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MEMORANDUM

June 18, 2004

To Our Clients and Friends

Re: FACT Act: FTC's Proposed Rule on Affiliate Marketing

The Federal Trade Commission's ("FTC") has issued a proposed rule implementing § 214 of the Fair and Accurate Credit Transactions Act of 2003 (the "FACT Act"), which provides consumers with the ability to restrict companies from using certain information obtained from affiliates to make marketing solicitations.¹ The final rule is required to be adopted by September 4, 2004 and is required to be effective by March 4, 2005. Comments on the FTC's proposal are due by July 20, 2004.

The FTC's proposed rule generally follows the language of § 214. However, in many instances, the proposal departs from the language of § 214. Many of these differences impose additional limitations or requirements on companies that are not provided in the statute. The following analysis indicates where the proposal departs from the language of the statute.

RESPONSIBILITY FOR PROVIDING NOTICE AND OPPORTUNITY TO OPT OUT

Section 214 amends § 624 of the Fair Credit Reporting Act ("FCRA") to provide that a company that receives from an affiliate information that would otherwise constitute a consumer report² may not use the information to make a solicitation for marketing purposes to the consumer about the person's products and

¹ 69 *Fed. Reg.* 33324 (June 15, 2004). The FACT Act also requires the Federal banking agencies and the Securities and Exchange Commission to prescribe regulations to implement § 214. The other agencies are expected to propose rules in the near future.

² A "consumer report" is any written, oral or other communication by a consumer reporting agency bearing on a person's credit worthiness, standing, capacity, character, general reputation, personal characteristics or mode of living that is used or collected for the purpose of serving as a factor to establish a consumer's eligibility for credit, insurance or employment.

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services until the customer is notified that the information is being shared and the consumer is provided an opportunity to prohibit the affiliate from making the solicitation.

The statute does not specify who should provide the consumer with the notice and opportunity to opt out. Despite the fact that § 214 appears to provide flexibility to permit the affiliate or the person providing the information to the affiliate to send the notice and opportunity to opt out to a consumer, the FTC proposes that the company with the relationship with the consumer and which communicates information to affiliates is to provide the required notice to consumers. The proposal, however, permits opt out notices to be given by the company's agent or through a joint notice with one or more affiliates or under a common corporate name or names used by the family of companies.

The FTC also requests comment on whether the affiliate receiving eligibility information should be permitted to give notice and opportunity to opt out on its own behalf.

DEFINITIONS

- The FTC uses the term “eligibility information” to refer to information that would be a consumer report if the exclusions from the definition of “consumer report” in § 603(d)(2)(A) of the FCRA did not apply. As a result, the disclosure to an affiliate of information that is experience and transaction information or certain other information that relates to the consumer's personal characteristics would trigger the requirements of § 214 if the affiliate wishes to use the information to market to the consumer.
- “Clear and conspicuous” means “reasonably understandable and designed to call attention to the nature and significance of the information presented.” The FTC has provided the following examples of methods to make notices clear and conspicuous:
 - using clear and concise sentences, paragraphs or sections;
 - using short explanatory sentences;
 - using bullet lists;
 - using definite, concrete everyday words;
 - avoiding legal and technical business terminology; and
 - avoiding explanations that are imprecise and subject to different interpretations.

These examples are not included in the language of the regulation.

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- “Consumer” is defined as an individual.
- The FTC’s preamble indicates that a person may act through an agent, such as a licensed agent in the case of an insurance company, or through another entity. Actions taken by an agent on behalf of the person that fall within the scope of the agency relationship will be treated as actions of the person.
- The FTC’s proposal slightly modifies the definition of “pre-existing business relationship” contained in the statute. The statute provides that the term means a relationship between a person (or a person’s licensed agent) and a consumer that is based on:
 - a financial contract between the person and consumer which is in force. The proposal, however, adds the requirement that the contract be in force on the date on which the consumer is sent the solicitation.
 - the purchase, rental or lease by the consumer of that person’s goods or services or a financial transaction between that person and the consumer within an 18-month period prior to the date the solicitation is sent. The FTC’s proposal uses the phrase “make or send rather than just send.
 - an inquiry or application by the consumer regarding a product or service offered by that person within a three month period prior to the date the solicitation is sent. The proposed rule uses the phrase “make or send” rather than just send.
 - The proposed rule provides that an inquiry includes any affirmative authorization or request by a consumer for information on a company’s products or services.
 - The preamble indicates that it is appropriate to consider the reasonable expectations of the consumer. Accordingly, an inquiry includes a request by a consumer for information the consumer would expect to receive from an affiliate.
- “Solicitation” means marketing initiated by a person to a consumer that is based on eligibility information and is intended to encourage the consumer to purchase a product or service.
 - A solicitation does not include a communication directed at the general public and distributed without the use of eligibility

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information from an affiliate.³ The FTC asks whether there are other communications that should not be considered solicitations.

- The phrase “distributed without the use of eligibility information from an affiliate” was added by the FTC and is not part of the definition in § 214.
- The proposed rule indicates that solicitations include direct mail, telemarketing, e-mail directed to a specific consumer that is based on eligibility information communicated by an affiliate.

USE OF ELIGIBILITY INFORMATION FOR MARKETING SOLICITATIONS

The proposed rule provides that if a company communicates eligibility information to its affiliate, the affiliate may not use the information to make or send solicitations to the consumer unless the company:

- has provided clear and conspicuous notice to the consumer that the information may be communicated to and used by an affiliate to make or send solicitations about the affiliate’s products and services; and
- has provided the consumer with a reasonable opportunity and a simple method to opt out of such use by the affiliate, and the consumer has not opted out.

Based upon the model form language set forth in the proposal, a company may use the generic term “affiliates” when describing the parties that may use eligibility information that the company has disclosed rather than indicating the actual names of the affiliates.

The notice may be provided either in the name of the company the consumer does (or has done) business with or in one or more common corporate names shared by the affiliated group, if it includes the common corporate name of the company. The notice may be provided jointly with affiliates as long as a common corporate name or names used by the family of companies is provided. The proposal contains provisions to avoid duplicate notices.

The proposal contemplates that notices will be provided to the consumer in writing or, if the consumer agrees, electronically. The FTC asks whether the required notices should be permitted to be provided orally.

³ Examples of communications directed to the general public include television, magazine and billboard advertisements.

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A company that receives eligibility information from an affiliate may not make or send solicitations to a consumer based on eligibility information unless the consumer has had the opportunity to opt out and has not opted out.

The proposal indicates that the provisions of § 214 do not apply if a company asks its affiliate to send information about the company's products and services to the affiliate's customers. However, the FTC requests comment on whether § 214 should apply if the company engages in "constructive sharing" of eligibility information to conduct marketing. Constructive sharing of eligibility information may arise when a company asks its affiliate to send information to the affiliate's customers who possess certain characteristics. The FTC suggests that when a customer who has received the targeted solicitation responds to the company, the customer is implicitly revealing eligibility information to the company. The concept of constructive sharing of eligibility information is not restricted by § 214.

EXCEPTIONS

The notice and opportunity to opt out requirement does not apply to a company's use of eligibility information received from another affiliate:

- to make or send a solicitation to a consumer with whom the company has a pre-existing business relationship;
- to facilitate communications to an individual for whose benefit the company provides employee benefits or other services arising out of a current employment relationship;
- to perform services on behalf of an affiliate. This exception, however, does not permit a company to make or send a solicitation on its own behalf or on behalf of another affiliate if the company or other affiliate would not otherwise be permitted to make or send the solicitation as a result of the consumer's having opted-out;⁴
- in response to a communication initiated by the consumer, orally, electronically or in writing;⁵
- in response to an affirmative authorization or request by the consumer to receive the solicitation;^{6 7} and

⁴ The preamble states that if the consumer has opted out, a company may not circumvent the opt out by instructing its affiliate that has a customer relationship with the consumer to send solicitations to the consumer on the company's behalf.

⁵ The FTC added the language "orally, electronically, or in writing," in order to clarify the statutory language in the FCRA.

⁶ This provision modifies the language of § 214, which does not require the consumer's *affirmative* authorization or request.

⁷ A pre-selected check box or boilerplate language in a disclosure or contract is not an affirmative authorization or request.

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- if compliance with the provision would prevent compliance with provisions of state insurance laws relating to unfair discrimination.

The FTC's proposal states that the restrictions of § 214 do not apply to eligibility information that was received by an affiliate prior to the date of compliance with the regulation. This represents a departure from the language of the statute, which does not prohibit the use of information to send a solicitation to a consumer if such information was received prior to the compliance date. Nothing in the statute provides that the information must have been received by the affiliate that intends to use the information prior to the effective date of § 214..

CONTENTS OF OPT OUT NOTICE

The proposed rule provides that the opt out notice must be clear, conspicuous and concise. The notice must accurately:

- disclose that a consumer may elect to limit the affiliate from using eligibility information to make or send a solicitation to the consumer;
- disclose that the consumer's election to opt out will last for a period of at least five years, which may be extended by the consumer; and
- provide consumers a reasonable and simple method to opt out, which may be by mail, telephone or electronic means.

The FTC has proposed model forms that may be used to satisfy the notice requirement.

A notice may be combined with other required disclosures to be provided under other provisions of law, including notices required under the Gramm-Leach-Bliley Act ("GLB Act") or the FCRA. The FTC asks whether companies will consolidate the notices with GLB Act privacy notices or FCRA affiliate sharing notices.

Companies may also provide consumers with a menu of opt out alternatives to choose from. The menu could include options to opt out from certain types of affiliates, information or methods of delivery, but must contain the option to opt out from solicitations from affiliates.

REASONABLE OPPORTUNITY TO OPT OUT

A company must provide the consumer with a reasonable opportunity to opt out following the delivery of an opt out notice before an affiliate may make or send solicitations to the consumer. While the FTC has not established a mandatory waiting period, it indicated that waiting 30 days is a safe harbor in certain circumstances. The

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FTC provides the following examples of what it considers a reasonable opportunity to opt out:

- allowing a consumer to opt out within 30 days from the date the notice was mailed or from the date the consumer acknowledges receipt of the electronic notice;
- providing a simple process on an Internet web site that the consumer can use at the time of an electronic transaction, which process is a necessary part of the transaction;
- providing the notice in a GLB Act privacy notice and allowing the consumer to exercise the opt out within a reasonable time period and in the same manner as the opt out under the GLB Act; and
- providing the consumer with an opportunity to opt-in by affirmative consent to the use of information by the affiliate.⁸

The proposed rule does not require companies to disclose in the notice how long a consumer has to respond before eligibility information communicated to affiliates can be used by the affiliates to send solicitations to the consumer. The FTC seeks comment on whether companies subject to the proposed rule should be required to disclose how long a consumer has to respond to the opt out notices.

REASONABLE AND SIMPLE METHODS OF OPTING OUT

The FTC provides the following examples of methods that represent reasonable and simple methods for consumers to opt out:

- designating check-off boxes in a prominent position on an opt out form;
- including a reply form and self-addressed envelope together with the opt out notice;
- providing an electronic means to opt out, such as an electronic form on a website; and
- providing a toll-free telephone number.

Methods that are not reasonable and simple for consumers to opt out include:

- requiring a consumer to write his or her own letter;
- requiring a consumer to call or write to obtain a form to opt out, instead of including it with the notice; and
- requiring a consumer who agrees to receive the opt out notice in electronic form to only be able to opt out by telephone or mail.

⁸ A pre-selected check box does not constitute a consumer's affirmative authorization to opt-in.

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DELIVERY OF OPT OUT NOTICES

The FTC is proposing that a company provide an opt out notice so each consumer can reasonably expect to receive the notice. A company may reasonably expect a consumer to receive the notice if the company:

- hand-delivers a printed copy of the notice to the consumer;
- mails a printed copy of the notice to the last known mailing address of the consumer; or
- for a consumer who has agreed to receive information electronically, posts the notice on an electronic site and requires the consumer to acknowledge receipt of the notice in order to receive the service.

A company cannot reasonably expect a consumer to receive a notice if the company:

- only posts a sign in a branch or office of the company;
- generally publishes advertisements presenting the notice; or
- sends the notice via e-mail to a consumer who has not agreed to electronic delivery of information.

A company may provide a joint notice with its affiliates as long as the notice is accurate as to each affiliate issuing the notice.

The proposed rule also addresses relationships when two or more consumers jointly obtain a product or service from a company. These provisions are derived from similar provisions in the GLB Act.

- a single opt out notice may be provided to joint consumers;
- any of the joint consumers may exercise the right to opt out;
- an opt out by a joint consumer may be treated as an opt out that applies to all joint consumers or just to the consumer who opted out;
- if joint consumers opt out separately, the company must allow one joint consumer to opt out on behalf of all joint consumers;
- the company must explain its policies with regard to the ability of joint consumers to opt out; or
- the company may not require all joint consumers to opt out before any opt out direction is implemented.

The FTC also requests comment on whether information about a joint account should be permitted to be used for making solicitations to a joint consumer who has not opted-out.

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DURATION AND EFFECT OF OPT OUT

Section 214 states that an opt out request by a consumer shall be effective for a minimum of five years beginning on the date the company receives the opt out request from the consumer. The FTC's proposed rule permits a company to extend the opt out period beyond five years, and may make it permanent. A consumer's opt out does not expire until the consumer revokes it in writing. Nothing in § 214, however, requires that the consumer's revocation of an opt out be in writing.

Once the opt out request has expired, a company may use all eligibility information it has received about the consumer from its affiliate, including information received during the opt out period. However, if the consumer opts out after the initial opt out period, a company may not use eligibility information about the consumer that it has received after the mandatory compliance date.

A consumer may opt out at any time even if the consumer did not choose to opt out in an initial response to a notice. The FTC also is proposing that once a consumer's business relationship with a company terminates, if an opt out is in effect, it will continue in effect until revoked by the consumer.

EXTENSION OF OPT OUT

The FTC is proposing that a company may not make or send a solicitation to a consumer based on eligibility information received from an affiliate after the expiration of an opt out period unless the company responsible for providing the opt out notice has given the consumer an extension notice and reasonable opportunity to extend the opt out. If no notice is given to the consumer, the opt out period is extended indefinitely. The FTC has provided a model form that companies may use to provide the extension notice.

The extension notice must be clear, conspicuous and concise and the notice must contain either the same disclosure as the initial opt out notice, along with a statement that explains the opt out will or has expired and that the consumer must opt out again if he or she chooses to continue the opt out. Alternatively, the notice may provide:

- that the consumer previously elected to limit the company's affiliate from using information about the consumer that it had obtained from the company to make or send solicitations to the consumer;
- that the consumer's election to opt out will or has expired;
- that the consumer may elect to extend the previous opt out; and
- a reasonable and simple method for the consumer to extend the opt out.

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A company that treats a consumer's opt out as permanent does not need to provide extension notices. The FTC requests comment on whether companies plan to limit the duration of the opt out and the relative burdens and benefits of the approaches for extension notices.

An extension notice may be provided to a consumer within a reasonable time period either before or after the opt out has expired. The opt out period may not be shortened to a period less than five years by sending an extension notice before the opt out expires. If a notice is sent after the opt out has expired, no solicitations may be made to the consumer until the consumer has had a reasonable opportunity to renew the opt out notice. The FTC indicates, however, that an extension may not be sent too far in advance of the expiration of the opt out period because it may confuse consumers. Nonetheless, an extension notice sent as part of an annual GLB Act privacy notice before the expiration of the opt out period will be regarded as reasonable.

The FTC indicates that GLB Act annual privacy notices typically state that a consumer need not opt out again if the consumer has previously opted out. Accordingly, the FTC advises that if the affiliate marketing opt out notice or the extension of the opt out is combined with the annual GLB Act privacy notice, companies will need to make clear that the consumer must opt out again in order to extend the opt out.

APPENDIX A – PROPOSED MODEL FORMS

The proposed rule contains three model forms that companies may use to satisfy the requirements for initial opt out notices, extension notices and for offering consumers a broader right to opt out. The FTC requests comment on the form and content of the proposed model forms.

The proposed rule can be found at http://www.schwartzandballen.com/whats_new.html.

If you have any questions, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700.