

[Compliance]

The effects of Regulation S-P on your business

Privacy policies continue to be front and center in the advisor industry, and recent moves by the SEC make them even more so.

The SEC has proposed amendments to Regulation S-P to tighten requirements for the safeguarding and disposing of confidential client information. One important aspect of the proposal includes a new exception on opt-out requirements to allow limited information sharing when financial advisors move from one broker/dealer to another. Since representatives may develop close relationships with their clients, the exception is designed to facilitate the efficient transfer of customer information and allow customers to continue working with their representative at the new firm.

The exception addresses the long-standing industry practice of transferring customer information when a representative moves to a new firm, but imposes restrictions to ensure the information is properly protected. According to the SEC, the exception will permit limited information sharing through the establishment of certain internal controls. Under the proposed exception, departing representatives can continue their client relationships.

However, the exception limits the information to a customer's name, a general description of the type of account and products held by the customer, and the customer's address, phone number and e-mail information.

As proposed, the exception is far less investor-focused than it would appear at first glance. The exception focuses on the firm with the departing representative and gives that firm absolute control over whether any information will be shared.

Because the old firm will have exclusive control over the information sharing, the proposed exception may not effectively satisfy its stated goals. Should the firm decide not to rely on the exception, representatives will be in the same position they were in prior to its adoption: The representative must get explicit customer consent (or implicit consent through notice and opt-out procedures) prior to trans-

ferring any such information. If not, they risk being in violation of Reg S-P.

Firms that decide to utilize the exception face uncertain implications if any information outside of the listed conditions is transferred to another firm. The departing representative is in violation for taking unauthorized customer information even if it inadvertently falls outside the scope of the exception. Additionally, the exception applies equally to all broker/dealers and registered investment advisers, without taking into account any differences in business models, services provided or degree of customer sophistication. To further complicate its applicability, the exception does not apply when representatives transfer to or from banks, state-registered advisors or other types of financial institutions. As a result, these institutions will continue to operate under current industry practices relating to information sharing, relying on the notice and opt-out procedures in order to properly transfer customer contact information.

When the SEC adopts the changes to Regulation S-P, firms must carefully consider how to handle the exception that permits disclosure of client contact information. While it may appear that the proposal empowers representatives to take investor information with them, this is not necessarily the case.

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