

DAVIS POLK & WARDWELL
450 Lexington Avenue
New York, NY 10017
212 450 4000

Date: March 24, 2008
To: Interested Persons
Re: Proposed Amendments to Regulation S-P Imposing New
Compliance Burdens on Registered Broker-Dealers and Other
SEC-Regulated Entities

On March 4, 2008, the Securities and Exchange Commission (the “**SEC**”) proposed amendments (the “**Proposal**”) to the information safeguarding and disposal requirements set out in Regulation S-P. If adopted, the Proposal would:

- require SEC-registered broker-dealers and certain other SEC-regulated financial institutions to adopt “information security programs” that are more comprehensive than the policies and procedures for safeguarding information currently mandated under Regulation S-P;¹
- broaden the scope of personal financial information covered by the rules concerning safeguarding and disposing of information;
- extend requirements concerning disposal of personal financial information to natural persons who are associated with registered broker-dealers and certain other covered persons; and
- permit (but not mandate) limited disclosures of investor information to a registered broker-dealer or investment adviser when an associated person of a registered broker-dealer or a supervised person of a registered investment adviser moves to another firm.²

¹ The provisions of Regulation S-P that are proposed to be amended also apply to investment companies and SEC-registered investment advisers. The Proposal would expand the scope of financial institutions covered by the information safeguarding provisions of Regulation S-P to include registered transfer agents. Certain futures commission merchants who are “notice-registered” as broker-dealers are excluded from coverage.

² The proposed exception to Regulation S-P’s notice and opt out requirements would permit a firm to disclose the customer’s name, a general description of the type of account and products held by the customer and limited contact information, but would not permit disclosure of certain more sensitive information such as a social security number.

Among the most significant practical implications of the Proposal for registered broker-dealers would be to: (1) require that information security programs include specified procedures for responding to incidents of unauthorized access to, or use of, personal information, including in many cases compelling notifications to affected individuals and to the firm's designated examining authority, and (2) mandate that broker-dealers oversee service providers by taking reasonable steps to select and retain service providers capable of maintaining appropriate safeguards for personal information and requiring service providers by contract to maintain such safeguards.³ Both of these proposed requirements could add significant costs and compliance burdens to registered broker-dealers (and other covered entities). In particular, since many firms make extensive use of service providers to perform various services that involve the handling of customer or consumer information, the Proposal may require changes to existing standard contract terms and the creation of additional infrastructure for service provider compliance oversight. Moreover, broker-dealers may be faced with difficult and costly decisions if it appears that their service providers are failing to meet contractual information security standards.

The Proposal is, in part, the SEC's response to an increase in information security breaches at regulated financial institutions, and is designed (among other things) to guard against identity theft and unauthorized intrusions into brokerage accounts. However, the SEC is also using the Proposal as a means to address other matters, including conforming Regulation S-P to standards adopted by other government agencies, resolving inconsistencies between the provisions of Regulation S-P that govern safeguarding information with those pertaining to information disposal, and addressing the concerns of registered broker-dealers and investment advisers that Regulation S-P would prevent them from providing investor information to enable departing brokers and adviser personnel to continue servicing their customers at their new firms.

The public comment period for the Proposal ends on May 12, 2008.

© 2008 Davis Polk & Wardwell

³ The Proposal requires that service provider oversight be documented in writing.