

Client Advisory

April 2001

Compliance With Regulation S-P Is Mandatory By July 1, 2001. Is Your Privacy Policy Notice Ready?

Regulation S-P was enacted by the Securities and Exchange Commission ("SEC") in response to the privacy provisions of the Gramm-Leach-Bliley Act. Such provisions required the SEC and certain other federal agencies to adopt privacy rules which impose requirements and restrictions on a financial institution's ability to disclose nonpublic personal information about its customers to non-affiliated third parties. The Commodity Futures Trading Commission ("CFTC") has proposed privacy rules substantially similar to Regulation S-P. Regulation S-P and the CFTC's proposed privacy rules collectively are referred to herein as the "Privacy Rules." Compliance with Regulation S-P is mandatory by July 1, 2001, while the CFTC's rules are scheduled to become mandatory by December 31, 2001.

What are the General Requirements of the Privacy Rules?

- Financial institutions **must** provide their "customers" (as defined below) with an initial and annual notice of their privacy policies and practices;
- Financial institutions **must not** disclose nonpublic personal information about their "consumers" (as defined below) to non-affiliated third parties unless the financial institution has provided such consumers with notice of their privacy policies and practices; and
- Financial institutions **must** provide a method for customers/consumers to prevent the financial institution from disclosing their nonpublic personal information (*i.e.*, the ability to "opt out" of disclosure).

Which Financial Institutions are Subject to the Privacy Rules?

- **Broker-Dealers:** Subject to Regulation S-P.
- **Investment Companies:** Regulation S-P applies to investment companies whether or not such investment companies are registered with the SEC.
- **Registered Investment Advisers:** Regulation S-P applies to SEC registered investment advisers.
- **Entities that Trade Futures:** Under the CFTC's proposed rules, both CFTC registrants and certain persons and entities exempt from CFTC registration (*e.g.*, a commodity pool operator exempt from registration pursuant to CFTC regulation 4.13 or a commodity trading adviser exempt from registration pursuant to CFTC regulation 4.14) will be subject to the CFTC's privacy rules. The CFTC's proposed rules are scheduled to become effective on June 21, 2001, and compliance will be mandatory by December 31, 2001.

Who are “Consumers” and “Customers” Protected by the Privacy Rules?

Generally, the Privacy Rules protect *individuals* who obtain financial products or services from a financial institution primarily for personal, family or household purposes. The Privacy Rules are not designed to protect institutions or individuals who obtain financial products or services primarily for business or commercial purposes.

Consumers: Individuals who obtain financial products or services but do not have a continuing relationship with such financial institution. *Example:* A consumer is an individual who provides a financial institution with personal information when seeking to establish a brokerage account or an advisory relationship (*e.g.*, when completing an application), even if such application or request is denied or withdrawn.

A financial institution must give a “consumer” notice of its privacy policies and practices only if the financial institution intends to disclose nonpublic personal information about such consumer to a non-affiliated third party.

Customers: An individual becomes a customer when he or she enters into a continuing relationship with a financial institution. *Example:* When an individual enters into a written or oral investment advisory contract, opens a brokerage account or buys shares of an investment company, he or she is a “customer.”

A financial institution must give all of its “customers,” both at the time of establishing a customer relationship and annually thereafter during the relationship’s continuation, a notice of its privacy policies and practices. Therefore, even if a financial institution does not intend to disclose nonpublic personal information to non-affiliated third parties, such institution still must prepare a notice of their privacy policies and procedures, and provide such notice to their customers upon establishment of the relationship and annually thereafter.

What is Nonpublic Personal Information?

- Information provided by an individual to a financial institution to obtain a financial product or service from such institution (*e.g.*, information provided on an application);
- Information about an individual resulting from any transaction with the financial institution (*e.g.*, transaction history);
- Information obtained about an individual in connection with providing a financial product or service to such individual (*e.g.*, information from a credit report);
- A list, description or other grouping of individuals (and publicly available information pertaining to them) that is derived from nonpublic personal information (*e.g.*, a list of individuals’ names and street addresses derived using such individuals’ account numbers);
- The fact that an individual is or has been a customer of a financial institution; and
- Any information collected through an internet “cookie.”

Nonpublic personal information does not include:

- A list of names and addresses of customers of an entity that is not a financial institution;
- Information that does not identify the individual (*e.g.*, aggregate information or blind data); or
- Publicly available information, unless the information is part of a customer list that is derived using nonpublic personal information.

Who is Considered a Non-Affiliated Third Party?

A non-affiliated third party is any person or entity other than (i) an affiliate of the financial institution and (ii) a joint employee of the financial institution and a third party. An affiliate of a financial institution is defined as any company that “controls,” is controlled by or is under common control with the financial institution. Control means the power to exercise a controlling influence over the management or policies of a company whether through ownership, contract or otherwise. Any person or entity that owns more than 25% of a company’s voting securities is presumed to control the company.

What Must a Financial Institution’s Privacy Policy Notice Contain?

- The categories of nonpublic personal information that the financial institution collects;
- The categories of nonpublic personal information that the financial institution may disclose;
- The categories of affiliates and non-affiliated third parties to whom the financial institution discloses nonpublic personal information;
- The financial institution’s policies with respect to sharing nonpublic personal information about former customers;
- If nonpublic personal information is disclosed to non-affiliated third parties who provide the financial institution services under contract, the financial institution must provide a separate disclosure regarding the categories of information disclosed and the categories of third parties with whom the financial institution has contracted;
- An explanation of the individual’s right to “opt out” of the financial institutions disclosure of nonpublic personal information, including the method(s) by which the individual may exercise such right; and
- The financial institution’s policies with respect to protecting the confidentiality, security and integrity of nonpublic personal information collected.

What are the Privacy Policy Notice Delivery Requirements?

- Notices may be delivered in any method where the individual can be reasonably expected to receive actual notice;
- Notices may be provided electronically, if such individual agrees to electronic delivery; and
- Oral notice is not sufficient.

Are There Other Privacy Rules Applicable to Financial Institutions?

In addition to Regulation S-P and the CFTC’s proposed privacy rules, the Federal Trade Commission (“FTC”) also has enacted privacy rules which are substantially similar to Regulation S-P and the CFTC’s proposed rules. The FTC’s privacy rules are applicable to financial institutions that are not otherwise regulated by the privacy rules enacted by another federal agency. Therefore, financial institutions that are not regulated by either Regulation S-P or the CFTC’s proposed privacy rules, may be required to comply with the FTC’s privacy rules. Compliance with the FTC’s privacy rules is mandatory by July 1, 2001.

How to Get Additional Information

Katten Muchin Zavis Rosenman is prepared to assist financial institutions in complying with these new Privacy Rules, including the preparation of a financial institution's privacy policy notice. If you have any questions regarding the Privacy Rules please contact one of the attorneys listed below.

Financial Services Selected Contacts

Milton K. Buckingham

312 902 5587
milton.buckingham@kmzr.com

Catherine L. Fletcher

312 902 5561
catherine.fletcher@kmzr.com

Arthur W. Hahn

312 902 5241
arthur.hahn@kmzr.com

Marla J. Kreindler

312 902 5621
marla.kreindler@kmzr.com

Sharron C. Lamoreaux

312 902 5403
sharron.lamoreaux@kmzr.com

Eric J. Nield

312 902 5482
eric.nield@kmzr.com

Wesley G. Nissen

312 902 5365
wesley.nissen@kmzr.com

Michael M. Philipp

312 902 5367
michael.philipp@kmzr.com

James D. Van De Graaff

312 902 5227
james.vandegraaff@kmzr.com

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KMZ Rosenman
KATTEN MUCHIN ZAVIS ROSENMAN

www.kmzr.com

525 West Monroe Street
Suite 1600
Chicago, IL 60661-3693
Tel 312.902.5200
Fax 312.902.1061

575 Madison Avenue
New York, NY 10022-2585
Tel 212.940.8800
Fax 212.940.8776

2029 Century Park East
Suite 2600
Los Angeles, CA 90067-3012
Tel 310.788.4400
Fax 310.788.4471

1025 Thomas Jefferson St., N.W.
East Lobby, Suite 700
Washington, DC 20007-5201
Tel 202.625.3500
Fax 202.298.7570

401 South Tryon Street
Suite 2600
Charlotte, NC 28202-1935
Tel 704.444.2000
Fax 704.444.2050

260 Sheridan Avenue
Suite 450
Palo Alto, CA 94306-2047
Tel 650.330.3652
Fax 650.321.4746

One Gateway Center
Suite 2600
Newark, NJ 07102-5397
Tel 973.645.0572
Fax 973.645.0573