

CALIFORNIA STATE ASSEMBLY
COMMITTEE ON INSURANCE
INFORMATIONAL HEARING

TESTIMONY OF

GILBERT T. SCHWARTZ

ON

THE GRAMM-LEACH-BLILEY ACT AND ISSUES RELATING TO THE
COLLECTION AND SHARING OF CONFIDENTIAL CONSUMER INFORMATION

BY THE INSURANCE INDUSTRY

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Chair Vargas, Vice Chair Maddox and Members of the Committee:

I am pleased to appear before the Committee today to discuss the Gramm-Leach-Bliley Act and issues relating to the collection and sharing of confidential consumer information by the insurance industry.

The issue of preserving the confidentiality of customer information is a vitally important matter. It is important not only to the citizens of this great State, but also to insurers and other financial institutions that provide critically important services to California consumers. I was involved in the deliberations that led up to Congress's enactment of the Gramm-Leach-Bliley Act (the "GLB Act"), and I have continued to play an active role in the subsequent debate on behalf of our financial institution clients.

I want to make a few basic observations that I hope you will keep in mind during the course of your discussions today.

INFORMATION SHARING AND THE GRAMM-LEACH-BLILEY ACT

The GLB Act represents a delicate balancing of consumer interests and the needs of financial institutions.

The GLB Act establishes a comprehensive, uniform approach to protecting the privacy of all Americans. It protects the privacy of consumers while preserving the ability of our nation's financial institutions to conduct their business and continue to develop new products and services. One of the major objectives of Congress in enacting the GLB Act was to provide consumers with the opportunity to understand what policies financial institutions follow regarding the sharing of their personal information. At the same time, Congress recognized the importance information flows play in our economy. Congress did not want to interfere with the customary operational needs of financial institutions. As a result, Congress struck a delicate balance. It chose to preserve the ability of institutions to compete on a level playing field in the financial services arena. Congress also empowered consumers to take control by requiring financial institutions to provide customers with information regarding their privacy policies and leaving it to consumers, under appropriate circumstances, to choose whether or not to permit financial institutions with which they do business to share their personal information.

U.S. financial institutions rely on information flows to develop and deliver products and services to consumers.

The world looks to U.S. financial markets and financial institutions as a wellspring for new products and services. Our financial institutions are constantly inventing new products and services, and improving the existing ones. The creative genius of our financial industry is based upon the continued ability to obtain and use information. The GLB Act recognizes that information is the lifeblood of all financial institutions. Insurance companies, banks and securities firms cannot develop and offer products and services unless they can collect information from customers to determine their needs. For example, innovations in the use of fixed and variable annuities are based upon information gleaned from customer use of insurance products. The GLB Act fosters the continued development of ideas by enabling financial institutions to collect and use information so that they can continue to serve their customers' needs.

The GLB Act accommodates evolving technologies by providing clear rules concerning the circumstances under which a financial institution may share customer information with service providers, and limits the ability of service providers to use such information. It recognizes that insurance companies, bank, securities firms and other financial institutions cannot provide products and services to their customers unless they can use information they have to process their customers' transactions. The reality of today's financial services industry is that financial institutions rely heavily upon third party service providers to facilitate the delivery of products and services to customers. In many instances there is little reason for companies to replicate infrastructure that is required to perform every element involved in the product delivery channel. For example, many insurers have concluded that it makes good sense for them to use unaffiliated third parties to process claims of their policyholders and others.

Making use of third party service providers also enables smaller financial institutions to compete with larger institutions in attracting customers. For example, a few years ago only large financial institutions could offer services through the Internet. Today, however, by using vendors to provide front-end and back-end processing, virtually every financial service provider is in a position to offer its products and services to customers through the Internet. Now, you can obtain premium quotes from dozens of insurance companies and complete the purchase over the Internet. I am certain everyone here is familiar with the convenience of Internet banking and the ability to obtain instantaneous stock quotations. These advances in product offerings came about as a result of information sharing.

The GLB Act requires financial institutions to protect customer information

The GLB Act also recognizes how important it is to protect customer information. The Act requires financial institutions to adopt policies and procedures to protect and safeguard customer information from inadvertent disclosures or improper attempts by third parties to obtain customer information. The Federal agencies with supervisory authority over financial institutions have adopted comprehensive regulations implementing the GLB Act's privacy¹ and data security provisions.² In addition, many State insurance authorities have adopted comprehensive regulations that track the Federal rules. In fact, California's Insurance Commissioner recently adopted rules harmonizing the GLB Act and California's Insurance Information and Privacy Protection Act.³ California has also enacted legislation which requires companies whose data processing facilities have been breached to make certain disclosures to persons whose information may have been compromised.⁴

Financial institutions throughout the country have been complying with the GLB Act's privacy provisions since the rules became effective. Consumer surveys indicate that consumers are aware that financial institutions are required to protect customer information, including Social Security numbers, and that they may limit the ability of financial institutions to share such information with others.

The GLB Act also contains provisions making it a violation of law for a person to obtain, or attempt to obtain, customer information, such as Social Security numbers, from a financial institution by making a false, fictitious or fraudulent statement or representation to the financial institution. These provisions provide added protections to customers by prohibiting people from obtaining confidential customer information by means of pretext calling.

LEGISLATION SHOULD ADDRESS REAL PROBLEMS

One of the problems with some legislative proposals that have been presented to date is that they do not address actual problems that are of concern to consumers. Too much attention has been given to the areas of information sharing with affiliates,

¹ See 65 *Fed. Reg.* 35162 (June 1, 2000) (Office of the Comptroller of the Currency, Federal Reserve Board, Federal Deposit Insurance Corporation and Office of Thrift Supervision); 65 *Fed. Reg.* 40334 (June 29, 2000) (Securities and Exchange Commission); 65 *Fed. Reg.* 33646 (May 24, 2000) (Federal Trade Commission); and 65 *Fed. Reg.* 31722 (May 18, 2000) (National Credit Union Administration).

² See 66 *Fed. Reg.* 8615 (February 1, 2001) (Office of the Comptroller of the Currency, Federal Reserve Board, Federal Deposit Insurance Corporation and Office of Thrift Supervision); 66 *Fed. Reg.* 8152 (January 30, 2001) (National Credit Union Administration); and 67 *Fed. Reg.* 36484 (May 23, 2002) (Federal Trade Commission).

³ 10 Cal. Code of Regs. §§ 2689.1 *et seq.* (2003).

⁴ Cal. Civ. Code §§ 1798.29, 1798.82.

joint marketing and opt-in versus opt-out. Let me discuss why I think that focusing attention on those areas is misplaced.

The FCRA pre-empts State laws affecting information sharing with affiliates

The GLB Act does not address the sharing of information with affiliates. This was not an oversight by Congress. Affiliates are not covered by the GLB Act for several reasons. In many instances an affiliate is nothing more than a department of the company. Financial institutions may establish separate subsidiaries for reasons related to licensing, tax and organizational objectives. For example, in view of the state-oriented regulatory structure applicable to the insurance industry, it is commonplace for insurers to establish subsidiaries in different states. Information relating to policyholders, however, is often made available to affiliates in order to better serve customers. As a result, the sharing of information among affiliates is tantamount to the company using the information itself for its own business-related purposes. Financial organizations often bundle their products and services in order to offer a full range of financial services to customers. For example, your insurance agent may also offer banking and securities products along with your homeowners' and automobile insurance. No purpose is served by imposing additional hurdles to the sharing of such information among affiliated institutions. Indeed, additional burdens on information sharing among affiliates would undoubtedly reduce the ability of financial institutions to serve their customers.

The rules for sharing information among affiliates are spelled out in the Federal Fair Credit Reporting Act (the "FCRA").⁵ The FCRA recognizes the benefits enjoyed by consumers from such information sharing among affiliated companies. In fact, Congress believed that the benefits of information sharing among affiliates was so important that it determined that the FCRA should pre-empt any State law that attempts to limit or affect such sharing. Specifically, Section 624 of the FCRA provides:

No requirement or prohibition may be imposed under the laws of any State . . . (2) with respect to the exchange of information among persons affiliated by common ownership or common corporate control . . .⁶

This pre-emption, however, is scheduled to sunset. The FCRA provides that a State law enacted after January 1, 2004 will not be pre-empted by Section 624 if the law provides greater protection to consumers.⁷ Accordingly, any California law that is enacted before January 1, 2004 is automatically pre-empted by the FCRA if it affects the sharing of information among affiliated institutions. In view of the broad FCRA pre-emption, I would not be surprised to see a challenge to any State law

⁵ 15 U.S.C. §§ 1681 *et seq.*

⁶ 15 U.S.C. § 1681t(b).

⁷ 15 U.S.C. § 1681t(d)(2).

enacted before January 1, 2004 which affects affiliate sharing. In any event, Congress is expected to take up the issue of the FCRA sunset shortly. Any State legislation in this area, therefore, would be premature.

Joint agreements level the playing field for smaller financial institutions

Under the GLB Act, financial institutions that offer financial products and services pursuant to joint agreements may share information about consumers, provided the consumer is informed that his or her information will be shared, and the financial institution to whom the information is provided agrees by contract to maintain the confidentiality of the information.

This narrowly constructed provision was enacted by Congress to enable smaller financial institutions to compete on a level playing field with larger financial institutions that could offer a complete array of financial products through affiliates. Because smaller institutions do not typically have affiliates offering other types of financial products, Congress was concerned that they would be at a competitive disadvantage in their ability to market to prospective customers. The joint agreement provision preserves competitive balance by enabling these financial institutions to compete through arrangements with nonaffiliated financial institutions to offer a full array of products and services in competition with larger financial institutions. Any legislation that affects the joint agreement provision runs the risk of disturbing the competitive balance between small and large financial institutions.

But consumers are not without protections. Only financial institutions qualify under the joint agreement provision. A financial institution may not use the provision to share information with an entity that is not a financial institution. All financial institutions, of course, are subject to the provisions of the GLB Act, including the requirement to safeguard consumer information. As a result, consumer information should be protected from possible abuse.

Opt-in versus opt-out

There has been a great deal of discussion regarding the advantages and disadvantages of opt-in and opt-out. As you are aware, the GLB Act provides consumers with the opportunity to opt-out from certain types of information sharing. Some have suggested that opt-out should be replaced with opt-in requirements. This would be a mistake. The requirement that a consumer opt-in before information can be shared would have severe adverse consequences for economic activity in California. Prohibiting financial institutions from sharing information until customers opt-in would put an immediate halt to a considerable amount of commerce. An opt-in requirement would interfere with the smooth and efficient flow of information about products and services flowing to California consumers. This is particularly the case for programs whereby financial institutions offer products and services in conjunction with other financial institutions.

Let me give you an example of a program that would be adversely affected by an opt-in requirement. Mortgage lenders often share information about prospective borrowers with insurance agents, who make information about life and homeowners' policies available to homebuyers. Unless they opt-in, California consumers will have a difficult time learning about new products and services available from banks, securities firms and insurance companies.

The burden of requiring consumers to opt-in in order to share information is significant. To ensure that consumers have been given sufficient opportunity to make their choices known, financial institutions will send repeated communications to customers who have failed to opt-in. Opt-in, therefore, has the unintended consequence of increasing the number of times a consumer is contacted to determine whether the consumer simply failed to remember to opt-in or whether the consumer truly does not desire to have his or her nonpublic personal information shared with others. This will increase the costs to financial institutions and undoubtedly increase fees incurred by California consumers.

Opt-out, on the other hand, is very efficient. It enables those consumers who desire to protect their privacy to do something about it. By opting-out, a consumer affirmatively instructs his or her financial institution to not share nonpublic personal information with others. No customer follow-up is necessary. A consumer who opts-out expresses his or her decision to keep nonpublic personal information protected. Under the GLB Act, a financial institution is required to abide by this clear and unambiguous instruction. Disclosures of personal information stop when consumers inform their financial institutions that they are opting-out.

Consumers who do not opt-out may do so because they want to continue to receive information about products and services available from their financial institutions, or because they are not concerned with restricting their financial institutions from using or sharing their personal information with others. In these instances, there would be no adverse disruption of the flow of information between financial institutions and others.

It is often unclear why consumers choose not to opt-in. Do consumers fail to opt-in because of concerns about privacy, or merely because they overlooked the response card? In this instance, commerce must be halted until the consumer's preference is determined. This could have serious and long-lasting adverse effects on the California economy.

Growing concerns with identity theft

Consumers are becoming increasingly concerned with the issue of identity theft. Just last week, the Federal Trade Commission announced that the number of identity theft complaints rose to 162,000 in 2002, an increase of 100% over 2001. Identity theft accounted for 43% of the total number consumer complaints, topping the list of consumer frauds for the third consecutive year.⁸

Some suggest that the way to deal with the problem of identity theft is to restrict further the ability of financial institutions to share information. This proposal sounds simple enough. Unfortunately, such legislation will not do much to reduce incidences of identity theft. This is because most victims of identity theft do not know the source of the information that was stolen from them. In a study released last June, the U.S. General Accounting Office (“GAO”), after studying the issue of identity theft, recommended that the government increase its efforts to prosecute incidents of identity theft and focus on prevention measures that make ID documents and information less susceptible to being counterfeited or used in a fraudulent manner.⁹

Congress is also concerned with the issue of identity theft. But in view of the results of studies conducted by the GAO, Congress has taken a different approach to this important matter. During the 107th Congress, Senator Feinstein took a leading role in this area by introducing S. 848 and S. 3100, the Social Security Number Misuse Prevention Act of 2002. The objective of the bill was to reduce identity theft by restricting the availability and usage of Social Security numbers. California, of course, addressed the use of Social Security numbers by enacting § 1798.85 of the California Civil Code.

S. 1742, the Identity Theft Victims Assistance Act of 2002, sponsored by Senator Cantwell, also addressed the issue of identity theft. Senator Cantwell’s bill passed the Senate in November, but died when Congress adjourned. I anticipate that the issue of identity theft will once again be considered during the 108th Congress.

CONCLUSION

The issues you have before you today are indeed complex. They should be studied and considered, but I urge that your attention be focused on legislation that specifically addresses the issues of real concern to consumers.

Thank you for your attention.

⁸ Wall Street Journal (January 23, 2002) D2.

⁹ “Identity Fraud, Prevalence and Links to Alien Illegal Activities.” Statement of Richard M. Stana, Director, Justice Issues, United States General Accounting Office, Before the Subcommittee on Crime, Terrorism and Homeland Security and the Subcommittee on Immigration, Border Security, and Claims, Committee on the Judiciary, House of Representatives, June 25, 2002 (GAO-02-830T).