

- **Exception for Limited Information Disclosure When Personnel Leave Their Firms**

Finally, we propose to amend Regulation S-P to add a new exception from the notice and opt out requirements to permit limited disclosures of investor information when a registered representative of a broker-dealer or a supervised person of a registered investment adviser moves from one brokerage or advisory firm to another. The proposed exception is intended to allow

See 17 CFR 240.17a-4(b); 240.17Ad-7(b); 270.31a-2(a)(4)-(6); 275.204-2(e)(1).

firms with departing representatives to share limited customer information with the representatives' new firms that could be used to contact clients and offer them a choice about whether to follow a representative to the new firm. At many firms, representatives develop close professional and personal relationships with investors over time. Representatives at such firms likely remember the basic contact information for their clients or have recorded it in their own personal records. Some firms discourage departing representatives from soliciting clients to move to another firm, while others do not. At any firm, departing representatives may have a strong incentive to transfer as much customer information as possible to their new firms, and it has been brought to our attention that, at some firms, information may have been transferred without adequate supervision, in contradiction of privacy notices provided to customers, or potentially in violation of Regulation S-P.⁹⁰

The proposed exception is designed to provide an orderly framework under which firms with departing representatives could share certain limited customer contact information and See, e.g., In re NEXT Financial Group, Inc., supra note 16.

41 90

could supervise the information transfer. The proposed exception would permit one firm to disclose to another only the following information: the customer's name, a general description of the type of account and products held by the customer, and contact information, including address, telephone number and e-mail information.⁹² We propose to include this particular information as it would be useful for a representative seeking to maintain contact with investors, but appears unlikely to put an investor at serious risk of identity theft. It also is the type of information an investor would expect a representative to remember. Broker-dealers and registered investment advisers seeking to rely on the exception would have to require their departing representatives to provide to them, not later than the representative's separation from employment, a written record of the information that would be disclosed pursuant to the exception, and broker-dealers and registered investment advisers would be required to preserve

91

In 2004, certain large broker-dealers entered into a protocol under which signatories agreed not to sue one another for recruiting one another's registered representatives, if the representatives take only limited client information to another participating firm. The initial signatories, Citigroup Global Markets/Smith Barney, Merrill Lynch, and UBS Financial Services, were joined more recently by Raymond James, Wachovia Securities and others.

We understand that, under the protocol, the information that a departing representative may take to another firm is limited to each client's name, address, a general description of the type of account and products held by the client, and the client's phone number and e-mail address. This information may be used at the representative's new firm only by the representative, and only for the purpose of soliciting the representative's former clients.

We further understand that there may be some confusion in the securities industry regarding what information may be disclosed to a departing representative's new firm consistent with the limitations in Regulation S-P, and that at times these limitations may cause inconvenience to investors. NASD (now consolidated into FINRA) issued guidance to its member firms regarding the permissible and impermissible use of "negative response letters" for bulk transfers of customer accounts and changes in the broker-dealer of record on certain types of accounts (see NASD NtM 04-72 (Oct. 2004); NtM 02-57 (Sept. 2002)). More recently, FINRA issued guidance relating to Regulation S-P in the context special considerations firms should use to supervise recommendations of newly associated registered representatives to replace mutual funds and variable products). See FINRA, Regulatory Notice 07-36, available at http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p036445.pdf. However, our staff reports that scenarios involving representatives moving from one firm to another continue to create uncertainty regarding firms' obligations under Regulation S-P.

92

See proposed paragraph (a)(8)(i) of Section 15.

42

such records consistent with the proposed recordkeeping provisions of Section 30.⁹³ This condition is intended to help ensure that firms relying on the exception are appropriately accounting for the information they are disclosing in connection with departures of their representatives.⁹⁴

The exception would be subject to conditions that are designed to limit the potential that the information would result in identity theft or other abuses. The shared information could not include any customer's account number, Social Security number, or securities positions.⁹⁵ A representative would not need this type of information to contact investors, although it would be useful to an identity thief, and an investor probably would not expect a representative to remember it. In addition, a representative could solicit only an institution's customers that were the representative's clients. This condition recognizes that an investor might expect to be contacted by a representative with whom the investor has done business before, but not by another person at the representative's new firm.⁹⁶

As noted above, the proposed exception is designed to facilitate the transfer of client contact information that would help broker-dealers and registered investment advisers offer

93

See proposed paragraph (a)(8)(iii) of Section 15 and proposed paragraph (c) of Section 30. For purposes of the proposed exception, the term "representative" would be defined to mean a natural person associated with a broker or dealer registered with the Commission, who is registered or approved in compliance with 17 CFR 240.15b7-1, or a supervised person of an investment adviser as defined in Section 202(a)(25) of the Investment Advisers Act. See proposed paragraph (a)(8)(iv) of Section 15.

94

Most firms seeking to rely on the proposed exception would not need to revise their GLBA privacy notices because they already state in the notices that their disclosures of information not specifically described include disclosures permitted by law, which would include disclosures made pursuant to the proposed exception and the other exceptions provided in Section 15 of Regulation S-P.

95

See proposed paragraph (a)(8)(ii) of Section 15.

96

See proposed paragraph (a)(8)(i) of Section 15 (permitting a representative to solicit customers to whom the representative personally provided a financial product or service on behalf of the institution).

43

clients the choice of following a departing representative to a new firm. At firms that choose to rely on it, the proposed exception also should reduce potential incentives some representatives may have to take information with them secretly when they leave. By specifically limiting the types of information that could be disclosed to the representative's new firm, the proposed amendments are designed to help firms safeguard more sensitive client information. This limitation also would clarify that a firm may not require or expect a representative from another firm to bring more information than necessary for the representative to solicit former clients. Because the proposed exception is designed to promote investor choice, provide legal certainty, and reduce potential incentives for improper disclosures, we preliminarily believe that it would be necessary or appropriate in the public interest, and is consistent with the protection of investors.

The proposed exception would not limit the disclosure of additional information to a new firm pursuant to a customer's consent or direction.⁹⁷ It also would not preclude the disclosure of additional information required in connection with the transfer of a customer's account.⁹⁸ Depending on its business organization, its policies regarding departing representatives and the

97

For example, if an investor chooses to move his or her business to the representative's new firm, he or she may consent to having the original firm disclose additional information about the customer's account to the representative's new firm without the firm first having to provide the customer with an opt out. See 17 CFR 248.15(a)(1).

98

If an investor requests or authorizes the transfer of his or her account from the representative's old firm to the representative's new firm, the old firm may disclose additional information as necessary to effect the account transfer. See 17 CFR 248.14(a)(1) and 248.14(b)(2)(vi)(B). The exception also would not preclude the disclosure of additional information about the investor if the firm has provided the investor with a privacy notice describing the disclosure and given the investor a reasonable opportunity to opt out of the disclosure, and the customer has not opted out. See 17 CFR 248.10. Thus, covered institutions that wish to disclose an investor's nonpublic personal information to a departing representative's new firm without relying on the proposed new exception or without first obtaining consent from the investor to the disclosure or to an account transfer could revise their privacy notices to describe disclosures the firm would make in the context of a representative's move to another broker-dealer or registered investment adviser.

44

circumstances of a representative's departure, a firm could choose to rely on existing exceptions rather than the proposed new exception.⁹⁹ The proposed exception is designed to allow firms that choose to share limited contact information to do so. The proposed exception would not, however, affect firm policies that prohibit the transfer of any customer information other than at the customer's specific direction.

We have chosen to propose this approach as opposed to an alternative approach that would require all firms to include specific notice and opportunity to opt out of this information sharing in their initial and annual privacy notices. Under this alternative, a broker-dealer or registered investment adviser's privacy notice would have to provide specific disclosure regarding the circumstances under which the broker-dealer or adviser would share customer information with another firm when a registered representative or supervised person leaves. We have chosen this approach because, as indicated earlier, many representatives develop close professional and personal relationships with investors. They are likely to remember basic contact information for their clients or have recorded it in their own personal records, and investors would expect representatives to have this information. This type of limited contact information is unlikely to put investors at serious risk of identity theft. Also, we believe that a description of disclosures to a departing representative's new firm would be difficult to distinguish from the description of disclosures made for the purpose of third-party marketing and would further complicate already complex privacy notices.

- Commenters are invited to discuss the proposed new exception. Would it permit the transfer of contact information so as to promote investor choice and convenience? Would it foreclose the transfer of particularly

sensitive information that, if misused,

See 17 CFR 248.14, 248.15.

45 99

could lead to identity theft? Should the transfer of customer contact information be conditioned on the broker-dealer or registered investment adviser receiving the information certifying to the sharing institution that it complies with the safeguards and disposal rules?

- We also invite commenters to share their views on the likely effect of the proposed new exception on competition in recruiting broker-dealer and investment adviser representatives. Are there alternative approaches that would both protect investor information and not unduly restrict the transfer of representatives from one firm to another?

- We seek comment on potential alternative approaches, including requiring specific disclosure. Are investors, particularly new clients to a firm, likely to understand disclosures about information that would be given to a departing representative's new firm in initial or annual privacy notices?¹⁰⁰ Should the availability of the proposed exemption be conditioned on providing investors with specific disclosure regarding whether a covered institution would disclose personal information in connection with a representative's departure?

- The proposed exception would permit broker-dealers and registered investment advisers to transfer limited information to other broker-dealers and registered investment advisers without first providing notice and opt out. Should we make the proposed exception available for information transferred to other types of financial

We expect that if the Banking Agencies, the FTC and the Commission were to adopt the proposed model privacy form, see Interagency Model Privacy Form Proposal, supra note 12, the description of the disclosure to a nonaffiliated firm could be included on page 2 of the proposed form in the section defining nonaffiliates.

46 100

institutions where a departing representative may go? For example, should we permit broker-dealers and registered investment advisers to rely on the exception to share information with investment advisers that are not registered with the Commission?

- Commenters are invited to express their views on the proposed exemption's condition that a departing representative of a covered institution relying on this exemption could solicit only the institution's customers that were the representative's clients.