# Regulatory Notice 07-36

## Supervision of Recommendations after a Registered Representative Changes Firms

### FINRA Clarifies Guidance Relating to SEC Regulation S-P under Notice to Members 07-06 (Special Considerations When Supervising Recommendations of Newly Associated Registered Representatives to Replace Mutual Funds and Variable Products)

### Executive Summary


In February 2007, FINRA (f/k/a NASD) issued *NTM 07-06*, which describes special considerations firms should use to supervise recommendations of newly hired registered representatives to replace mutual funds and variable products. This *Notice* clarifies the guidance in *NTM 07-06* regarding SEC Regulation S-P.


Questions concerning this *Notice* should be directed to Patricia Albrecht, Assistant General Counsel, Office of General Counsel, at (202) 728-8026; or Kosha K. Dalal, Associate General Counsel, Office of General Counsel, at (202) 728-6903.

**August 2007**

Notice Type

- Guidance

Suggested Routing

- Compliance
- Executive Representatives
- Legal
- Operations
- Senior Management

Key Topic(s)

- SEC Regulation S-P
- Mutual Funds
- Registered Representatives
- Supervision
- Variable Products

Referenced Rules & Notices

- NTM 07-06
- SEC Regulation S-P

Financial Industry Regulatory Authority

## Background and Discussion

As stated in *Notice to Members (NTM) 07-06,* registered representatives with an established customer base may change their association from one firm to another from time to time, and may wish to bring with them customer assets, including mutual funds and variable products. However, there may be impediments to the representative's ability to continue servicing or selling these investments, as well as receiving trail commissions from the sponsor for products the representative previously serviced or sold, such as the new firm not having a dealer or servicing agreement with the product sponsor or the products being proprietary to the prior firm. In such cases, *NTM 07-06* states that representatives may be tempted to recommend to customers that they replace their existing mutual funds or variable products with other investments, without adequately considering the customer's best interests and the suitability for the customer of those recommendations.

As a result, the *NTM* recommends that firms should have procedures in place, including supervisory procedures, that are specifically designed to review and evaluate investment recommendations relating to mutual funds and variable products that are made by newly associated persons to their existing customers. Specifically, the *NTM* recommends that these procedures provide that when a firm conducts due diligence concerning a prospective new registered representative, the new firm should seek to learn the nature of the representative's business and the extent to which he or she offers investment products for which the new firm would need a dealer or servicing agreement in order for the representative to sell and provide service.

Some firms have questioned the scope of due diligence described in the *NTM,* and have specifically asked whether any such due diligence procedures may conflict with a firm's obligations under SEC Regulation S-P (Privacy of Consumer Financial Information), which imposes restrictions on the ability of financial institutions to disclose or share nonpublic personal information about consumers.[1] The obligations set forth in *NTM 07-06* do not conflict with a firm's obligations under SEC Regulation S-P. Indeed, in establishing due diligence procedures, *NTM 07-06* does not recommend, nor does it suggest, that a firm obtain nonpublic personal information about any customers the prospective registered representative may seek to bring to the new firm. FINRA expects firms to keep in mind that the goal of such due diligence procedures is for the firm and its prospective new registered representative to understand the extent to which there exist mutual funds and variable products currently held in the representative's customer accounts that may not be serviced or sold by the new firm.

Therefore, in conducting reasonable due diligence of the prospective registered representative's customer base, the new firm needs to learn only the identity of the various mutual fund and variable products held by the registered representative's customer base. Detailed, nonpublic, personal information about individual customers and their particular investments is not necessary or relevant to meet the objectives of this review. Finally, it is incumbent upon firms to educate their prospective representatives in understanding that a change of employment is not by itself a suitable basis for recommending a switch from one product to another and to supervise with respect to such conduct.

## Endnote

1 17 CFR Part 248; Release No. 34-42974.