



VOICE OF INDEPENDENT BROKER-DEALERS  
AND INDEPENDENT FINANCIAL ADVISORS

www.financialservices.org

VIA ELECTRONIC MAIL

May 29, 2007

Nancy M. Morris  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

RE: File Number S7-09-07 – Model Privacy Form

Dear Ms. Morris:

On March 29, 2007, the Office of the Comptroller of the Currency - Treasury, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision - Treasury, National Credit Union Administration, Federal Trade Commission, Commodity Futures Trading Commission, and Securities and Exchange Commission (SEC) (referred to collectively herein as the Agencies) issued the Interagency Proposal for Model Privacy Form under the Gramm-Leach Bliley Act, and solicited comments on the proposal.<sup>1</sup> As required by Section 728 of the Financial Services Regulatory Relief Act of 2006 (Act)<sup>2</sup>, the Agencies have proposed a safe harbor model privacy form (Model Privacy Form) that financial institutions may use to provide disclosures under the privacy rules. Financial institutions that utilize the Model Privacy Form will be deemed to be in compliance with the notice requirements of the Gramm-Leach Bliley Act. The Financial Services Institute<sup>3</sup> (FSI) appreciates this opportunity to comment on the Agencies' proposed Model Privacy Form.

The proposed Model Privacy Form would be 2-3 pages in length, depending on whether the financial institution is required to provide consumers with the ability to opt-out of information sharing. The first page would include general background information and a "key frame"<sup>4</sup> with information regarding why, what, and how a financial institution uses personal information, the reasons for such sharing, and opt-out rights. The second page includes supplementary material such as definitions and further explanatory information in the form of Frequently Asked Questions. The final page includes an opt-out form for those financial institutions that share information in a manner that triggers consumer opt-out rights. The proposed rules would require

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<sup>1</sup> See *Interagency Proposal for Model Privacy Form under the Gramm-Leach-Bliley Act*, SEC Release Nos.: 34-55497, IA-2598, IC-27755, File No.: S7-09-07 (March 20, 2007).

<sup>2</sup> P.L. 109-351 (Oct. 13, 2006), 120 Stat. 1966.

<sup>3</sup> The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed in 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI's 110 Broker-Dealer members have more than 130,000 registered representatives serving more than 14 million American households and generating in excess of \$13.7 billion in annual revenues. FSI also has more than 7,800 Financial Advisor members.

<sup>4</sup> The "key frame" is a term used by the Agencies to describe an introductory section with standardized, generic language regarding the categories of personal information generally collected by financial institutions and a description of reasons why an institution may share that information.

a minimum font size and sufficient spacing between lines of type to promote readability. The specified text would be required to appear on single sided sheets of 8.5 by 11 inch paper to allow side by side viewing of pages one and two. The Model Privacy Form's use of a uniform style and text for disclosures is meant to insure consumers can read, understand, and compare the privacy policies of financial institutions. One year following enactment of the model proposal, financial institutions will lose the safe harbor protections previously derived from using the sample clauses for their privacy notices as specified in the current rules.

FSI supports the Agencies' efforts to develop a model privacy notice that provides clear and conspicuous disclosures in a succinct and readable format thereby allowing consumers to easily identify and compare the information sharing practices of financial institutions. However, FSI is concerned that the Model Privacy Form fails to grant financial institutions the flexibility necessary to make accurate disclosures that will be easily understood by consumers. As a result, adoption of the Model Privacy Form, in its current form, will not be a viable alternative for independent broker-dealer (IBD) firms. For this reason, FSI encourages the Agencies to consider significant revisions to the Model Privacy Form that will allow greater flexibility without sacrificing the accessibility, readability, and usability benefits they seek.

#### Background on FSI Members and their Customer Relationships

The IBD community has been an important and active part of the lives of the American consumers for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice with little, if any, proprietary product bias,<sup>5</sup> while avoiding some of the pitfalls to which other financial service business channels have been susceptible in recent years. IBD members also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products, by "check and application"; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment advisor firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisors are especially well positioned to provide middle class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 105,000 independent financial advisors – or approximately 20 percent of all registered representatives – practice in the IBD channel.<sup>6</sup> These financial advisors are independent contractors, rather than employees of the IBD firms. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisors are typically "main street America" – it is, in fact, almost part of the "charter" of the independent channel. The core market of advisors affiliated with IBDs is clients with a net worth of \$250,000 to \$1 million.<sup>7</sup> Independent financial advisors are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client

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<sup>5</sup> Please note that there are some large independent broker-dealer firms who offer proprietary products such as mutual fund, variable annuity, and/or investment advisor products offered by an affiliated or parent insurance company, broker-dealer or investment advisor. Nevertheless, these IBD firms, and their proprietary products, represent the exception to the rule.

<sup>6</sup> Cerulli Associates, "Trends in the IBD Marketplace," December 2004. Please note that this figure represents a conservative estimate of independent financial advisors. In fact, more than 130,000 financial advisors are affiliated with FSI member firms.

<sup>7</sup> Ibid.

base. Most of their new clients come through referrals from existing clients or other centers of influence. Independent financial advisors get to know their clients personally and provide them investment advice in face-to-face meetings – oftentimes over the client’s kitchen table. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients’ investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisors. Member firms formed FSI in 2004 to share best practices and improve compliance efforts. FSI is committed to preserving the valuable role that IBDs and independent advisors play in helping Americans plan for and achieve their financial goals. Making sure our members operate in a regulatory environment that is fair, balanced, and free from unintended negative consequences is of primary importance to FSI. FSI’s advocacy efforts on behalf of its members include research, industry surveys, and outreach to legislators, regulators, and policymakers. FSI also provides its members with an appropriate forum to share best practices in an effort to improve the compliance, operations, and marketing efforts of member firms.

The Model Privacy Form is of particular interest to FSI and its members. Maintaining the privacy and security of client data is an issue of great concern to IBDs. As a result, FSI members recognize the importance of providing consumers with the information necessary to comprehend and compare the privacy practices of financial institutions. FSI members welcome the Agencies’ efforts to provide guidance and safe harbor protections through the proposal of the Model Privacy Form. However, we are concerned that FSI members will not be able to accurately disclose their information-sharing practices by using the standardized provisions and vocabulary used in the Model Privacy Form. As a result of these concerns, FSI cannot support the current incarnation of the Model Privacy Form and encourages significant revisions to improve the final version.

#### Detailed Comments

To obtain the benefit of the safe harbor provided by Section 728 of the Act, financial institutions must use the exact language of the Model Privacy Form as written by the Agencies.<sup>8</sup> This standardization is intended to insure that consumers have the ability to make “apple-to-apple” comparisons of the privacy practices of financial institutions. It also is meant to limit the use of language to phrasing that has been consumer tested to insure readability and understanding. However, the lack of flexibility inherent in this approach to privacy practice disclosure will have significant unintended consequences. These unintended consequences include the following:

1. Model Privacy Form Disclosure Language Fails to Accurately Describe IBD’s Business Practices - While the language chosen for the use in the Model Privacy Form may accurately reflect the business activities and privacy practices of certain large financial institutions, namely banks and fully integrated financial conglomerates, it implicitly misrepresents the activities of the IBD segment of the securities industry because many of the examples cited are beyond the scope of products and services offered by these brokerage firms. The text of the Model Privacy Form is largely irrelevant to the activities of IBDs and their affiliated financial advisors who do not offer banking-related products and services or engage in other activities contemplated by the form. It simply does not relate to the activities in which these financial institutions engage with most clients,

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<sup>8</sup> Please note that the Model Privacy Form allows for modest customization in order to identify the relevant financial institution, provide appropriate contact information, clarify specific terms, and specify the opt-out options. However, the vast majority of the Model Privacy Form’s text is mandated.

including many retirees and seniors. Examples of confusing or irrelevant language in the Model Privacy Form include the following:

- References to “payment history,” “credit history” and “credit scores” in page one’s key frame section.
- References to “credit bureaus” and “creditworthiness” in page one’s disclosure table.
- References to data collection methods involving consumers paying their bills, applying for loans, and using credit or debit cards as contained in page two’s frequently asked questions on sharing practices.

Thus, the Model Privacy Form’s language fails to recognize the material differences that exist in the customer relationships enjoyed by the largest integrated financial institutions and IBD firms. This failure is likely to cause confusion in customers of IBD firms. The result is that the Model Privacy Form is unlikely to be adopted by IBD firms and no safe harbor will be available to them following the withdrawal of the SEC’s current model language. Since IBD firms represent a large and important segment of the broker-dealer community, FSI believes this is a significant defect in the Model Privacy Form.

2. Model Privacy Form Disclosure Language Fails To Use Plain Language - The Model Privacy Form fails to use language that clearly describes the relationship between the IBD firm and its affiliated financial advisors. The Model Privacy Form would require IBD firms to use the term “affiliates” to describe independent financial advisors who are currently associated with the firm. Independent financial advisors who terminate their affiliation with an IBD firm would be referred to as “nonaffiliates.” FSI believes these legalistic descriptions, while technically accurate, will prove confusing to investors. Clearly the use of these terms is less helpful to consumers than the use of plain language alternatives like “your financial advisor” and “a financial advisor no longer affiliated with our firm” or other more descriptive alternatives that rely upon plain English. Allowing IBD firms to modify the definitions of the terms “affiliates” and “nonaffiliates” contained on page two of the Model Privacy Form is unlikely to mitigate the confusion experienced by clients of independent financial advisors. While the term “nonaffiliates” provides simple shorthand for a complex legal concept, most consumers, particularly seniors, will not understand. The use of plain English is critical to achieving the Agencies’ goal of providing consumers with easily understood disclosures. The Model Privacy Form falls short.
3. Model Privacy Form Likely to Result in Unacceptably High Opt-Out Rates – It is anticipated that IBD firms that choose to utilize the form will experience higher than normal rates of consumer opt-outs. FSI believes this will be caused by the confusing and irrelevant nature of the disclosures contained in the Model Privacy Form. For example, a client who opens an IRA account holding a single mutual fund would predictably be confused and/or concerned to read that their credit history, credit and debit card usage, and bill paying history may be collected and shared by their IBD firm. Such a client is likely to opt-out of the sharing of such information and perceive the IBD firm as intruding into very personal and private data that is not connected to the services the consumer is seeking from the IBD firm. In addition, the Model Privacy Form does not permit an institution to provide an explanation of its particular reasons for sharing information or the benefits that consumers may receive as a result of information disclosure. In light of these issues, the current Model Privacy Form is expected to result in unacceptably high opt-out rates simply due to customers’ misunderstanding of the disclosures provided. The

likely result is that very few IBD firms will choose to adopt the form and will thus be deprived of safe harbor protections.

4. Model Privacy Form Fails to Consider Impact of State Law – Despite the concerns raised above, the current Model Privacy Form may be adopted by IBD firms who seek the federal safe harbor protections provided to those who use it. This may, however, lead to problems under state law. Since the description of information collection practices is standardized and does not permit variation, the Model Privacy Form will likely fail to accurately describe the full range of information collected by a particular IBD and/or the procedures relevant to its sharing in a particular state. If the IBD then shares information it collects that has not been described accurately in the Model Form, it risks exposure to liability under state law, including claims of unfair and deceptive trade practices.

In addition, unique disclosure requirements imposed by individual states have the potential to thwart the Agencies' objective of making privacy notices more meaningful to consumers. For example, a number of states require consumers to opt-in to the sharing of their personal information.<sup>9</sup> Some state statutes go as far as to specify the specific text font size used in privacy notices and impose other readability requirements.<sup>10</sup> Since the Model Privacy Form cannot be amended by IBD firms to accommodate these unique state requirements, IBD firms are likely to create multiple state specific supplements relating to information use and sharing of residents of the relevant states. Such a disclosure regime will only add complexity and serve to confuse consumers.

For these reasons, FSI is concerned that the Model Privacy Form fails to provide a viable option to IBD firms who seek to comply with both state and federal requirements. These issues will also impact other financial institutions attempting to comply with the competing state and federal disclosure regimes.

5. Length of Model Privacy Form is Likely to Thwart Its Stated Purpose – Unfortunately, consumers are already inundated with lengthy disclosures from their broker-dealers. This information overload results in consumers being selective about the materials they review. While the suggested format of the Model Privacy Form will certainly assist consumers in understanding and comparing information sharing practices, they must first choose to read the document. The required 2-3 page length of the Model Privacy Form will discourage consumers from reading it upon receipt. Many IBD firms now provide a full privacy statement on a single side of a single 8.5 by 11 inch piece of paper. Even at this modest length, many consumers decide to dedicate their valuable time to other pursuits. FSI is concerned that the length of the Model Privacy Form is likely to discourage consumers from reviewing its contents and thus defeat the Agencies' purposes. As a result, we believe the Agencies' goal of providing more effective disclosures will not be realized.
6. Cost of Producing Model Privacy Form is Prohibitive – FSI members are also concerned with the cost of creating, printing, and annually mailing the 2-3 page Model Privacy Form. While we acknowledge the benefits of achieving a consistent look for privacy practice disclosures, expanding the disclosure to a one sided, multi-page document will

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<sup>9</sup> For example, see Alaska (Sec. 06.01.028), California (Cal.Fin.Code § 4053), Maine (9-B M.R.S.A. § 162), Massachusetts (M.G.L c. 110A), North Dakota (NDCC, 6-08.1-03), and Vermont (8 V.S.A. § 10203).

<sup>10</sup> See Cal. Fin. Code div. 1.2, § 4053(d) for an example.

significantly increase the cost of adoption of the Model Privacy Form without providing significant benefits.

As a result of these issues and related unintended consequences, FSI believes the vast majority of IBD firms are likely to conclude that they can craft disclosures that more accurately reflect their information collection and sharing practices. The Model Privacy Form simply will not serve as a viable alternative for IBD firms. Since approximately 20 percent of all registered representatives are associated with an IBD firm, a very large segment of the industry would have no safe harbor and no sample language upon which to rely. Indeed, withdrawing the existing model language could have negative implications to firms who continue to rely upon it. Ultimately, we believe the unintended result of the Model Privacy Form could be even less uniformity than at present. As a result, FSI encourages the Agencies to consider significant revisions to the Model Privacy Form.

#### Recommendations for Improving the Model Privacy Form

The limitations inherent in the current Model Privacy Form are the result of the current draft's lack of flexibility and orientation to large, multi-affiliate financial organizations that offer a wide range of banking, securities, and insurance products and services. While we understand that standard language and a uniform structure is essential to achieve the goals of accessibility, readability and usability, we believe that the following changes would result in greater adoption of the Model Privacy Form, lower unnecessary opt-out rates, and greater compliance with state law:

- Provide financial institutions with the flexibility necessary to accommodate variations in business model, business practices, and information sharing practices that exist in the financial services industry.
- Allow greater customization of the Model Privacy Form's disclosures by developing acceptable industry specific language and/or adopting a principles-based approach and sample phrases to guide financial institutions in drafting appropriate language.
- Allow financial institutions to explain the reasons for and benefits of information sharing activities to fully inform consumers and reduce unnecessary opt-out rates.
- Explore options to shorten the length of the Model Privacy Form thereby increasing the likelihood consumers will read the disclosures.
- Provide greater flexibility in formatting requirements to reduce the cost of creating, printing, and mailing of the Model Privacy Form.
- Allow financial institutions to utilize the Internet to deliver the disclosures required by the Model Privacy Form.
- Pre-empt the states from imposing their own privacy disclosure requirements that differ materially from those adopted by the Agencies or allow financial institutions to adapt the Model Privacy Notice to conform to both state and federal law.

#### Additional Issues to Address in the Model Privacy Form

Finally, FSI urges the SEC to consider changes to the Model Privacy Form and an amendment to Regulation S-P to address information sharing in the context of customer account transfers. Earlier this year, the SEC Division of Enforcement raised the issue of customer information sharing under Regulation S-P in the context of preparing for customer account transfers when financial

advisors change broker-dealers. These issues are more fully discussed in the enclosed "Member Briefing" that accompanies this comment letter.<sup>11</sup>

In summary, the enforcement staff's position is that (1) the brokerage firm's privacy notice must state that it allows representatives to continue using information when they leave to join a new firm unless the firm affirmatively prevents representatives from continuing to possess or use the information; and (2) in the absence of such a notice and opt-out, prior customer consent must be obtained before any customer information can be shared with the new broker-dealer or used by the representative after departing his/her current broker-dealer. Indeed, at that later point in time, basic contact information and even the fact that a person was formerly a customer is deemed to be nonpublic personal information according to the SEC's adopting release.<sup>12</sup> Today, virtually no privacy notices in use by financial institutions address information sharing in this context because this issue had not previously been identified by any regulator. Indeed, to the contrary, it has been a long-standing practice in the securities industry for representatives to retain copies of customer information and the latest account statements to facilitate communications with customers and the account transfer process. Therefore, to satisfy the enforcement staff's position, customer consents must be separately obtained before preparation of any account transfer documentation can be started. This prerequisite will substantially add to delays in the account transfer process, which is already the most frequent subject of customer complaints to regulators and firms.<sup>13</sup>

These compliance issues were never addressed in the rulemaking process for Regulation S-P, nor have these issues been raised in any published guidance, interpretations, or public statements by the SEC, NASD, or other regulators. Indeed, recently issued NASD Notice to Members 07-06, *Supervision of Recommendations after a Registered Representative Changes Firms*, directs member firms to consider account information related to proprietary products held by customers in their accounts at the firm from which the representative is transferring. Member firms are directed to assure the suitability of any liquidation recommendations by the transferring representative. Of course, no suitability analysis can be performed without having the customer's information. Therefore, it is not clear how firms can fully comply with both NtM 07-06 and Regulation S-P.

If information sharing with a former registered representative is not addressed in the privacy notice, then obtaining each customer's consent at the time of the proposed account transfer will be highly time consuming. Clients may or may not be available when contacted or prompt in responding. The unintended consequences will increase delays and disruptions of customer service during the account transfer process. As the number of affected customer accounts increases, the time and cost of processing each account transfer increases, so smaller accounts will end up lower in priority. Many small accounts will, either in fact or effect, be orphaned with no one to service or monitor them. These clients are often those in need of the most help and support from a financial advisor. An increase in customer complaints will be the very likely result.

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<sup>11</sup> The Member Briefing, entitled "SEC Staff Recommends Enforcement Action under Regulation S-P Dramatically Affecting Customer Transfers When Financial Advisors Change Firms," can also be found at <http://www.financialservices.org/MediaLibrary/FSI%20Member%20Briefing%20-%20Reg%20S-P.pdf>

<sup>12</sup> SEC Proposing Release Nos. 34-42484, IC-24326, IA-1856; File No. S7-6-00 (March 2, 2000); SEC Adopting Release Nos. 34-42974, IC-24543, IA-1883; File No. S7-6-00 (June 22, 2000).

<sup>13</sup> NASD *Report of the Customer Account Transfer Task Force*, September 2006, on page 4. See at <http://www.nasd.com/RulesRegulation/PublicationsGuidance/ReportsandStudies/index.htm>. The SEC has also acknowledged a large number of customer complaints pertaining to account transfers (see, for example, former Commissioner Cynthia Glassman's comments at FSI's 2006 OneVoice Broker-Dealer Conference that can be seen at <http://sec.gov/news/speech/spch012506cag.htm>).

These compliance issues affect every broker-dealer, representative, and customer in the U.S. To resolve this problem and provide consumers with plain language disclosure of the information sharing practices of broker-dealers, FSI proposes an amendment to Regulation S-P and a related change to the Model Privacy Form. The proposed amendment would call for each broker-dealer to disclose whether or not it allows former representatives to retain and continue using copies of nonpublic customer information when they depart the firm and, if customer information can be retained:

- What information is retained,
- What purposes can such information be used by the former representative or his/her new broker-dealer, and
- How the customer may opt-out of this information sharing.

Bear in mind that, particularly among IBD firms and their representatives, this information has long been in the representative's possession. In many cases, the representative has had a longer and more personal relationship with the client than the firm itself. The representative owns or leases his/her own office space, files, computers, PDA, cell phones, etc., containing this customer information. The personal relationships between customers and their financial advisors are dramatically different from the relationships between banks and their customers. This reality is not today recognized in Regulation S-P.

The proposed amendment would avoid unnecessary delays in the account transfer process by allowing customers to decide, when their account is opened, whether or not to opt-out of the firm's information sharing with former representatives. The proposed amendment would result in the Model Privacy Form including a plain language discussion of the information sharing practices of the IBD in relation to its former affiliated financial advisors. This rulemaking proposal would not require the SEC to take a policy position that favors one broker-dealer over another, one business model over another, or the broker-dealer over the representative. Firms would then have the information and ability to promptly provide/obtain the information necessary for the new firm to fulfill the directives of NASD NtM 07-06.

#### Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, would welcome the opportunity to work with you to find solutions to these concerns that achieve your objectives without the unintended consequences we have outlined above.

Again, thank you for the opportunity to comment on the Model Privacy Form. Should you have any questions, please contact me at 770 980-8487.

Respectfully submitted,



Dale E. Brown, CAE  
President & CEO



April 17, 2007

## SEC Staff Recommends Enforcement Action under Regulation S-P Dramatically Affecting Customer Transfers When Financial Advisors Change Firms

When financial advisors (“representatives”) change broker-dealers, their clients typically want to follow them to the new firm. This is no surprise because the personal relationships are between the representatives and their clients. Unfortunately, the client account transfer process is cumbersome, time consuming, and paper-intensive, and it is the single-most prevalent source of client complaints to firms and regulators. Many brokerage firms assist representatives in preparing and completing the necessary account transfer-related forms and communications so that in the account transfer process clients bear as little inconvenience as possible. All that may soon change for the worse and clients will be the big losers. The Enforcement Division of the Securities and Exchange Commission (“SEC”) intends to recommend an enforcement action against a broker-dealer under Regulation S-P<sup>1</sup> that will have far reaching adverse consequences to clients transferring their accounts, to representatives trying to continue servicing their clients when they change firms, and to firms trying to assist representatives in the account transfer process.

### Executive Summary

According to the SEC staff’s enforcement position, when representatives are making preparations for clients’ account transfers, sharing client information with the new brokerage firm without each client’s prior consent is a violation of Regulation S-P. Broker-dealers may be aiding and abetting violations of Regulation S-P if they assist representatives in organizing their client data or in preparing account-related forms, particularly if the new firm receives any client information to do so. Once a representative actually departs his or her current brokerage firm, the representative’s use of client information for any purpose without prior client consent is a violation—even when that information is already in the representative’s possession. Moreover, the SEC staff believes that a firm violates Regulation S-P if it does not disclose in its privacy policy that representatives are allowed to continue using client information when they leave.

A client’s consent must be either explicit or implied from a disclosure in the current broker-dealer’s privacy notice and the opportunity to “opt-out” of the information sharing. Today, very few broker-dealers’ privacy policies say that the firm allows representatives to continue using clients’ information when they join another firm, so in most instances each client’s consent must be explicitly obtained before the representative leaves his or her current firm. This enforcement headline comes as a shock to independent contractor firms who, like their representatives, believe that the client relationships belong to the representative. This news will also come as a surprise to most clients who expect to continue working with their representative.

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<sup>1</sup> Letter from the SEC Salt Lake City District Office to NEXT Financial Group, Inc., dated February 12, 2007.

The unintended consequences of the SEC staff's enforcement position, if adopted by the Commissioners,<sup>2</sup> will be substantial delays in the account transfer process. Each client must be individually contacted and his or her consent must be documented before client information can be shared outside the current firm. Preparation of client communications and forms by anyone outside the current firm cannot start until that client's consent has been received. Adding the time and cost of these additional steps to today's account transfer process will dramatically slow the process and add significant costs for staffing and communications. Ironically, the SEC staff's view allows the current firm to share the client's information with a complete stranger, within the broker-dealer firm, without the client's prior consent while precluding the information's use by the representative who received it from the client in the first place. Technology used to merge data with required account transfer forms will be largely useless since nothing can be done for a client until his or her consent is obtained. While the account transfer process is pending, clients will be largely unable to access their accounts or, in many cases, have their current representative service their accounts. The biggest impact will be upon smaller accounts, which are likely to be the lowest in priority. Some smaller accounts may even be abandoned, in fact or effect, as the result of an unduly costly and cumbersome account transfer process.

The SEC staff's position conflicts with NASD Notice to Members 07-06, *Supervision of Recommendations after a Registered Representative Changes Firms*, directing member firms to conduct due diligence concerning a prospective new representative to learn, among other things, the nature of the representative's business and to assure that any recommendation to liquidate, replace or surrender proprietary products is suitable for the customer based upon the customer's financial needs and investment objectives. Until the application of Regulation S-P in this context is resolved, many firms may choose not to accept a transferring client's information until evidence of the client's consent to information sharing has been obtained. This may, in effect, prevent a firm's ability to fully follow the dictates of Notice to Members 07-06.

Representing the interests of affected clients, representatives and firms, FSI expects to propose an amendment to Regulation S-P that would require all firms to disclose in their privacy notices whether they do, or do not, allow client information sharing when representatives change firms. By putting this disclosure in the privacy notice that every client receives when the account is opened, and allowing clients the opportunity to "opt out," if a representative later changes firms it would not be necessary to go back to each client for consent. Clients almost always follow their representatives, so few clients can be expected to "opt out." This approach would assure that clients' wishes are known in advance and followed at the time of an account transfer, thus avoiding unnecessary delays in the account transfer process.

The SEC has recently proposed amending Regulation S-P to provide a standardized form and format for the privacy notice used by all firms.<sup>3</sup> Using the standardized privacy notice would

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<sup>2</sup> The published meeting agendas of the Commission have not yet indicated their consideration of the SEC staff's enforcement recommendations with respect to these issues.

<sup>3</sup> The proposal was jointly proposed by the SEC, Commodities Futures Trading Commission, Federal Trade Commission, and the five federal banking regulators, each proposing the same model privacy notice form and format. *Interagency Proposal for Model Privacy Form under the Gramm-Leach-Bliley Act*, SEC Release Nos.: 34-55497, IA-2598, IC-27755, File No.: S7-09-07 (March 20, 2007). Comments are due by May 29, 2007. The proposal is entirely silent on the client information sharing issues covered here. See at <http://www.sec.gov/rules/proposed/2007/34-55497.pdf>.

provide a “safe harbor” for compliance with Regulation S-P. FSI’s proposed amendment to Regulation S-P could be incorporated into the new standardized privacy notice. The SEC’s proposal to adopt a standardized privacy notice will be the subject of a separate FSI Member Briefing.

#### Issues Raised by the SEC Enforcement Staff

On February 12, 2007, NEXT Financial Group, Inc.<sup>4</sup>, an FSI member broker-dealer and investment adviser headquartered in Houston, Texas, received a “Wells notification” letter from the SEC staff stating that the staff intends to recommend to the Commission an enforcement proceeding alleging that the firm violated various Sections of Regulation S-P, 12 C.F.R. Part 248 *Privacy of Consumer Financial Information*, including Rule 10 (*Limits on Disclosure of Nonpublic Personal Information to Nonaffiliated Third Parties*), Rule 30 (*Procedures to Safeguard Customer Records and Information*), Rule 4 (*Initial Privacy Notice to Consumers Required*), Rule 6 (*Information to Be Included in Privacy Notices*), and that the firm also aided and abetted violations of Rule 10 by registered representatives or principals (“representatives”) who left their former broker-dealers to join the firm. The Wells notification follows an extended dialog with SEC staff, including a January 2007 meeting with senior SEC staff in Washington, DC. In February 2007 several other FSI member firms and other broker-dealers received inquiries from the SEC about their representative recruiting practices and related services, which have been the focus of the SEC’s investigation of these issues.

The SEC staff’s application of Regulation S-P to information sharing in this context was never publicly considered during the rulemaking process when Regulation S-P was promulgated or adopted. While the SEC staff challenges NEXT’s practices, the outcome of an enforcement proceeding will affect every independent broker-dealer. From every firm’s perspective there are two factual scenarios to consider. The “Inbound Scenario” occurs when a representative is joining the firm, when the firm is in the position of being the “New BD” in this analysis. The “Outbound Scenario” occurs when a representative is leaving the firm, when the firm is in the position of being the “Current BD.”

#### Exacerbating Today’s Account Transfer Issues

The SEC staff’s application of Regulation S-P would require representatives, prior to departing the Current BD, to contact each of their clients in order to obtain the clients’ express consent to (i) continue using their information personally to service their accounts; and (ii) share the information with the New BD in the account transfer process. While this “just go ask” approach seems simple enough, in practice it will have serious unintended consequences for clients.

The staff’s position will create a classic “Catch 22” scenario. Typically, there are too many clients affected when representatives change firms to contact them all by having personal meetings or making phone calls. This necessitates sending letters, typically to more than 25 existing retail customers. Before departing the Current BD, representatives cannot simply do a mailing to all of their clients without the Current BD’s prior approval under NASD rules. Subsection (b)(1) of NASD Rule 2211, *Institutional Sales Material and Correspondence*, can be construed to require prior approval of correspondence to more than 25 existing customers within a 30-day period.<sup>5</sup> In a perfect world, the Current BD would give that approval but

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<sup>4</sup> NEXT Financial Group, Inc. has given FSI permission to share this information with FSI members.

<sup>5</sup> See Notice to Members 06-45, *SEC Approves Amendments to NASD Rule 2211 to Require Principal Pre-Use Approval of Certain Member Correspondence Sent to 25 or More Existing Retail Customers within a 30 Calendar-*

unfortunately nothing in any law or regulation compels it. In reality, some Current BDs may delay or refuse to approve the communication and instead reassign the clients to other representatives—likely someone whom the clients have never met nor ever intended to share their information with. If the Current BD's approval is delayed or not received, then before departing, representatives face the choice of either violating NASD Rule 2211 by sending a client mailing requesting information-sharing consents or, in the staff's view, violating Regulation S-P by using information in preparation for the account transfer process without prior client consent. Either way, the Current BD could report the representatives' alleged violations to the NASD or SEC—unwittingly enlisting the regulators to fight its competitive battles.

On the other horn of this dilemma is the SEC's staff's view that, the moment the representative's Form U-5 is filed, the representative becomes a "nonaffiliated third party" to the Current BD and is, therefore, prohibited from using any client information—some of which information may already be in his or her possession—to contact his or her clients. At that point in time, if the Adopting Release<sup>6</sup> is applied literally, even the fact that a person was formerly a customer is itself nonpublic personal information.<sup>7</sup> Assuming that representatives could recreate a list of customers and contact information from memory without using any historical documents from the Current BD, contact the client, and obtain information-sharing consent, then to the extent that the representative does not already have the information in his or her possession, the representative must either go back to the Current BD and request copies of each client's information—the Current BD being under no legal obligation to provide it—or ask the clients to recreate the account information themselves. If the historical information is not timely provided by the Current BD, the clients' only choice is to fill out blank ACATS forms and copy their own account statements. Most clients would be dumbfounded and many would be highly irritated by the apparent lack of customer service from their representative.

Whether express client consents are requested before or after representatives depart the Current BD, these additional steps will be highly time consuming and further delay the account transfer process. Once requested, consents will come back piecemeal, in random order, and spread over the course of, at best, several days and, more likely, more than a week. Of course, the documents and forms preparation process can only begin when the client's consent arrives. Then each client's documents and forms must be separately created and sent back to the client for review, signature, return, and processing. If the SEC staff's approach is adopted, the technologies used to efficiently pre-populate and generate client communications and account transfer-related documents will be largely useless, a small advancement over manually completing the forms one by one.

These unintended consequences of the SEC staff's approach all translate to significantly increasing delays and disruptions of client service in the account transfer process. The account transfer process creates, in effect, a "blackout period" when clients generally cannot place trades or access their accounts. In these days of volatile markets a few hours, let alone days or

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*Day Period*, effective December 1, 2006. See at

[http://www.nasd.com/RulesRegulation/NoticestoMembers/2006NoticestoMembers/NASDW\\_017265](http://www.nasd.com/RulesRegulation/NoticestoMembers/2006NoticestoMembers/NASDW_017265).

<sup>6</sup> SEC Release Nos. 34-42974, IC-24543, IA-1883; File No. S7-6-00 (June 22, 2000) ("Adopting Release").

<sup>7</sup> The Adopting Release says customers' names, addresses, telephone numbers, any compilations or customer lists (e.g., a rolodex, a PDA, a "birthday list"), and even the existence of a prior customer relationship are nonpublic personal information unless there is a reasonable basis to believe this information is, in fact, publicly available.

weeks, of a “blackout” can result in investors’ losses, missed opportunities, and client complaints. Moreover, as the number of affected accounts increases and/or the time and cost of handling each account transfer increases, smaller accounts will be lower in priority and many will, either in fact or effect, be orphaned and abandoned. These are all unacceptable outcomes, likely resulting in serious client harm, and are likely to significantly increase client complaints about the account transfer process. Account transfers are already the leading subject of clients’ complaints to the NASD and the SEC.

According to the NASD Account Transfer Report, more than 17,000 full accounts or partial accounts are transferred via ACATS each day.<sup>8</sup> The Report says that, assuming that there are no problems with the transfer process, an ACATS transfer should generally take about six to 10 days (presumably referring to business days and measured from the date when the signed and completed ACATS forms are actually presented to the clearing broker for processing to when the account’s assets have actually been transferred). The NASD Account Transfer Report says that the level of customer dissatisfaction with the customer account transfer process is already “high.” It says, “in the past two years, more than 700 customers submitted complaints to NASD about the transfer of their accounts. In the same period, firms received more than 6,000 direct customer complaints about account transfers.”<sup>9</sup>

We understand from the SEC’s statistics that among the broker-dealer complaints it received, account transfer problems were up by 8.55 percent in 2005 (622) over 2004 (573). The trend likely continued in 2006. Indeed, account transfer issues were a key topic of discussion for former Commissioner Cynthia Glassman at FSI’s 2006 Broker-Dealer Conference.<sup>10</sup> Among the account transfer-related problems she addressed were non-transferable proprietary products held in clients’ accounts. To mitigate those issues, she recommended:

If you the broker (whether at the old firm or the new firm) take the time upfront, when the initial account transfer request is made, to analyze the customer’s existing account and the difficulties that may arise from transferring it, you can inform your customer of the anticipated problems and options to deal with them. In other words, you can manage your customer’s expectations. (*Emphasis added.*)<sup>11</sup>

If the SEC staff’s approach to Regulation S-P is adopted, the New BD will not be in a position to address these concerns because it will not know the clients’ holdings in the relevant time frame. In reality, it is only possible for representatives and the New BD to proactively address these kinds of account transfer issues by reviewing the client’s account holdings early in the account transfer process. Typically, the Current BD has no serious interest in handling this account analysis—it knows that the client is leaving. As suggested by Ms. Glassman and NASD Notice to Members 07-06, getting clients’ account information into the New BD’s hands early in the

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<sup>8</sup> NASD *Report of the Customer Account Transfer Task Force*, September 2006, on page 4. See at <http://www.nasd.com/RulesRegulation/PublicationsGuidance/ReportsandStudies/index.htm>.

<sup>9</sup> *Id.* page 4, at note 5.

<sup>10</sup> The complete text of her remarks can be found at <http://sec.gov/news/speech/spch012506cag.htm>.

<sup>11</sup> Similarly, see NASD’s Notice to Members 07-06 *Supervision of Recommendations after a Registered Representative Changes Firms*, directing member firms to conduct due diligence concerning a prospective new representative to learn, among other things, the nature of the representative’s business and to assure that any recommendation to liquidate, replace or surrender proprietary products is suitable for the customer based upon the customer’s financial needs and investment objectives.

process is the best way to reduce these kinds of customer complaints. Unfortunately, under the SEC staff's approach to Regulation S-P it would be reasonable to expect these complaints to increase.

#### The "Real Life" Contexts of these Issues

Policymakers on these issues must bear in mind the context for client account transfers when representatives change firms. NASD reports that the nearly 5,100 brokerage firms under its jurisdiction conduct business through approximately 171,000 branch offices.<sup>12</sup> For firms that conduct business under the independent contractor model, substantially all of those branch offices are owned or leased, operated and controlled by the representatives themselves, subject to the firm's regulatory supervision and oversight. The file cabinets, computers, laptops, PDAs, and client information storage media are all owned by the representatives themselves, not by the firms. By law, each of the representatives in those 171,000 branch offices must have and use client information in order to "know their customers" and determine the suitability of their investment advice. Every one of those clients provided their personal information to the representative knowing that the information would be used to service their accounts. In these common settings, when representatives change firms, they do not "take" anything—the client information is already in the representatives' possession.

In these settings, representatives are simply changing the broker-dealer through whom the securities business will be conducted, the firm name on their door, business card, letterhead, etc., and where their clients' accounts will be held. To be sure, clients always have complete freedom to choose whether or not they will transfer their accounts to the New BD. However, most clients choose to follow their representatives rather than have their personal information shared with a stranger at the Current BD. Often, these client relationships have been built over many, many years. Indeed, in many small branches in small towns serving less populated parts of the country, there are no other local representatives of the Current BD to whom the clients' accounts could be reassigned.

Representatives often change firms to obtain better service or lower costs for their clients. In the face of the additional account transfer-related costs and effort created by the SEC staff's approach, many representatives will decline to put their clients through the whole ordeal, even if their customers would be better served by a different firm at a lower cost. Moreover, in recent years there have been many regulatory actions brought against firms for such serious issues as late trading and market timing, biased investment analysts reports, undisclosed payments for shelf space, differential compensation for proprietary investment products, and failure to give breakpoint credits. Many representatives may be outraged and embarrassed by their firm's conduct. Yet, there will be no meaningful marketplace accountability if the offending firms can anticipate that Regulation S-P's effect will be to make large numbers of account transfers too costly, too time consuming and too disruptive to clients for representatives to contemplate.

We believe that the GLB Act and Regulation S-P can and should be applied in a way that balances the need for privacy and protection of client data with the need for efficient account transfers. The SEC staff's approach would, in reality, be too cumbersome, too costly, and too time consuming, and cause further delays in the account transfer process. Ultimately, clients

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<sup>12</sup> NASD website: <http://www.nasd.com/AboutNASD/index.htm>.

are more likely to be caused actual harm in the account transfer process for the sake of avoiding a perceived risk from information sharing. As clients typically follow their representatives when they change firms, we believe that the SEC staff's approach unintentionally turns clients' priorities upside down. If the public understood the unintended consequences of the SEC staff's approach, we believe they would have the SEC strike a different balance.

#### SEC Staff's Position is Contrary to Well-Established Legal Precedents

The SEC staff's application of Regulation S-P ignores long-standing, pro-consumer, legal precedents in the context of post-employment restrictive covenants where some firms have long battled over who owns the client account and relationship. Nothing in the SEC's Proposing<sup>13</sup> or Adopting Releases, staff interpretations, no-action letters, enforcement cases, or staff speeches questions these long-standing, industry-wide practices in light of Regulation S-P. Indeed, nothing in the legislative history of the GLB Act suggests that Congress intended to change them. Nothing in the related regulatory guidance provided by the NASD, Inc., New York Stock Exchange, or other self-regulatory organizations has questioned these practices under Regulation S-P. There have been a number of regulatory releases addressing transfers of representatives and clients accounts between firms,<sup>14</sup> but none have ever questioned these historical practices of sharing clients' information when representatives change firms. We believe the SEC staff's interpretation will, unintentionally, reinforce the competitive battle lines of some Current BDs in preventing clients from following their representatives.

Most of the "name brand" national firms have long had strong restrictive post-employment covenants that courts, among others, have concluded do not serve the best interests of clients.<sup>15</sup> For example, in *Morgan Stanley DW, Inc. v. Spencer Frisby and Patrick Lovell*, 163 F. Supp. 2d 1371, at 1378; 2001 U.S. Dist. LEXIS 18334 (N.D. Ga. 2001), the court quoted with approval the opinion in *Dean Witter v. Imperatore*, No. C-32-97E (N.J. Super. Ct. Feb. 14, 1997), where that court stated: "Customer records and the right to deal, the right of dealing between customer and former employee is regarded within the industry as something that belongs to and is determined by the customer." 163 F. Supp. 2d at 1379. The *Morgan Stanley DW* court also cited NASD arbitration decisions which ruled that the departing broker was entitled to retain and use customer records and accept business from his/her clients (*emphasis added*). 163 F. Supp. 2d at 1380. In assessing the public interests involved in enforcing a non-compete covenant and preventing a representative (identified as a "broker" below) from using client information, the court concluded:

The Court agrees with Defendants that the entry of injunctive relief is not in the public interest. The court in *Prudential Securities v. Plunkett*, 8 F. Supp. 2d

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<sup>13</sup> SEC Release Nos. 34-42484, IC-24326, IA-1856; File No. S7-6-00 (March 2, 2000) ("**Proposing Release**").

<sup>14</sup> NASD NtM 07-06 *Supervision of Recommendations after a Registered Representative Changes Firms*; NASD NtM 04-72 *Supplemental Memorandum* (November 4, 2004); NASD NtM 04-72 *Transfers of Mutual Funds and Variable Annuities*; NASD NtM 04-58 *Partial Account Transfers*; and NASD NTM 02-57 *Negative Response Letters*; NASD NtM 02-07 *Interfering with Account Transfers*; NASD IM-2110-7 *Interfering With the Transfer of Customer Accounts in the Context of Employment Disputes*; NASD Rule 11870 *Customer Account Transfer Contracts*; see also the NASD Account Transfer Report.

<sup>15</sup> Even among "name brand" firms having notoriously restrictive post-employment covenants, the SEC is no doubt aware of the so-called *Protocol for Broker Recruiting* that expressly contemplates the sharing of customer information when representatives leave to join another firm in exchange for a cash settlement based on the representatives book of business. If the SEC staff's position is adopted, information sharing pursuant to the *Protocol* would be a violation of Regulation S-P.

514, 520 (E.D. Va. 1998) noted that the broker-client relationship was similar to that of attorney-client or doctor-patient. Personal trust and confidence pervades each of these relationships, and "clients should be free to deal with the broker of their choosing and not subjected to the turnover of their accounts to brokers associated with the firm but unfamiliar to the client, unless the client gives informed consent to the turnover." Id. . . . In a time of market volatility, the inability of a client to consult a trusted advisor for even a single day could result in enormous financial losses to the client. This danger outweighs any injury to the Plaintiff that may occur due to the disloyalty of its former employees. Issuance of a temporary restraining order in this case is not in the public interest. (*Emphasis added.*) 163 F. Supp. 2d at 1382.

Courts have acknowledged and endorsed industry practices of information sharing to facilitate clients following their representatives. For example, in Merrill Lynch, Pierce, Fenner & Smith Inc., v. E. F. Hutton & Co., Inc., James Bond, Paul Camilleri, Arthur Ciagne And John Kulhavi, 403 F. Supp. 336; 1975 U.S. Dist. LEXIS 15371 (E.D. Mich. 1975), the court noted:

The affidavits offered by defendants, not seriously controverted by plaintiff, establish that it is the usual practice for account executives to retain photocopies of records when they change employers.[fn.] Furthermore, the individual defendants indicate that removal of records and solicitation of clients is consistent with industry practice, and that plaintiff has, in fact, sanctioned such action. (*Emphasis added.*) 403 F. Supp. at 341.

Similarly, in H&R Block Fin. Advisors, Inc. v. Majkowski, 410 F. Supp. 2d 1, 2006 U.S. Dist. LEXIS 2437 (D.D.C. 2006); aff'd. and injunction denied, H&R Block Fin. Advisors, Inc. v. Majkowski, 2006 U.S. App. LEXIS 2657 (D.C. Cir. Jan. 30, 2006), the trial court said:

In recent years, the securities industry has come to grips with the serious public policy problems presented by its very restrictive employment contracts. NASD Rule 11870 and NASD Interpretive Materials 2110-7 make it clear that clients must have free access to registered representatives of their choice and that "it is inconsistent with just and equitable principles of trade for a member or person associated with a member to interfere with a customer's request to transfer his or her account in connection with the change in employment of the customer's registered representative . . . ." (*Emphasis added*) 410 F. Supp. 2d at 1.

Notwithstanding the representatives' alleged misconduct, the court concluded that the public interest was in favor of the representatives:

*Public interest.* The NASD materials referred to earlier [*in the opinion*] lay out what I believe to be the correct version of the public interest, which is indifferent to whether H&R Block or SunTrust is more successful in the marketplace and which is focused on the needs of the investing public. If the public interest has any weight in the calculations presented by this case, it



weighs on the side of open competition and vigorous solicitation -- on the defendants' side, in other words. (*Emphasis added*) 410 F. Supp. 2d at 3.

The GLB Act's legislative history says, in a number of places, that Congress intended to promote competition, choice, and efficiency to benefit customers and participants in the financial services marketplace. The SEC should not "federalize" the states' laws of fair trade and unfair competition by, in effect, interpreting the GLB Act and Regulation S-P in such a way as to either force representatives to get the Current BD's consent in order to request their clients' consents before changing firms or, after changing, force representatives to recreate from memory client names, addresses, and telephone numbers to contact them. The case law cited above underscores the importance to clients of maintaining access to their representatives' services. The unintended effect of SEC staff's position will be to substantially interfere with their access.

#### Analysis of GLB Act and Regulation S-P

We believe that the GLB Act and Regulation S-P can be interpreted to avoid these unintended consequences—balancing and safeguarding consumer interests while allowing for the free flow of clients, accounts, and related commerce among all types of financial institutions and their representatives. To date, the SEC's enforcement staff has not agreed with this interpretation.

Section 502 of the GLB Act, *Obligations with Respect to Disclosures of Personal Information*, contains the primary directives governing a financial institution's disclosure of nonpublic personal information. These include providing "customers" (a statutorily defined term) with a notice containing the firm's privacy policy and an opportunity to "opt out" of a proposed disclosure of nonpublic personal information to a nonaffiliated third party. A representative becomes a "nonaffiliated third party" (a statutorily defined term) with respect to the Current BD when his or her Form U-5 is filed by the Current BD. In the circumstances relevant here, the Current BD and the New BD are also nonaffiliated third parties.

Subsection 502(e), *General Exceptions*, provides that the prior notice and opt-out requirements of Section 502(a) and (b) do not apply in two circumstances that are relevant in this context. Specifically, Subsections 502(e)(1) and (7) provide, in relevant part, that:

(e) GENERAL EXCEPTIONS.--Subsections (a) and (b) shall not prohibit the disclosure of nonpublic personal information—

(1) as necessary to effect, administer, or enforce a transaction requested or authorized by the consumer, or in connection with—

(A) servicing or processing a financial product or service requested or authorized by the consumer;

\* \* \*

(7) in connection with a proposed or actual sale, merger, transfer, or exchange of all or a portion of a business or operating unit if the disclosure of nonpublic personal information concerns solely consumers of such business or unit; (*Emphasis added.*)

The statutory phrase "*necessary to effect, administer, or enforce*," underscored above, is defined in Section 509 of the GLB Act. It provides, in relevant part, that:

(7) NECESSARY TO EFFECT, ADMINISTER, OR ENFORCE.--The term "as necessary to effect, administer, or enforce the transaction" means—

\* \* \*

(D) the disclosure is required, or is a usual, appropriate or acceptable method, in connection with—

\* \* \*

(ii) the transfer of receivables, accounts or interests therein;*(Emphasis added.)*

The above quoted statutory definition makes clear that Congress envisioned that account transfers are within the scope of servicing a customer's account for purposes of the exception to the notice and opt-out requirements under Section 502(e)(1), quoted above. By way of example from the banking context, it is common for banks or mortgage companies to sell branches or portfolios of mortgages or mortgage servicing rights with respect to a group of customers the sellers choose. The sharing of nonpublic personal information about affected customers, either before or after the sale, is a well-recognized permitted exception to Regulation S-P's notice and opt-out requirements.

The statutory exception to the notice and opt-out requirements in Subsection 502(e)(7), quoted above, are also relevant in the context of the transfer of clients accounts when representatives change firms. Firms that conduct business using the independent contractor model believe that the representatives are the primary owners of the client relationships, not the firms, and so the representatives are free to join and leave the firm bringing with them their clients. The GLB Act does not prescribe any characteristics or conditions to the transactions in which accounts are transferred, such as sale consideration, ownership, or method of transfer. Indeed, the statute simply uses the term "transfer" of accounts and does not require a "sale."

The statute does not define the term "business or operating unit" as used in Section 502(e)(7). The logical and plain English meaning of those words should include an identifiable part of the business of a firm such as the services performed for a group of clients serviced by one or more identifiable representatives. In the account transfer process, the representative's part of the brokerage business, reflected in an identifiable group of clients he or she is servicing, is being transferred to the New BD. The overriding requirement of Subsection 502(e)(7) is that the nonpublic personal information to be disclosed must concern solely the customers of the business unit to be transferred. In the context of transitioning a representative between firms and the transfer of his or her client accounts, this means that the only nonpublic personal information that can be shared is limited to the clients to be transferred and limited in use to the account transfer process.

Regulation S-P mirrors the two exceptions in Section 502(e), described above, in Rule 14, *Exceptions to Notice and Opt Out Requirements for Processing and Servicing Transactions*, and Rule 15, *Other Exceptions to Notice and Opt Out Requirements*, 12 C.F.R. §§ 248.14 and 248.15. Regulation S-P does not, however, provide further elaboration or any relevant examples to apply the GLB Act's exceptions in the context of representatives and their customers changing firms. Indeed, in the SEC's release adopting Regulation S-P, the SEC expressly declined to provide examples, stating that:

Several other commenters requested that the final rule provide specific examples of situations that would fall within the exception for processing and servicing customer accounts (such as transfers from a broker-dealer to its registered representatives, or as necessary to arbitrate a dispute, with the consent of the consumer's fiduciary or representative). Others stated that certain services, such as those provided by attorneys, are "necessary" to effect, administer, or enforce a transaction. We believe that disclosures to these types of professionals and under the circumstances posited by the commenters may be necessary to effect, administer, or enforce a transaction in a given situation. (*Emphasis added. This text follows footnote 169.*)

Similarly, in commenting about the exceptions contained in Rule 14(a), the Adopting Release states:

Many commenters offered specific suggestions for additional exceptions or revisions to the proposed exceptions. In some cases, the suggestions are accommodated elsewhere in the regulation (such as exceptions to permit disclosures to independent contractor registered representatives or attorneys to effect a transaction). In other cases, the suggestions are inconsistent with the statute.[fn.] Accordingly, we have retained the statement of the exceptions as proposed.[fn.] (*Emphasis added. This text appears at footnotes 171 to 173.*)

The Adopting Release does not indicate any limitation on the representative's use of the information in servicing or transferring the client's account. This is the only guidance provided—it does not address information sharing in the context of account transfers.

The SEC's Adopting Release does discuss what can be done with nonpublic personal information when it is received by a broker-dealer, either under a disclosure exception provided in Section 502(e) of the GLB Act or outside of those exceptions. Specifically, the Adopting Release states:

Limits on redisclosure and reuse when information is received under Section 502(e). If a broker-dealer, fund, or registered adviser receives nonpublic personal information provided under Section 502(e), it may disclose the information to its affiliates or to the affiliates of the financial institution from which it received the information. The broker-dealer, fund, or registered adviser also may disclose and use the information under the same type of exceptions in the ordinary course of business to carry out the activity covered by the exception under which the institution received the information.[fn.] The affiliates of the broker-dealer, fund, or registered adviser may disclose and use the information, but only to the extent permissible for the broker-dealer, fund, or registered adviser.[fn.] (*Emphasis added; this text precedes footnote 155.*)

The Adopting Release also addresses what a firm must do with respect to nonpublic personal information in the event that it is not received pursuant to an exception under Section 502(e). Specifically, it states:

Limits on redisclosure and reuse when information is not received under Section 502(e). If a broker-dealer, fund, or registered adviser receives nonpublic personal information *outside* one of the Section 502(e) exceptions, it may disclose the information to (i) its affiliates, (ii) the affiliates of the financial institution that made the initial disclosure, or (iii) any other person if the disclosure would be lawful if made directly by the financial institution from which the information was received.[fn.] Thus, the receiving broker-dealer, fund, or registered adviser may disclose under one of the Section 502(e) exceptions. (*Emphasis added. This text is found at footnote 156.*)

Thus, in either scenario, a broker-dealer is permitted to share the nonpublic personal information with its affiliates, including its representatives, and to use the information for purposes of one of the permitted exceptions to Section 502(e) of the GLB Act discussed above.

When client information is shared solely for purposes of effecting account transfers, the SEC could permit firms and representatives to rely upon these permitted exceptions to the notice and opt-out requirements of the GLB Act and Regulation S-P. No harm has befallen the client from this limited information sharing. The client is in a demonstrably better position than if the start of the whole process were delayed until the day that the representative's Form U-5 was filed by the Current BD. We believe the SEC has sufficient flexibility under Regulation S-P to apply the servicing and account transfer exceptions to achieve this pro-consumer result.<sup>16</sup>

#### Proposed Rulemaking

When Regulation S-P was proposed and adopted, the SEC did not directly address client information sharing issues in this critically important context—a context that affects every registered broker-dealer in the U.S. If the Commission declines to apply the account servicing or the account transfer exceptions to the notice and opt-out requirements of Regulation S-P, there are many facets of these issues that will not be fully explored by the SEC's staff. Whether by concept release or by rulemaking, public policy would be best served by a comprehensive examination and public dialog about these important issues.

More specifically, we believe that all clients should have the right to know whether a firm does or does not allow its representatives to bring their client information with them upon departing the firm. This could be accomplished by amending Regulation S-P to require firms to state these practices. As noted above, even the *Protocol for Broker Recruiting*, allows its signatories to share client information. Substantially all clients expect to follow the representatives with whom they have a personal relationship and will not opt-out. Those clients can know that their account transfer process will not be delayed or disrupted by the extra steps and time required to obtain their explicit consent to sharing their information at the point of the representative's departure. For any client who may be unsure or unwilling to authorize this information sharing in advance, they may choose to opt-out but will be advised of the potential ramifications of their decision in the account transfer process. If a firm refuses to allow client information

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<sup>16</sup> The SEC has been flexible in adapting Regulation S P's requirements to fit real world circumstances. Rule 4(e), *Exceptions to Allow Subsequent Delivery of Notice*, allows for delivery of the initial privacy notice within a reasonable time after a broker-dealer establishes a customer relationship under limited circumstances and examples are provided for guidance. The premise for this Rule's exceptions is to avoid substantial delays in customer transactions.

sharing in this context, clients should know that and the consequences that may occur upon their representative's departure.

Amending Regulation S-P to address this type of limited information sharing would not require the SEC to take a policy position, one way or the other, on this question. Requiring this disclosure would not have a disparate impact on one firm's business model over another. Indeed, it will allow all firms, all representatives, and all clients to structure their relationships in a timely and orderly way, and avoid disruptions of client service at the time of the representative's departure. In view of the staff's enforcement position, what will hurt clients the most is a privacy policy that is simply silent on this important issue. If the privacy policy does not address this issue, clients will not be aware of the impact on their account transfers and representatives will be forced into the untenable Catch 22 dilemma described earlier.

### Conclusions

We believe that the securities industry's current, limited client information sharing practices in both the Inbound and Outbound Scenarios is consistent with the account servicing and account transfer exceptions to the notice and opt-out requirements of the GLB Act and Regulation S-P. To conclude otherwise, as is presently the SEC staff's position, will impose substantially greater burdens of time, money, and resources on firms and representatives in handling client information and account transfers that are not outweighed by the perceived reduction in potential risk to breach of clients' personal privacy from these practices. The unintended consequences of the SEC staff's position will be to cause significant delays in the account transfer process, create orphaned client accounts, and cause actual harm to clients.

The Commission should give public notice of this dramatic change in long-standing industry practices, consider the potential unintended consequences, seek comment on the appropriate balance between the continuity of account service versus personal privacy, and afford the public and the industry opportunity for input. These adverse effects could be avoided by an amendment to Regulation S-P requiring all firms to address in their privacy policies their information sharing practices with respect to former representatives, thus allowing clients to set their expectations and make their wishes known when their accounts are opened.

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