costs per the SEC's release for the development, implementation and ongoing maintenance of an information security program appear woefully understated. Firms could certainly not hire an employee capable of or willing to accept the inherent responsibilities for \$10,000 per year; nor is it reasonable to expect that a consultant could be identified, engaged, and retained for such a nominal sum.

In the absence of exemptive relief for small firms, NAIBD requests that the SEC revise the proposal to permit firms to outsource, share, or otherwise address the requirement using non-employee resources. We further suggest the SEC review best practices for the implementation of proposed amendments and provide smaller firms and/or their third party service providers with 'model programs' and templates to utilize in support of required implementation and testing procedures to help reduce the margin for error and the time to develop proposed measures internally.

Establish Exemption for Non-Custodial Firms; Firms of Limited Size and Resources

The proposed amendments to Rule 248.30 would require every broker-dealer, investment company, investment adviser, and transfer agent registered with the SEC to develop, implement, and maintain a comprehensive information security program. NAIBD feels that this requirement is particularly burdensome to small firms and does not provide significant additional customer protections when imposed on those small firms that do not carry customer assets. NAIBD requests that the SEC further investigate the risk of a security breach among non-custodial firms relative to the proposed benefit

to customers, in consideration of the significant obstacles that small firms would face to meet the requirements of this section.

In addition, many smaller broker-dealers do not currently have the means to provide customer account information online, and therefore should be exempt from Internet-based security processes and documentation.

We recommend that the SEC develop broker-dealer exemption criteria from compliance for proposed technical requirements in terms of firm size, revenues, and number of clients (e.g., small, non-clearing introducing and limited broker-dealers).

Eliminate Duplicate Test Processes

The proposed rule will require each registrant to regularly test or otherwise monitor its program's key controls, systems, and procedures. FINRA members are already subject to rule 3520 that requires testing of a firm's business continuity plan. NAIBD suggests that the testing requirements incumbent on FINRA member firms under NASD rule 3520 be deemed adequate to meet this requirement of the proposed amendments, and would ask for clarification as to any additional testing that might be required.

Clarification with Third Party Service Providers

It is standard practice for independent broker-dealers to outsource many of the transactional functions of service given the size and resources of the typical-sized firm. Under the proposed rules, there would be an issue as to whether multiple entities each have an independent duty to provide notice and, if not, which entity is responsible for the duty. In our view, the entity on whose behalf the non-public personal information was collected should be deemed the "owner" of such information and be responsible for providing notice. This approach would be consistent with current state breach laws and eliminate multiple and confusing messages to the customer.

In the event a service provider experiences a breach involving a registrant's non-public personal information, we recommend that the SEC expressly provide that only one entity needs to provide notice of the breach. We further recommend that the SEC establish clear cut policies and procedures to specify which entity – the owner of the information or the service provider experiencing the breach – shall be responsible for sending the notice or how such decision will be made in the event of a breach.

It is our position that any security measures required of firms to implement proposed amendments would also apply to the SEC and self-regulatory organizations, as would all established exception criteria.

Data Security Breach Response

Notification Criteria

NAIBD supports the incorporation of breach reporting into the rule amendments. Nonetheless, we urge the SEC to consider the significant burden of reporting under the broad and varied terms of the current proposal, and encourage the requirements to be amended in three key respects:

- Timeliness Standard (clarification of the term “as soon as possible”)
- Content of Report (at the earliest possible warning, as would be implied by “as soon as possible” it is likely that insufficient data would be available to fully complete the proposed reporting requirement)
- Risk Severity (provided the risk is limited in its impact, reporting is unnecessary)

NAIBD asks for clarification regarding the timing of submission of notices. In particular, we ask that the SEC more specifically define “as soon as possible” or otherwise amend the language to help firms better understand expectations.

With respect to the content of Form SP-30, NAIBD feels that certain information required by Form SP-30 as it is proposed may only be available upon the completion of an internal or external investigation. Discovery of unauthorized disclosure of information such as names, addresses, Social Security numbers, dates of birth, employment and securities-related information is likely to take additional time and thereby require either the untimely or incomplete filing of Form SP-30 and subsequent follow-up paperwork.

NAIBD recommends abbreviating Form SP-30 itself to allow for the initial information that is likely to be known at the outset, pending further investigation, with the inclusion of contact information for further information and assistance from the institution. In this respect, the form could serve as early warning, and provide maximum protection to customers and to firms alike.

We further suggest that criteria be established regarding parameters for the severity of breach that would trigger filing a more detailed report, given the outcome of further investigation. Our recommendation is to amend the proposal to reflect risk

exclusively to “sensitive customer information” that creates “significant risk that an unauthorized access to information has resulted or might result in substantial harm or inconvenience to an individual identified with the information.”

We believe that substantial paperwork and needless investigation can be eliminated by allowing firms discretion in filing procedures, considering the multiple pressures and sensitivities that would impact the accuracy of the filing based on timing and context.

With regard to breach severity, we recommend that notification requirements to both the customer and the SEC be subject to the same criteria.

(B) Scope of the Safeguards and Disposal Rules

Exception for Limited Information Disclosure When Personnel Leave Their Firms

NAIBD members believe there should be a balance between privacy and facilitating a smooth transfer in the best interest of the client. This process often involves many parties, including the rep, his/her supervisor(s), the broker-dealer of record, the clearing firm and its operational personnel, and of course the client. In respect to all parties involved, the security of the data transfer is of paramount concern. In addition to this, in many instances, urgency and/or competitive pressures also play a role. NAIBD feels that the complexities of the process should be ironed out, with high priority given to the best interests of the customer. We do not feel that the proposal as presented adequately considers the various circumstances and pressures that may impact any given account or customer at the time of transfer. For this reason, we respectfully request that the SEC consider additional investigation particularly focused on the independent contractor industry, and those accounts with multiple stakeholders, such as accounts managed by an independent investment adviser with broker-dealer ties, among other such complex, yet common, arrangements. For instance, what steps are necessary, and what less or greater risk might exist, when the RR leaves his/her broker-dealer, but does not change location because he/she is the principal owner of the practice? Or, what steps should be taken when there is a broker-dealer change but the individual or entity serving as investment adviser does not change? In scenarios such as this, we feel additional clarification is required to ensure that there is a reasonable balance between risk and the incumbent requirements.

NAIBD appreciates the opportunity to comment on this proposal. If you have any questions or would like to request clarification, please contact me at 619-283-3107.

Ms. Nancy Morris,
US Securities and Exchange Commission
Page 8 of 8

Respectfully,

Lisa Roth
Chairman, NAIBD

National Association of Independent Broker-Dealers
16835 West Bernardo Drive, Suite 120
San Diego, CA 92127