

Regulation S-AM: Limitations on Affiliate Marketing

SUPPORTING STATEMENT

A. Justification

1. Necessity for the Information Collection

a. Background

Section 214 of the Fair and Accurate Credit Transactions Act of 2003 (“FACT Act”) requires that consumers must be given notice and an opportunity to opt out before a company makes marketing solicitations to them based on the communication of certain personal financial information by an affiliated company. The FACT Act required the Federal Trade Commission, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the Secretary of the Treasury, and the National Credit Union Administration (collectively, the “Agencies”), as well as the Securities and Exchange Commission (“Commission”), to prescribe regulations necessary to implement the purposes of Section 214. As required by the FACT Act, the rules proposed in Regulation S-AM are, to the extent possible, consistent with and comparable to the rules proposed by the Agencies.

b. Proposed Collections of Information

Regulation S-AM implements the requirements of Section 214 as applied to brokers, dealers, and investment companies, as well as investment advisers and transfer agents that are registered with the Commission (collectively, “Covered Persons”). As directed by Section 214, before a receiving affiliate may make marketing solicitations based on the communication of certain consumer financial information (“eligibility information”) from a Covered Person, the Covered Person must provide a notice to each affected individual informing the individual of his or her right to prohibit such marketing. In addition, as a practical matter, one or both affiliates would need to keep records of any opt-out elections in order for the opt-outs to be effective. The opt-out period must last at least five years. At the end of the opt-out period, the consumer must be provided with an expiration notice and a new chance to opt out before the receiving affiliate may resume making marketing solicitations based on the consumer’s eligibility information.

Notice and opt-out are only required if a Covered Person communicates information to an affiliate for use in marketing solicitations. Covered Persons that do not have affiliates, or whose affiliates do not make marketing solicitations based on the communication of eligibility information, would not be required to provide notice and opt-out. The proposed rules contain a number of other exceptions as directed by Section 214, such as where the affiliate has a pre-existing business relationship with the consumer or where the consumer requests marketing information.

c. Necessity of the Collections of Information

Proposed Regulation S-AM is necessary to implement Section 214 of the FACT Act as directed by Congress. In drafting the proposed rules, the Commission and the Agencies attempted to retain procedural flexibility and to minimize compliance burdens except as required by the terms of the FACT Act. The Agencies believe that the proposed rules do not impose significant burdens in excess of the statutory requirements.

2. Purposes of, and Consequences of Not Requiring, the Information Collection

The proposed rules would require that consumers be provided with notice and an opportunity to opt out of receiving marketing solicitations that are based on the communication of eligibility information between affiliates. The notice and opt-out requirements are designed to benefit consumers by enabling them to limit certain marketing solicitations from affiliated companies. The collection of information is required by Congress pursuant to Section 214 of the FACT Act.

3. Role of Improved Information Technology and Obstacles to Reducing Burden

In general, improved information technology would not reduce the burdens associated with Regulation S-AM. However, notices may be delivered electronically to consumers who have agreed to the electronic delivery of information.

4. Efforts to Identify Duplication

Regulation S-P (17 CFR 248.1 *et seq.*) and the Fair Credit Reporting Act both contain provisions related to the *sharing* of consumer credit information between affiliates. However, no other rule addresses affiliate marketing practices with respect to Covered Persons.

5. Effect on Small Entities

Small entities would not be required to provide notice and opt-out if they do not have affiliates or if they do not engage in the types of affiliate marketing practices covered by the proposed rules. Even where notice and opt-out is required, smaller entities should not be subject to any disproportionate burden.

6. Consequences of Less Frequent Collection

The notice and opt-out need only be given once, before affiliate marketing may begin. Less frequent reports would not be viable because this initial reporting requirement is established by Section 214 of the FACT Act.

7. Inconsistencies with Guidelines in 5 CFR 320.5(d)(2)

Not applicable; the information is collected in a manner consistent with 5 CFR 1320.5(d)(2).

8. Consultations Outside the Agency

All Commission rule proposals are published in the Federal Register for a comment period lasting at least 30 days. This comment period allows the public an opportunity to respond to the proposal. As directed by the FACT Act, the Commission worked closely with the Agencies to ensure that the proposed affiliate marketing rules were consistent with and comparable to one another.

9. Payment or Gift to Respondents

Not applicable.

10. Assurances of Confidentiality

Not applicable; no assurances of confidentiality are provided.

11. Sensitive Questions

Not applicable; no questions of a sensitive nature are asked.

12. Estimate of Respondent Reporting Burden

a. One-Time Review Burden

According to Commission filings, there are approximately 6,016 broker-dealers, 4,920 investment companies, 10,669 registered investment advisers, and 501 registered transfer agents that could be subject to the proposed rules, for a total of approximately 22,106 Covered Persons. However, the notice and opt-out requirements would not apply to Covered Persons that do not have a corporate affiliate, and the Commission has estimated that only 70% of Covered Persons, or approximately 15,474 entities, have affiliates. Every Covered Person that has one or more affiliates would incur a one-time burden of reviewing its policies and business practices to determine the extent to which it communicates eligibility information to affiliates for marketing purposes and whether those affiliates make marketing solicitations based on the communication of that eligibility information. This determination should be straightforward for most entities, in part because privacy regulations already require Covered Persons to review their information sharing practices and to disclose whether they share information with affiliates.¹ The amount of time required to review their policies would vary widely, from a few minutes for companies that do not share eligibility information with affiliates to 4 hours or more for affiliated persons with more complex information sharing arrangements. The Commission has estimated that each affected Covered Person would require 1 hour on average to review its policies and practices, for a total one-time burden of 15,474 hours.

b. Initial Notice and Opt-Out Burdens

¹ See 17 CFR 248.6(a)(3).

Only a fraction of all Covered Persons would be required to provide notice and opt-out to consumers. First, the proposed rules only apply to Covered Persons that have affiliates, and then only if receiving affiliates make marketing solicitations based on the communication of eligibility information. The proposed rules also contain a number of exceptions to the notice and opt-out requirements. Moreover, even if notice is required, the proposed rules allow all affiliates within a common corporate family to provide a single, joint notice, and Covered Persons that are required to provide affiliate marketing notices could be covered by the notice sent by one or more affiliates and would not be required to provide the notice independently. In light of these factors, the Commission has estimated that approximately 10% of Covered Persons, or 2,211 respondents, would be required to provide consumers with notice and an opt-out opportunity under the proposed rules.

The notice and opt-out process would consist of several steps. First, the Covered Person would need to create an affiliate marketing notice. The amount of time required to develop a notice should be reduced significantly by the inclusion of model forms in the proposed rules. Second, the notices would need to be delivered. The proposed rules allow that affiliate marketing notices could be combined with any other notice or disclosure required by law, and the Commission expects that most persons subject to proposed Regulation S-AM would combine their affiliate marketing notices with some other form of communication. Because those communications are already delivered to consumers, adding a brief affiliate marketing notice should not result in added costs for processing or for postage and materials. Third, as a practical matter, persons subject to proposed Regulation S-AM would need to keep accurate records in order to honor any opt-out elections and to track the expiration of the opt-out period. The Commission cannot estimate with precision the number of actual notice mailings in any given year because that total would depend on the number of consumers who do business with each Covered Person. The Commission has estimated that the hour burden for developing, sending, and tracking the opt-out notices would range from 2-20 hours, with an average of 6 hours for each of the affected entities (13,266 hours total).

c. Initial and Annual Burdens Related to Future Notices and Opt-Outs

Because the notice and opt-out requirements represent a prerequisite to covered forms of affiliate marketing, most Covered Persons would provide notice within the first year after compliance with the proposed regulations would be required. However, additional notices may be required on a smaller scale as new customer relationships are formed. The Commission has predicted that many Covered Persons would ensure delivery to new consumers with a minimum of additional effort by integrating the notices as a permanent part of account opening documents, initial privacy notices under the Gramm-Leach-Bliley Act, or some other form of regular communication. Accordingly, the Commission has estimated a one-time average burden of 2 hours for Covered Persons to create the notices (4,422 hours total) and an ongoing annual burden of 2 hours per year (4, 422 hours total) to deliver the notices to new consumers and to record any opt-outs.

d. Future Burdens

A consumer opt-out may expire at the end of five years, but the Covered Person that provided the initial notice must provide the consumer with renewed notice and an opportunity to extend his or her opt-out election before any affiliate marketing may begin. Designing, sending, and recording opt-out extensions notices would require additional hours and costs. However, any burden related to these extension notices would not arise within the first five years of the collection of information.

e. Total Burdens

In sum, the Commission has estimated that each of the approximately 15,474 Covered Persons having one or more affiliates would require an average one-time burden of 1 hour to review affiliate marketing practices (15,474 hours total). The majority of this review would take place at a managerial level, with an estimated staff cost of \$231 per hour (this figure is based on a national hourly rate of \$245 for a Compliance Manager from the SIA's *Report on Management & Professional Earnings in the Securities Industry 2006*, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead), for a total cost of approximately \$3,791,130 (15,474 x \$245). Approximately 2,211 Covered Persons would be required to provide notice and opt-out and would incur an average first-year burden of 6 hours in doing so, for a total estimated first-year burden of 13,266 hours. The staff time required to fulfill this task would be divided between senior staff, computer professionals, and secretarial staff, with some review by legal professionals. At an estimated average cost of \$189.25 per hour (this figure is based on the averages of a national hour rate of \$269 for a Sr. Database Administrator, \$209 for a Programmer Analyst, and \$261 for a Compliance Attorney from the SIA's *Report on Management & Professional Earnings in the Securities Industry 2006*, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, and a national hourly rate of \$59 for a Secretary from the SIA's *Report on Management & Professional Earnings in the Securities Industry 2006*, modified to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, a division of the 6 hours into 1.75 hours of a Sr. Database Administrator's time (at a cost of \$470.75 (\$269 x 1.75)), 1.75 hours of a Programmer Analyst's time (at a cost of \$365.75 (\$209 x 1.75)), 1.75 hours of a Secretary's time (at a cost of \$103.25 (\$59 x 1.75)) and 0.75 hours of a Compliance Attorney's time (at a cost of \$195.75 (\$261 x 0.75)), and a total cost for the 6 hours of \$1,135.50 (\$470.75 + \$365.75 + \$103.25 + \$195.75), for an average hourly cost of \$189.25 (\$1,135.50/6)) the total would be \$2,510,590.50 (13,266 x \$189.25). With regard to continuing notice burdens, each of the approximately 2,211 Covered Persons required to provide notice and opt-out would incur a one-time first-year burden of 2 hours to develop notices for new consumers (4,422 hours total) and an annual burden of 2 hours to deliver the notices and record any opt-outs (4,422 hours total). Assuming the same average staff cost of \$189.25 per hour, these collections of information would cost an estimated \$1,673,727 (8,844 x \$189.25). All together, these estimates would represent a total one-time burden of 15,474 hours, a total first-year burden of 17,688 hours (13,266 hours for initial notices and 4,422 hours for future notices), and an ongoing annual burden of 4,422 hours. Averaged across the first three years for which compliance would be required, the total average yearly burden would be approximately 12,528 hours ((15,474 + 17,688 + 4,422)/3) and \$7,975,447.50 in staff costs ((\$3,791,130 + \$2,510,590.50 + \$1,673,727)/3).

13. Estimate of Total Annualized Cost Burden

Other than the staff costs discussed in Item 12 above, Regulation S-AM does not impose any additional start-up or materials costs.

14. Estimate of Cost to the Federal Government

Not applicable; Regulation S-AM requires public notice rather than government reporting.

15. Explanation of Changes in Burden

Not applicable; Regulation S-AM would represent new rules.

16. Information Collections Planned for Statistical Purposes

Not applicable.

17. Explanation as to Why Expiration Date Will Not Be Displayed

Not applicable.

18. Exceptions to Certification

Not applicable.

B. Collections of Information Employing Statistical Methods

Not applicable. The collections of information do not employ statistical methods, nor would the implementation of such methods reduce the burdens or improve the accuracy of results.