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SEC Adopts Regulation S-AM, Restricts Affiliate Marketing Using Consumer Information

The Securities and Exchange Commission (the “Commission”) recently adopted Regulation S-AM, which addresses affiliate marketing through the use of consumer information. Regulation S-AM is designed to prevent registered investment advisers, investment companies, broker-dealers and registered transfer agents (“Covered Persons”) from using certain consumer information provided by a Covered Person’s affiliate to market products or services, unless there is full disclosure to the consumer and the consumer does not “opt out” of such marketing. Compliance with Regulation S-AM is required by January 1, 2010.

The Regulation’s Provisions

In general, Regulation S-AM contains two key provisions: notice to consumers and an opt-out provision. Covered Persons may not use “eligibility information” (defined below) about a consumer obtained from relationships with affiliates to solicit the consumer, unless:

- (i) the consumer receives a clearly, conspicuously and concisely disclosed notice that the Covered Person may use such eligibility information;
- (ii) the consumer is provided a reasonable method and opportunity to “opt out” of the use of such information for marketing purposes; and
- (iii) the consumer does not opt out.

The consumer notice need not be in a specific form, but it must include the names of the affiliate(s) providing the notice, the types of eligibility information that may be used in solicitations and the length of time that the “opt out” provision will remain effective. The opt-out period must last at least five years, though the agreement may be for a longer period. The appendix to the Commission’s adopting release contains model forms that the Commission states will satisfy Regulation S-AM’s requirement of a clear, conspicuous and concise notice.

The Information Used

“Eligibility information,” use of which triggers the notice requirement, is defined broadly, including personally identifiable information obtained as a result of a relationship with an affiliate. However, it excludes “aggregate or blind data that does not contain personal identifiers such as account numbers, names, or addresses.”

Similarly, Regulation S-AM only applies to specific solicitations. It excludes marketing to the general public – such as “radio, television, general circulation magazine, billboard advertisements and publicly available Web sites that are not directed to particular consumers” – because such broad-scale solicitations do not use specific consumer information. The adopting release for Regulation S-AM explains that marketing solicitations subject to the Regulation include “a telemarketing call,

direct mail, e-mail or other form of marketing communication directed to a particular consumer that is based on eligibility information received from an affiliate.”

Exemptions

Regulation S-AM provides for several exemptions from the notice and opt-out requirements, including:

- Covered Persons responding to consumer-initiated communications about products or services;
- Covered Persons responding to authorizations by the consumer to receive solicitations; and
- Solicitations to consumers who have a “pre-existing business relationship” with the Covered Person. In these cases, the Covered Person can use eligibility information from affiliates to solicit its services without a notice or opt-out provision. They include:
 - a consumer having a brokerage account currently in force with a broker-dealer;
 - a consumer having an investment advisory contract with a registered investment adviser;
 - a consumer who was the record owner of an investment company’s securities, but who redeemed those securities, for up to 18 months after the date of redemption;
 - a consumer who applies for a margin account offered by a broker-dealer, but does not ultimately enter into a financial transaction with the broker-dealer, for up to three months after the date of application; and
 - a consumer who asks via the phone or e-mail about a broker-dealer’s products or services and provides contact information,

but does not obtain any products or services, for up to three months after the date of inquiry.

The final rule, which implements Section 624 of the Fair Credit Reporting Act, essentially incorporates Regulation S-AM’s notice and opt-out provisions into the privacy notices required by Regulation S-P. The Commission stated that the notice and opt-out provisions of Regulation S-AM may be combined with other similar disclosures, such as Regulation S-P’s required initial and annual privacy notices.

The Commission originally proposed Regulation S-AM in 2004. The adopting release differs from the proposed rules in several ways. Most importantly, it states that an affiliate that transmits eligibility information is not responsible for providing a marketing notice, which instead may be provided by any affiliate identified in the notice that has or had a pre-existing business relationship with the consumer receiving the notice. Also, the final rules state that notices to consumers can only be delivered in writing or electronically; they cannot be given orally. However, consumers may still opt out orally (though they can only revoke a previous opt-out in writing).

Though compliance currently is required beginning January 1, the Investment Company Institute recently requested a five-month delay in the compliance date to June 1, 2010, to become consistent with the Federal Reserve’s and other federal regulators’ compliance dates and to allow sufficient time for Covered Persons to comply with the Regulation’s notice and opt-out requirements.

The text of the final rule, including model notice forms, is available at <http://www.sec.gov/rules/final/2009/34-60423.pdf>.

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