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Compliance Deadline Imminent for Regulation S-P Requirements Regarding Disposal of Consumer Information

In December 2004, the Securities and Exchange Commission ("SEC") adopted amendments to Regulation S-P, which requires financial institutions to adopt policies and procedures to protect consumer information. The new amendments require covered financial institutions that possess information derived from consumer reports to properly dispose of the information, and to maintain written disposal policies and procedures.

Covered institutions must comply with the new requirements by July 1, 2005. For covered institutions that have existing contracts with service providers to dispose of consumer information, the compliance date is July 1, 2006.

Background

In 2003, Congress passed the Fair and Accurate Credit Transactions Act ("FACT Act"). Section 216 of the FACT Act amended the Fair Credit Reporting Act by placing new requirements on persons who, for a business purpose, possess and maintain information on consumers that is derived from consumer reports. Specifically, the FACT Act requires that "any person that maintains or otherwise possesses consumer information, or any compilation of consumer information, derived from consumer reports for a business purpose[,] properly dispose of any such information or compilation."[1]

The purpose of the new disposal requirements is to protect against identity theft and other types of fraud by making it more difficult for unauthorized persons to gain access to consumer information during the disposal process. Government agencies, including the SEC, were required to pass regulations implementing the new requirements in a manner consistent with the Gramm-Leach Bliley Act ("GLBA"). The agencies involved coordinated their regulatory efforts so that, to the extent possible, their respective rules would also be compatible with each other.

New rule 30(b), and amended and redesignated rule 30(a) of Regulation S-P, are the results of this process.

Rule 30(b)

New rule 30(b)(2)(i) of Regulation S-P requires covered institutions that maintain or possess information derived from consumer reports for a business purpose to take reasonable measures to guard against access to such information by unauthorized persons when disposing of it. The new requirements apply to registered investment advisers, investment companies, registered transfer agents, and broker-dealers, except for futures commission merchants and introducing broker-dealers that are in compliance with the financial privacy rules of the Commodity Futures Trading

[1] FACT Act § 216 (codified at 15 U.S.C. 1681w(a)(1)). A consumer report is defined by the FACT Act as any written, oral, or other communication of any information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumer's eligibility for (a) credit or insurance to be used primarily for personal, family, or household purposes;(b) employment purposes; or (c) any other purpose authorized under 15 U.S.C. 1681b.

Commission ("covered entities"). Private funds that are excepted from the Investment Company Act of 1940 pursuant to Section 3(c) thereof are not covered.

In the Adopting Release[2], the SEC made clear that the disposal rule does not require covered entities to ensure perfect destruction of consumer information in every instance in order to avoid unauthorized access. Rather, the new rule simply requires covered entities to adopt disposal measures that are *reasonable*.

In order to aid covered entities in determining what methods are reasonable, the SEC provided examples of disposal procedures:

- Adopting policies that require the destruction of papers containing consumer information through burning, pulverizing or shredding, and monitoring employee compliance with such policies
- Adopting policies that require the destruction or erasing of electronic documents that contain consumer information, and monitoring employee compliance with such policies
- Performing due diligence and subsequently entering into a contract with a company that is in the business of disposing of consumer information in a manner consistent with the disposal rule
- For covered entities that maintain or possess consumer information as a result of providing services to other covered entities, adopting policies to protect against the unintentional or unauthorized disposal of such information
- For covered entities subject to the GLBA and Regulation S-P, incorporating any new disposal policies into existing safeguard policies and procedures

The SEC also noted that the aforementioned policies are only examples, and that each covered entity must evaluate what is appropriate for such entity in consideration of company size and complexity of operations.

New rule 30(b)(2)(ii) makes clear that the new disposal rules are not intended to require that persons maintain or destroy any records, nor are they intended to alter any rules under any other provisions of law that require the maintenance or destruction of such records; rather the new rules only require that when covered entities do destroy records, they do so in a reasonable manner.

Rule 30(a)

Previously, Regulation S-P did not require entities subject to it to have their safeguard policies and procedures in writing. The Adopting Release noted that not having such procedures in writing made it difficult for the SEC to test for compliance. Accordingly, rule 30(a) requires that all safeguard policies and procedures, including disposal policies, be in writing.

Compliance Deadline

The effective date of the amendments to Regulation S-P was January 11, 2005. For covered entities that have existing contracts with service providers, the compliance date is July 1, 2006. For all other covered entities, the compliance date is July 1, 2005. Covered entities without pre-existing service provider contracts should adopt written disposal policies and have all other safeguarding procedures in writing in advance of the July 1 deadline. Covered entities with pre-existing contracts should negotiate changes with their service providers so as to bring such contracts into compliance with the amendments by July 1, 2006.

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[2] Disposal of Consumer Report Information, Exchange Act Release No. 50781 (Dec. 2, 2004).

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