

Subcommittee on Government Management, Information and Technology  
Committee on Government Reform  
U.S. House of Representatives

**THE PRIVACY COMMISSION:  
AN EXAMINATION OF PRIVACY PROTECTION**

Professor Fred H. Cate

on behalf of the

Financial Services Coordinating Council

April 12, 2000

Mr. Chairman and Members of the Subcommittee:

My name is Fred Cate, and I am a Professor of Law, Harry T. Ice Faculty Fellow, and Director of the Information Law and Commerce Institute at the University of Indiana School of Law—Bloomington. For more than a decade, I have researched, taught, and written about information law issues generally, and information privacy specifically.<sup>1</sup> I am appearing today on behalf of the Financial Services Coordinating Council, for which I recently completed a research report on *Personal Information in Financial Services: The Value of a Balanced Flow*. The FSCC is an alliance of the principal, national trade organizations in each of the financial service sectors, formed to address issues which cut across financial industry lines. Its members are the American Banker's Association, the American Council of Life Insurers, the American Insurance Association, the Investment Company Institute, and the Securities Industry Association. The FSCC is pleased to be able to present its views on H.R. 4049, the Privacy Commission Act.

There is obviously a great deal of consumer concern over privacy issues. That concern touches on many issues—ranging from identity theft, credit card fraud, and other criminal uses of personal information, to complaints about telemarketing calls during the dinner hour, seemingly endless solicitations from charities, and so-called “cookies” used by websites to track the habits of internet users; many types of information—ranging from sensitive medical information to video rental records; and

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<sup>1</sup>A biographical statement is attached. In compliance with House Rule XI, clause 2(g)(4), I certify that I have received no federal grant, contract, or subcontract in the preceding two fiscal years.

many users of information—public and private, foreign and domestic, disclosed and undisclosed. In short, there are a wide variety of distinct consumer concerns and contexts involved in the current privacy debate.

However, we wish to highlight two important points that we believe the subcommittee should bear in mind as it considers the constitution and activities of the proposed privacy commission.

### **Financial Privacy Provisions**

First, one important set of privacy issues—those surrounding the use of personal financial information by financial institutions—has recently been subjected to intensive congressional review. Just last November, as part of the Gramm-Leach-Bliley Financial Modernization Act, Congress adopted sweeping new privacy protections for customers of the nation’s financial institutions. These new provisions supplement and broaden earlier-enacted privacy provisions—contained in the Fair Credit Reporting Act, the Fair Credit Billing Act, and in state insurance privacy statutes—to subject banks, insurers and securities firms, whether operating individually or as part of diversified financial entities, to the most extensive privacy restrictions ever enacted at the federal level.

In addition, the federal banking and securities regulators, in consultation with state insurance regulators, have proposed expansive regulations to implement the new privacy requirements. These regulations will become final on May 12 of this year. Six months later, on November 12, the full package of statutory requirements and regulations will go into effect.

Briefly, the major provisions of Gramm-Leach-Bliley are as follows:

- Financial institutions must adopt policies on the collection and use of non-public personal financial information and must disclose such policies to their customers at the time the customer relationship is established and at least annually thereafter.
- The notice must specify the types of information collected and the types of entities, whether affiliates of third parties, to which the institution would propose to disclose such information.
- There must be a “clear and conspicuous” notice of the customer’s right to “opt-out”, or prevent the disclosure of his or her personal financial information to

unaffiliated third parties. (To answer criticisms of some previous uses of the opt-out which were deemed to place an unreasonable burden on consumers to be exercised, the regulations also require that this opt-out provision be easy to exercise, as with a pre-addressed card, a click-through screen or a toll-free number.)

- Financial institutions are prohibited from disclosing customer credit card numbers and other account number information to unrelated third parties for marketing purposes.
- Financial institutions are required to initiate procedures to protect the security and confidentiality of their customer's non-public personal information in conformance with the new standards established in the bill.
- Identity theft and obtaining personal information under false pretenses are made federal crimes.

These are not insignificant mandates. As a result of Gramm-Leach-Bliley, financial institutions will bear the most extensive obligations with regard to the privacy of personal, non-public information of any type of business.

The privacy provisions of Gramm-Leach-Bliley provide real protection to consumers, but come at a price. As we are beginning to realize, implementation and compliance with these provisions are going to be complicated and time-consuming and will entail significant costs, not just for those financial institutions that choose to affiliate, but for all of them. Approximately forty thousand financial institutions will be sending as many as two and a half billion notices to their various customers by December 12. Estimates are that individual households will receive an average of twenty notices each. Printing and mailing costs alone will be in the hundreds of millions of dollars, if not more.

These disclosures will just be the tip of the iceberg. The costs of establishing privacy policies, training employees, setting up internal mechanisms to coordinate differing information systems between subsidiaries and segregating the information of those that opt-out will also be high. So will establishing new security systems and systems for monitoring overall compliance with the Act. The more subsidiary operations a company has—and many diversified financial companies have scores of affiliates—the more complex the task will be.

Enforcement by the regulatory agencies will be no less complicated or burdensome. They know they will be operating under the glare of Congress and the public to make sure the intent of the bill is carried out, and this is a huge undertaking for them as well. And it is important to remember that the costs of implementing, complying with, and overseeing these new regulations will be borne by consumers, as well as by business and government.

In order to gauge the effectiveness of these new measures in protecting the financial privacy of consumers, Gramm-Leach-Bliley also requires the Department of the Treasury to conduct a comprehensive study of information-sharing practices among financial institutions and their affiliates and report back to Congress by January 1, 2002.

For this reason, while we do not oppose the creation of a privacy study commission as envisioned by H. R. 4049, we believe that, in the area of financial privacy, it would largely duplicate the Treasury study Congress directed just six months ago. Even so, we are confident that with the Gramm-Leach-Bliley privacy provisions in force and fully implemented by the financial institutions regulators, the financial services industry would receive an excellent report card. Relatedly, if the Subcommittee determines to move forward with H.R. 4049, we would urge that the bill specifically include financial industry representatives among the commission members, both because of the importance and widespread use of financial information and to take advantage of the considerable experience this industry has developed and is in the process of expanding in implementing federal regulations and self-regulatory measures to enhance consumer privacy.

### **The Beneficial Uses of Personal Information by Financial Institutions**

The second consideration we would urge the Subcommittee to consider when constituting and charging the privacy commission is the critical need for balancing legitimate privacy interests with the responsible, productive use of personal information. The financial services industry has extensive experience with achieving this balance, the need for which was the subject of my report, *Personal Information in Financial Services: The Value of a Balanced Flow*, that the FSCC recently published. The privacy provisions of Gramm-Leach-Bliley were intended to protect the legitimate privacy concerns of consumers while at the same time preserving the benefits to consumers, as well as to businesses and the economy as a whole, that responsible information-sharing produces. In examining the privacy issue, however, it has become all too easy for industry critics to lose sight of the benefits side of the equation.

Most financial institutions recognize that the most valuable resource they hold is public trust. Historically, the focus of the financial services industry's trust relationship with customers has been on the responsible handling of information—protecting against unnecessary disclosure or fraudulent use, ensuring the accuracy and security of that information, and using information productively—so that the customer benefits. Few customers commit their personal information to financial institutions without the expectation of personal benefit: interest on a savings account, money to buy a house or car, insurance against unanticipated loss, gains in the stock market to provide for a comfortable retirement.

The responsible use of information to serve the needs of customers is the very definition of the trust relationship that financial institutions have such a long history of achieving and it is exactly what most people expect of the financial services industry. It is the balance between respect for personal information and its responsible, productive use that has yielded exceptional benefits for consumers and contributed to the longest sustained economic growth in modern history. Opt-in legislation and limits on affiliate-sharing threaten to destroy that balance, and with it the many benefits that have resulted from responsible information use and the economic prosperity to which that use has contributed.

The importance of information-sharing in the modern American economy cannot be overstated. The rapid and reliable availability of accurate and complete personal information is essential to—it is no exaggeration to say that it is the very foundation of—virtually all financial services. The benefits of responsible information-sharing include:

**Improving the Speed, Availability, and Affordability of Credit and Other Financial Services.** The almost universal reporting of personal information about consumers is the foundation of consumer financial services in the United States and, in the words of economist Walter Kitchenman, a “secret ingredient of the U.S. economy’s resilience.” The responsible use of personal information enhances the speed of credit, insurance, and many other financial services decisions; reduces the cost of virtually all financial services; gives consumers real choices; facilitates consumer mobility; and “democratizes” opportunities.

**Providing Efficient, Reliable Service.** The sharing of personal information is essential to the services that financial institutions provide to their customers. In fact, many transactions performed today by financial institutions require access to customer information across affiliates. For example, debit and credit card transactions, one-stop-shopping, consolidated statements and customer service, and

comparison-shopping for insurance and investments all require standardized, reliable sharing of customer information.

**Identifying and Meeting Customer Needs.** Information-sharing allows financial institutions to provide their customers with tailored services that recognize and respond to their individual needs. Financial institutions notify customers who maintain high balances in checking accounts of the availability of higher return investments; analyze customer data to protect customers against inappropriately risky investments; offer customers with recurring credit card balances lower-interest home equity loans; provide customers with bundled services at a single lower price; aggregate all of a customer's accounts to satisfy minimum balance requirements; make instant decisions whether to increase credit lines; create new investment and insurance products; and offer co-branded products, such as affinity credit cards. These uses of data allow the institution to provide customers with valuable, targeted opportunities.

**Informing Consumers of New Opportunities.** Financial institutions use their own information, as well as data from public records and other sources, to inform consumers most likely to be interested in new products and services. Target marketing dramatically reduces the cost of soliciting customers, thereby lowering their costs and improving the likelihood that a customer will in fact be interested in the service or product; reduces the impact on the environment; and allows new and smaller businesses to compete more effectively with well-established competitors.

**Preventing and Detecting Fraud.** The financial services industry uses personal information to prevent and detect fraud, recognize atypical behavior that may signal unauthorized credit card or debit card use, share information about lost or stolen cards with affiliates, reduce fraudulent insurance applications and claims, recover stolen funds, and deter money laundering.

**Ensuring Solvency and Facilitating Safety.** Access to customer information helps ensure the solvency of the U.S. financial services industry. That information helps companies innovate, attract customers with new services and products, control costs, target market, prevent and detect fraud, make better decisions about loans and credit opportunities and avoid delinquencies and bad debts. In short, access to personal information, in the words of Federal Reserve Board Chairman Alan Greenspan, makes individual financial institutions "more creditworthy and efficient," and the U.S. financial services sector "more transparent and stronger in general."

Responsible information-sharing also facilitates compliance with legal obligations. Regulators and auditors use standardized data to identify unusual transactions and accounts, evaluate the risk associated with different portfolios, and compare institutions and portfolios nationwide. Internally, many financial institutions centralize their compliance activities in a central unit, responsible directly to the CEO or President. This helps ensure effective oversight across all affiliates and guarantee the independence of institution officials responsible for compliance.

**Improving Efficiency and Lowering Costs.** Financial institutions rely on personal information to operate more efficiently and reduce costs to consumers. Affiliated companies can combine their data systems and operations, thereby acquiring information systems more cost-effectively, avoiding the costs of maintaining redundant systems, and employing fewer technicians. Information-sharing also allows financial institutions to outsource many basic business operations, such as customer account servicing, records management, claims administration, auditing, check-printing, and certain compliance functions. Integrated data systems and third-party contractors offer enhanced services, customer convenience, and lower costs.

**Serving the Underserved.** The many services that financial institutions use information to provide are especially important for middle- and lower-income Americans. The middle class and previously unserved or underserved populations benefit most directly from lower financial services prices, the dramatic expansion of financial services, 24-hour online banking, reduced transaction costs of stock purchases and other investments, consolidated statements and service centers, universally accepted credit and debit cards, instant credit, and the creation and marketing of new investment products. Market-wide information sharing allows for a vibrant reinsurance market, which permits broader sharing of previously unacceptable risk. As a result, many Americans who were previously thought uninsurable, today can obtain reasonably priced policies. Information-sharing has allowed the financial services industry to deliver benefits to those Americans who need them most.

**Promoting Competition and Helping Small Companies.** New and smaller financial institutions—such as community banks, independent insurance agents, and Internet brokerage services—use accessible personal information to compete more effectively with larger companies. Target marketing allows companies without extensive customer lists of their own or the resources to engage in mass marketing, to reach customers most likely to be interested in their products or services. The ability to outsource information processing and marketing tasks permits companies to manage data effectively without investing in expensive information systems and personnel. Data-sharing allows new companies to emerge that specialize in single

financial services products or services. Similarly, data-sharing is a prerequisite for independent agents and brokers, who offer their clients a wide range of products of services offered by many different companies. Enhanced competition increases opportunities for customers and reduces prices.

**Facilitating E-Commerce and Innovation.** Responsible information-sharing facilitates innovation in financial services and products and the ways in which they are provided to customers. In addition, one of the largest components of electronic commerce in the United States today is in the field of financial services. Online stock trades, insurance applications, and banking services—effectively all digital financial services—require sharing information.

To provide all of these and other opportunities, access to data is essential. Laws restricting affiliate-sharing or requiring ad hoc opt-in consent make the provision of these services, and the convenience and benefits they provide, untenable. It is no answer to condition these services and products on consumer consent, because it is impractical and prohibitively expensive to build and operate the systems that compare data in literally millions of accounts on an ad hoc basis. Virtually all of these information uses depend upon the routine availability of standardized, reliable, complete data. Moreover, the sheer cost of seeking consent would act as a dramatic disincentive to investing in innovation.

This does not mean that privacy is unimportant or unprotected, but rather that it must be balanced—as consumers do everyday—with the benefits that flow from the responsible use of personal information. The privacy commission’s important work will be better served if the commission is constituted to include members who are knowledgeable about and experienced in not only privacy, but also the value that flows from responsible use of personal information and the costs—to both business and consumers—of overprotecting or inappropriately protecting privacy.

## **Conclusion**

In closing, I want to re-emphasize that the financial services industry is committed to protecting the privacy of customer financial information in full compliance with the requirements of the Gramm-Leach-Bliley Act. The FSCC believes that, in combination with existing privacy requirements under other laws, these new provisions provide financial institution customers with more extensive privacy protections than customers of any other industry. Finally, should the decision be made to move forward with H.R. 4049, we strongly urge the Subcommittee to

recognize the need for the proposed privacy commission to take a balanced approach to the issue of information-sharing, cognizant of the recent legislation and ongoing rulemaking proceedings concerning financial information and of the substantial benefits which responsible information-sharing produces.

Thank you.

## FRED H. CATE

Fred H. Cate is a professor of law, Harry T. Ice Faculty Fellow, and director of the Information Law and Commerce Institute at the Indiana University School of Law—Bloomington, and senior counsel for information law in the Indianapolis law firm of Ice Miller Donadio & Ryan.

Professor Cate is an internationally recognized authority on privacy and other information law issues. He has testified before Congress on financial privacy and privacy in electronic communications. He is a member of the Federal Trade Commission's Advisory Committee on Online Access and Security and vice chair of the American Bar Association Section on Health Law's Electronic Communications and Privacy Interest Group. He directed the Electronic Information Privacy and Commerce Study for the Brookings Institution and served as a member of Indiana Governor Frank O'Bannon's Public Access Task Force. He currently chairs the International Telecommunication Union's High-Level Experts on Electronic Signatures and Certification Authorities and directs the American Institute for Contemporary German Studies' project on German-U.S. electronic commerce.

Professor Cate is the author of many articles and books concerning privacy and information law, including the award-winning *Privacy in the Information Age* and *The Internet and the First Amendment*. He is the editor of *Visions of the First Amendment for a New Millennium* and the sixth edition of the best-selling *Mass Media Law* (with Marc Franklin and David Anderson), and the co-author (with Richard Varn) of *The Public Record: Information Privacy and Access—A New Framework for Finding the Balance*. He recently completed work on the and a volume of essays on privacy law in the United States and Europe (with Lucien Rapp).

Professor Cate writes widely for the popular press and has appeared on CNN, PBS, and many local television and radio programs. He received his J.D. and his A.B. with Honors and Distinction from Stanford University. A member of the boards of trustees of Phi Beta Kappa Fellows and of National History Day, Cate is listed in *Who's Who in American Law*.

He may be contacted at the Indiana University School of Law—Bloomington, 211 South Indiana Avenue, Bloomington, IN 47405-7001, telephone (812) 855-1161, facsimile (812) 855-0555, [fcate@indiana.edu](mailto:fcate@indiana.edu).