May 12, 2008

U.S. Securities and Exchange Commission
Nancy M. Morris, Secretary
100 F Street, N.E.
Washington, D.C. 20549-1090

RE: File Number S7-06-08
Comments on Proposed Amendments to Regulation S-P

Dear Ms. Morris:

On behalf of NEXT Financial Group, Inc. ("NEXT"), a registered independent broker-dealer and investment advisor, I appreciate this opportunity to submit comments regarding the recent proposal by the Securities and Exchange Commission ("SEC" or "Commission") to amend Regulation S-P.[1]

Specifically, NEXT has concerns regarding the proposed *Exception for Limited Information Disclosure When Personnel Leave Their Firms*, to be codified as 17 C.F.R. section 248.15(a)(8) (hereinafter the "Proposed Amendment").[2] Due to pending litigation, NEXT is uniquely affected by the Proposed Amendment, and while the Commission's intentions are undoubtedly in the right place, we would respectfully suggest that the Proposed Amendment is premature.

I. BACKGROUND

The Commission adopted Regulation S-P in 2000 to implement the privacy provisions of the Gramm-Leach-Bliley Act of 1999 ("GLB Act").[3] Regulation S-P, *inter alia*, prohibits disclosure of nonpublic personal information ("NPI") unless customers first receive an initial privacy notice explaining what NPI will be disclosed, to whom, and under what circumstances, followed by the opportunity to opt out of that disclosure.[4] NPI can only be disclosed to non-affiliated third parties

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[1] SEC Release No. 34-57427 (March 4, 2008); published at Fed. Reg. Vol. 73, No. 50 at 13692 (March 13, 2008).

[2] *Id*. at 13702, 13716. Please note the term "Proposed Amendment" as used herein only refers to this one aspect of SEC Release No. 34-57427 and does not include or address the other proposed changes regarding Information Security and Safeguards, Disposal Rules, and Compliance Records.

[3] Regulation S-P is codified at 17 C.F.R. Part 248; the GLB Act is codified at 15 U.S.C. §§ 6801-6809.

[4] NPI is defined as personally identifiable information; and any list, description, or other grouping of consumers (and publicly available information pertaining to them) that is derived using any personally identifiable financial information that is not publicly available information. 17 C.F.R. § 248.3(t)(1).

if the disclosure complies with the privacy notice requirements and the consumer does not opt-out, or an exception from the requirements is available.

On August 24, 2007, the Commission's Enforcement Division staff filed an Order Initiating Proceedings ("OIP") against NEXT in response to alleged violations of Regulation S-P.[5] Generally, the Enforcement Division staff contends that Regulation S-P is violated:

1. when an independent financial advisor affiliated with a firm whose privacy policy restricts the use of clients' NPI is preparing to transfer those clients' accounts and shares such information with a new broker-dealer firm (without each client's prior consent);

2. by allowing outbound independent financial advisors to retain their clients' NPI when they depart the firm;

3. by failing to disclose in a firm's privacy policy the fact that independent financial advisors are permitted to continue using their clients' NPI after they depart from the firm; or

4. through a theory of aiding and abetting when an independent broker-dealer assists inbound financial advisors in organizing their clients' NPI to facilitate transition to the new firm.

The foregoing interpretation of Regulation S-P came as a great surprise to many independent broker-dealers, not least of all NEXT.[6] NEXT believes preexisting exceptions to Regulation S-P (taken verbatim from the GLB Act) conflict with this interpretation and permit these particular NPI disclosures. A trial was held before an Administrative Law Judge, post-trial briefs were filed, and the matter is currently pending adjudication.[7] During the pendency of the OIP litigation, the Commission published the Proposed Amendment, which would allow extremely

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[5] *In re NEXT Financial Group, Inc.*, Exchange Act Release No. 56316 (August 24, 2007), http://www.sec.gov/litigation/admin/2007/34-56316.pdf, and Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (August 24, 2007), http://www.sec.gov/litigation/admin/2007/34-56316-o.pdf.

[6] *See* Financial Services Institute, *SEC's Proposed Amendment to Regulation S-P: A Step in the Right Direction, But Much Work Still to be Done*, at pages 3-4 (April 8, 2008), http://www.financialservices.org/uploadedFiles/FSI/Advocacy_Action_Center/SEC_Issues/Member_Briefing_on_SEC_Proposal_to_Amend_Reg_S-P_04-0408.pdf (last visited May 1, 2008).

[7] It is the policy of NEXT not to comment on pending litigation. NEXT only mentions the pending OIP litigation because it is relevant to the content of this comment letter. All statements made herein are based entirely on publicly available documents. This public comment letter is not intended to supplement, assert, or waive any claim, defense, or argument in the pending OIP litigation, nor is it an ex parte communication per 5 U.S.C. § 551(14).

limited NPI disclosures prohibited under the Enforcement Division staff's (contested) interpretation of Regulation S-P.

II. THE INDEPENDENT BROKER-DEALER MODEL

Independent broker-dealer firms like NEXT do not employ financial advisors. Rather, independent financial advisors, many with their own businesses, associate with and become independent contractors to the independent broker-dealer of their choice. There is no employee-employer relationship between the independent advisors and the independent firms with whom they affiliate. Independent broker-dealer firms like NEXT, along with their independent representatives, have always understood that the client relationship belongs to the *representative* and not the firm.

In the independent firm model, the representative advisor–as opposed to the firm–has the primary relationship with the client. In fact, clients often may not know the name of or care about the broker-dealer firm with which their advisor is associated. In contrast to the employee firm or "wirehouse" model, clients of independent broker-dealer firms provide their NPI to their representative advisor with the understanding that the information will be used by him or her to service the clients' various needs. Moreover, it is expected that most clients will follow their representative advisor when he or she changes firms.

This being the case, clients expect their chosen independent financial advisor to have and retain their NPI so long as they maintain their relationship—regardless of a change in the advisor's firm. It is true that neither Regulation S-P nor the GLB Act makes a formal distinction between an independent firm and an employee firm/"wirehouse." However, ignoring the fundamental difference in the firm-advisor relationship between the two models leads to adverse consequences which are neither intended by the GLB Act nor in the best interest of investors.

Those consequences include causing significant delays in the transfer of client accounts and interfering with the freedom to choose one's financial advisor by precluding the use of NPI by the independent advisor who received it from the client in the first place. Such results were never intended by the GLB Act and are incompatible with the concept of the client relationship belonging to the advisor.

Unfortunately, the Proposed Amendment would implicitly adopt the failure to distinguish between an advisor who is an *employee* of a firm as opposed to an advisor who is an affiliated *independent contractor*, with his or her own independent business. In fact, the Proposed Amendment would exacerbate this problem by establishing the date of "separation of employment" as the deadline for departing representatives to provide their firms written records of the (extremely limited)

client information that will be disclosed to their new firms pursuant to the terms of the proposed exception.[8] Independent contractors are not employees, thus no "separation of employment" can occur where no actual employment ever exists.

Recognizing that some broker dealer firms hire, as employees, their financial advisors while other firms associate with their financial advisors as independent contractors, is vital to understanding why preexisting exceptions to Regulation S-P already exempt the NPI disclosures identified in the Proposed Amendment—at least with respect to the independent firm model.

III. THE PROPOSED AMENDMENT IS PREMATURE

In addition to being problematic due to the lack of distinction between employee advisors and independent contractor advisors, the Proposed Amendment is premature while the OIP litigation is pending. The Proposed Amendment is unnecessary if existing exceptions to Regulation S-P permit the transfers of NPI which the Commission's Enforcement Division staff contends violate Regulation S-P.

As such, NEXT respectfully suggests the Commission stay any adoption of the Proposed Amendment until such time as the administrative proceeding against NEXT is fully adjudicated. Both the propriety and necessity of the Proposed Amendment are contingent on the interpretation of Regulation S-P asserted by the Commission's Enforcement Division staff being correct. However, if NEXT were to prevail, then the Proposed Amendment would conceivably be moot. Furthermore, insofar as the position of the Enforcement Division staff may be found to be inconsistent with certain existing disclosure exceptions contained in Regulation S-P and the GLB Act, the Proposed Amendment would ostensibly exceed the Commission's authority as contrary to the intent of Congress.

IV. CONCLUSION

The simple solution to the foregoing issues regarding the Proposed Amendment is for the Commission to formally recognize the important distinction between financial advisors who are employees of a firm versus those who have their own businesses and are affiliated with a firm as independent contractors. While employee-advisors of a broker-dealer should not take client NPI with them when they depart the firm, independent advisors should be allowed to keep their clients'

[8] *See* proposed § 248.15(a)(8)(iii). Additionally, the word "personnel" in the title of the Proposed Amendment, *Exception for Limited Information Disclosure When Personnel Leave Their Firms*, implies an employee-employer scenario.

NPI when they transfer affiliation from one independent broker-dealer to another. This is congruent with client understanding and expectation. While the privacy concerns of Regulation S-P are of the highest importance, they should not come at the expense of investors being able to have and maintain relationships with the financial advisors of their choice.

On behalf of NEXT, I want to thank the Commission for the opportunity to provide this comment letter and for its sincere consideration of the same.

Sincerely,

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