FINANCIAL PRIVACY, CONSUMER PROSPERITY, AND THE PUBLIC GOOD: MAINTAINING THE BALANCE

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Executive Summary

The FCRA Balance

For more than 30 years, the Fair Credit Reporting Act has deftly regulated the U.S. credit reporting system. The product of extensive congressional hearings, the Act creates a simple, powerful, and largely self-enforcing regulatory structure. It has proven so efficient, flexible, and durable that, with only a single substantive amendment, it has guided the world's most robust credit reporting system and overseen exceptional growth in consumer mortgages and other credit opportunities for three decades. Consumers in the U.S. enjoy the "miracle of instant credit" because, under the rules established by the FCRA, sensitive information about a person's credit history is given to credit reporting agencies so that individual creditworthiness can be evaluated quickly and efficiently. In this way, consumers can qualify for credit, insurance and other financial services based on their own past payment experience.

The Act, as amended in 1996, reflects a careful balancing of consumer privacy interests with consumers' desire for the benefits that flow from accessible credit report information. At the heart of that balance are protections that govern the content and use of credit reports, the obligations of institutions that furnish information to be included in reports, and the right of consumers to "opt out" of the use of credit information to prescreen credit or insurance opportunities and the sharing of credit information among affiliates. Given the inherently national character of credit reporting, its importance in the national U.S. economy, and the

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significant impediments and costs that state regulation could impose, Congress preempted state laws that would alter this balance.

However, recognizing the dramatic changes taking place in technologies, commerce and markets, Congress provided that preemption would expire on January 1, 2004. With this step it signaled an intent that the amended operation of FCRA be reviewed and evaluated, to determine whether the balance struck in 1996 yielded the intended benefits.

Consumer Benefits

The U.S. credit reporting system has compiled an extraordinary record, including the following collection of benefits for consumers, businesses and the U.S. economy. The FCRA, in place for 32 years, provided the foundation on which this record was built.

- **Unprecedented consumer access to more than $7 trillion in credit**. In 2001, 75 percent of U.S. households participated in the consumer credit markets and held some type of debt; more than two-thirds of U.S. households own their own homes, thanks in large part to mortgage credit being increasingly available to previously underserved segments of the population. Accessible credit information has "democratized" financial opportunity: because of ubiquitous credit reporting, U.S. consumers can get credit, insurance and a host of other financial services based on their individual experience using credit in the past. Consumers in the U.S. have access to more credit, from a greater variety of sources, more quickly than consumers anywhere else in the world.

- **Accurate and efficient decision-making**. The fact that credit reports include information about consumers from a wide range of sources throughout the nation, collected over time, and updated daily, is critical to evaluating individuals' creditworthiness. The result is more accurate and responsible financial decision-making, a sounder financial services sector, lower delinquency rates, decreased risk of consumer bankruptcy, and greater consumer and lender confidence. As Federal Reserve Board Chairman Alan Greenspan has noted, access to personal information makes individual financial institutions "more creditworthy and efficient," and the U.S. financial services sector "more transparent and stronger in general."

- **Enhanced competition**. Because credit reports dramatically reduce the cost of identifying and assessing the risk of new potential customers, they facilitate entry by new lenders and greater competition, thus contributing to lower prices and greater consumer choice. The ability of new entrants to use personal information to establish and cultivate relationships with customers thousands of miles away has transformed the competitive landscape in the United States, injecting intense price and service competition into markets.

- **Reduced costs**. By increasing efficiency, facilitating competition, improving risk-management tools (like credit scoring), providing the standardized information necessary to securitize loans, and reinforcing borrower incentives to manage credit wisely and avoid delinquencies and defaults, credit reporting has significantly reduced the cost of credit.

- **Speed and convenience**. The depth of information in U.S. credit reports enhances the speed of credit, insurance, and other financial service decisions. Even very significant decisions about financing a college education or a new home or writing automobile or homeowners insurance are often made in a matter of hours or minutes, instead of days and weeks as is the case in most other countries, because credit history data is readily accessible.

- **Consumer mobility**. Another benefit to consumers of national credit reporting is the ease of shopping across competing offers and of obtaining financial services when moving or doing business far from home. The availability of comprehensive borrower credit histories nationwide helps U.S. consumers more rapidly adapt to the dislocations that are an inevitable result of a more global economy, freer trade and a rapidly changing job market. Because reputations are more mobile, consumers are more willing to move to take advantage of job opportunities far away. Thus, the U.S. labor market is more productive, relative to other countries, because workers and job opportunities are matched more quickly and efficiently.

What is at Risk if Preemption Expires?

Some legislators and privacy advocates are now suggesting that Congress—or even states and municipalities—alter the balance established by the FCRA. They propose abandoning federal preemption to give the states the freedom to impose new restrictions on the content and use of consumer credit reports or files. The most commonly proposed new restrictions affecting file content involve expanding the responsibilities of furnishers of credit information, imposing liability for errors, and reducing the length of time that information (especially negative information) could be included in credit reports. As for restrictions on usage, there are numerous proposals to condition certain uses of credit reports—particularly for "prescreening" of credit applications and sharing of information for marketing purposes among affiliates—on opt-in consent.

Such proposals threaten to undo the system that underpins the most dynamic and competitive consumer credit environment in the world. Abandoning preemption would burden the national credit reporting system with the significant costs of having to comply with overlapping, inconsistent, and even contradictory state and local credit reporting rules. Because no one is *required* to provide information to credit bureaus, the extra compliance and liability burden could drive some creditors to only partial reporting, or cause them to drop out completely. Those creditors who pull back from reporting would no longer enhance the quality and depth of the bureau information by contributing their full portfolio experience. Because credit files would be less complete, they would be less valuable to all users. Competition would be diminished, as new entrants found it more costly to get accurate data on potential new customers. Choice would diminish and prices would rise. In sum, the many benefits of our national credit reporting system would be reduced.

What if a Shift Toward Opt-in Was the Price of Continued Preemption?

Some privacy advocates have argued for making federal preemption permanent, but only if it included new restrictions on the sharing of credit data across affiliates and the use of credit data to prescreen and target new offers of credit. Their proposals to incorporate an opt-in approach to giving consumers a voice in how credit data are used would effectively prohibit these activities. The process of contacting consumers individually and eliciting explicit consent prior to usage (as required under an opt-in regime) could be prohibitively expensive, annoying to consumers, and inefficient, relative to other alternatives. Opt-in imposes a burden on consumers to receive and respond to hundreds or potentially thousands of opt-in requests, and exacts a significant penalty in the form of missed opportunities if they do not. Experience with opt-in in a variety of contexts consistently shows that it acts as a drag on commerce. Worse still, the resulting loss of efficient prescreening would diminish competition by raising barriers to entry into new markets.

The irony of both the general proposal to abandon federal preemption and of proposals to require opt-in consent for permissible uses is that both would impose high costs and restrain information flows simply because of how they operate. Complying with 50 different regulations is always more expensive than complying with one. Opt-in is always more expensive than opt-out as a means of letting consumers determine how information is used. Moreover, both proposals would raise costs relative to the current system, without being more protective.

The Absence of Demonstrated Need

Given the variety and magnitude of consumer benefits created through the current FCRA structure, and the inefficiency and cost that the absence of preemption would impose, those who wish to upset the balance present in the current FCRA face a high hurdle to show why the change is necessary. To date, they have failed to show how the public would be better served by either the end of preemption or the imposition of opt-in.

For example, some privacy advocates argue that the sharing of credit and other information increases the risk of fraud and identity theft. The available evidence, however, offers little if any support of a causal link between the use of credit report data for prescreening and target marketing and the frequency of identity theft. In fact, it appears that most cases of identity theft involve a friend, family member, or co-worker. Virtually all prescreening is done at the credit bureau: creditors specify criteria and the credit bureau creates a list of consumers meeting those criteria. The bureau provides only the list, not the criteria or any credit information. Similarly, affiliate-sharing, by definition, involves information that is already possessed by the company. Any “sharing” is wholly within that company. In any event, the most direct and effective response to identity theft is to target the fraudulent activity itself—through stiffer penalties, more vigorous enforcement, greater coordination among enforcement agencies, and improved consumer education.

Some privacy advocates also charge that the sharing of information could lead to sufficiently targeted marketing that would result in fewer opportunities and higher prices for some groups. However, the economics of competitive markets reveal the opposite to be true. Credit report data reduce redlining by providing creditors with more precise information for measuring risk that is based on a borrower's own past credit experience, and not on geography or other aggregated information. Credit report data also reduce redlining by facilitating entry and competition, which stimulates the supply of credit and holds down the price. If policymakers are concerned that the price for some groups is too high, the best way to bring price down *and* ensure the continued supply of the product is to stimulate competition. New limits on the use of credit data have the opposite effect.

Many privacy advocates argue that some information (e.g., medical and transactional information) is too sensitive to share without a consumer-initiated purpose. This may be true, and may therefore help to explain why credit reports do not contain medical or transaction-specific information. The FCRA reflects this same concern by prohibiting the use of medical information, for example, in a credit report furnished in connection with employment, credit, insurance, or direct marketing. Opt-in is also required under the new health privacy regulations for medical information to be used for marketing. The sharing of financial information with third parties for marketing requires opt-out consent under Gramm-Leach-Bliley. Congress should avoid enacting new restrictions based on the "sensitivity" of information unless there is evidence that such sensitivity in fact warrants additional regulation and that existing laws fail to provide the necessary protection.

Finally, a growing argument for new privacy laws is that prescreening, affiliate-sharing, and the sharing of information for marketing increase annoyances like telemarketing calls and unsolicited commercial mail (i.e., junk mail) and e-mail (i.e., spam). In a society that values freedom of expression, annoyance alone is a problematic justification for the effective ban on target marketing that opt-in would create. This is especially true when there are many existing more effective ways—including company-specific opt-out lists required by the Telephone Consumer Protection Act, state and federal do-not-call lists, state regulation of unsolicited commercial e-mail—to address the annoyance of unsolicited communications. It is ironic to try to remedy the annoyance of those contacts by restricting the information that is used to target them only to people whose past behavior suggests they are likely to be interested. Without the ability to target potential customers that opt out requirements allow, consumers would likely be bombarded with *even more* solicitations—by mail, phone, or email—than they now receive, and those solicitations would likely be of less interest, since they would be untargeted.

In short, however real privacy concerns may be, there is no evidence that either state-by-state regulation or a federal preemptive shift toward an opt-in regime would be effective in solving any of these problems, and certainly no evidence that they would be worth the exceptional costs they would impose.

Recommendations

This does not mean that there is no room for improvement. The remarkable benefits that flow from the delicate balance of competing privacy and commercial interests under the current FCRA make a compelling case for maintaining federal preemption. At the same time, the privacy rights already imbedded in FCRA can be enhanced by strengthening the existing mechanism that gives consumers a choice in how personal financial information is used. The FCRA gives consumers the right to opt-out of having their credit report data used for prescreening or shared across affiliates. Steps that would make this opt-out system work better will enhance privacy protection at the same time preserving the benefits that consumers enjoy as a result of robust credit reporting and accessible information.

We recommend the following:

- **Maintain the 1996 FCRA Preemption.** Congress should eliminate the January 1, 2004 sunset provision from the amended FCRA, so that the balance worked out in 1996 remains intact.

- **Avoid Unnecessary Impediments to the Use of Credit Information.** Congress should avoid imposing new restrictions on the content and use of credit data, without first requiring evidence that (a) such restrictions are necessary to remedy a specific harm, and (b) that the remedy does not impose greater costs than the asserted harm.

- **Make Opt-Out Notices Work.** Amend FCRA to require that opt-out notices be clearly and simply communicated to consumers regarding their rights with respect to prescreening and affiliate sharing and how those rights can be exercised.

- **Make Privacy Notices Work.** If privacy notices are to be the cornerstone of privacy regulation, then privacy notices should be made clear and attention-getting. The time is ripe for development of a layered notice system that will provide a clear and succinct initial notice that contains the information that consumers want, and instructions as to where to find an easily accessible statement of a company's complete privacy policy for those that want more detail. Such a layered system should make it vastly easier for consumers to understand and act on their privacy rights than the current, cumbersome system that seems to appeal to no one—whatever their perspective on the privacy debate.

I. Introduction

The United States' economic prosperity and the public's standard of living depend in large part on the availability of $7 trillion in outstanding mortgages and other consumer loans. Consumer credit finances homes and cars, funds college educations, and provides the credit cards that consumers use every day to purchase goods and services. Consumer credit is critical for large purchases (e.g., homes, cars, college educations) and distance transactions (e.g., purchases via telephone, mail, and the Internet). U.S. consumers have access to more credit, from a greater variety of sources, more quickly, and at lower cost than consumers anywhere else in the world.

The "almost universal reporting" of personal information about consumers is, in the words of economist Walter Kitchenman, the "foundation" of consumer credit in the United States and a "secret ingredient of the U.S. economy's resilience."[5] The U.S. credit reporting system makes possible what U.S. Federal Trade Commission (FTC) Chairman Timothy Muris has called the "miracle of instant credit." According to Muris, "this 'miracle' is only possible because of our credit reporting system. The system works because, without anybody's consent, very sensitive information about a person's credit history is given to the credit reporting agencies."[6] In this way individual creditworthiness can be evaluated quickly and efficiently, and consumers can qualify for credit, insurance and other financial services based on their own past payment experience.

Since 1971 the U.S. credit reporting system has operated under the Fair Credit Reporting Act (FCRA).[7] In 1996, Congress amended the FCRA to address a variety of concerns related to the proper uses of credit report information, its accuracy, and consumer privacy.[8] The amendments that Congress enacted after years of hearings and debate reflected a careful balancing of these interests. A critical component of that balance was preemption of state laws affecting core elements of the credit reporting system and its privacy protection provisions. In the face of ongoing and dramatic changes in technologies, commerce, and markets, however, Congress provided that preemption would expire on January 1, 2004.

As that date nears, some legislators and privacy advocates have suggested that states be allowed to alter the balance struck in 1996 by imposing their own individual restrictions on the content and use of consumer credit reports. They have also advanced proposals for Congress to impose new limits on specified uses of credit reports by conditioning those uses—particularly "prescreening" and affiliate-sharing—on opt-in consent. These proposals have generated significant controversy.

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[5]Walter F. Kitchenman, *U.S. Credit Reporting: Perceived Benefits Outweigh Privacy Concerns* 1 (The Tower Group 1999).

[6]Timothy J. Muris, *Protecting Consumers' Privacy: 2002 and Beyond*, Privacy 2001 Conference, Oct. 4, 2001.

[7]Fair Credit Reporting Act of 1970, Pub. L. No. 91-508, 84 Stat. 1114 (codified at 15 U.S.C. §§ 1681-1681t).

[8]Consumer Credit Reporting Reform Act of 1996, enacted as title II, subtitle D, chapter 1 of the Omnibus Consolidated Appropriations Act for Fiscal Year 1997, Pub. L. No. 104-208, 104th Cong., 2d Sess. §§ 2401-2422 (Sept. 30, 1996) (codified at 15 U.S.C. §§ 1681-1681t).

This report examines the emerging debate over privacy and preemption, both in the FCRA context and more broadly. We seek to move beyond the rhetoric of the political arena to provide a thoughtful analysis of what is at stake in this debate and the likely impact on consumers and the economy of new state or federal restrictions on credit reporting. Much of the analysis is applicable to proposed new restrictions on the use and sharing of personal information generally, especially in connection with financial products and services.

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This report reflects the views of the authors alone and not necessarily of the institutions with which they are affiliated, the Joint Center, or the symposium participants.

II. The U.S. Credit Reporting System and the Fair Credit Reporting Act

A. The 1970 Fair Credit Reporting Act

Credit reporting evolved in the United States from the market, without any assistance from the government, in response to consumer and business need. Credit reporting began as a product of the Industrial Revolution, but it blossomed in the aftermath of World War II and the post-war demand for consumer credit. By 1969, there were 2,200 credit bureaus, collecting data from 400,000 creditors and public records, to maintain credit files on more than 110 million consumers.[9]

U.S. credit bureaus maintain four categories of personal data in credit files for purposes of issuing consumer reports:

1. Personal identification information (e.g., name, address, social security number);

2. Open trade lines (e.g., credit card accounts, auto loans, first and second mortgage accounts, personal loans, etc.) with data such as outstanding balance, credit limit, date account opened, date of last activity, and payment history;

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[9] *The Consumer Reporting Reform Act of 1994*, 103 S. Rpt. 209, 103rd Cong., 2d Sess. (1993).

3. "Public record" items related to the use of credit (e.g., bankruptcies, accounts referred to collection agencies, legal collection judgments and liens); and

4 Inquiries on the credit file, including date and identity of inquirer, for the previous two years.

Creditors supply the information voluntarily because they need access to it themselves to evaluate prospective new accountholders and serve their existing customers.

Credit reporting was largely unregulated until passage of the FCRA in 1970. The Act was a notably even-handed attempt to balance the need for accessible credit data with consumers' privacy concerns. The balance adopted in the FCRA consists of three primary features:

First, the law permits consumer reporting agencies (credit bureaus) to assemble freely and market consumer reports, whose content would consist of factual information concerning a "consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living."[10]

Second, the law establishes "permissible purposes" for the release of consumer reports. Those permissible purposes fall into five categories:

1. In connection with determining a consumer's eligibility for credit, insurance, employment, or "a license or other benefit granted by a governmental instrumentality required by law to consider an applicant's financial responsibility or status";
2. In connection with evaluating consumer eligibility for, or the risks associated with, an existing account;
3. For a legitimate business purpose in connection with a transaction involving the consumer;
4. As required by court order; or
5. In accordance with the written instructions of the consumer.[11]

Finally, the FCRA limits the disclosure of certain "obsolete" information. For example, most negative information on the credit file (e.g., delinquencies, charged-off accounts, collection judgments) can reside on the file no longer than seven years. Bankruptcy was originally allowed on the file for 14 years, but was changed to a maximum of ten years in 1979.

The FCRA thus permits the collection and centralized storage of data about an individual's creditworthiness, but imposes limits on their use. From an economic standpoint, the

[10]Subjective, interview-based investigative reports are subject to separate regulations and disclosures under FCRA. They play virtually no commercial role in credit granting today in the U.S, and so are beyond the scope of this paper.

[11]15 U.S.C. § 1681b(a).

resulting structure of the FCRA can be characterized as a simple but subtly clever and largely self-enforcing regulation. A testament to the flexibility designed into the initial statute is the fact that for a quarter century—from 1971 until 1996—the statute supported an explosion in consumer and mortgage credit opportunities for the U.S. population.

B. The 1996 Amendments

The regulatory structure created in 1970 by the FCRA remained essentially unchanged for the next 26 years, despite dramatic changes in technologies, markets, and uses for credit report information. Significantly, through the adoption of computerized storage systems and subsequent advances in data processing technology, local credit bureaus, which provided information only in the town or region where they did business, began to link the data they held. Consumer "reputations" (for handling credit) became mobile, so that consumers could have the benefit of their complete credit report irrespective of where they lived or were seeking credit.

The trend toward nationwide credit markets and the subsequent need for linked credit reporting became so powerful that by 1996 the many local credit bureaus had evolved into essentially three national automated reporting systems—Equifax, Experian, and TransUnion. However, the growth and national scope of credit marketing, coupled with greater consumer awareness of the importance of credit reports, raised new concerns about the balance between the need for accessible, accurate credit information and privacy. In addition, an increasing number of inconsistent state laws were beginning to upset the balance achieved in the federal FCRA.

In 1996 Congress amended the FCRA to respond to these concerns. The revisions permitted new uses of credit reports, subject to new opportunities for consumers to oversee the use of information about them. The amendments explicitly authorized the sharing of consumer report information among affiliated companies, provided that the consumer is given an opportunity to "opt out" of that sharing.[12] "Prescreening" credit information for the purpose of marketing credit or insurance opportunities to consumers was expressly authorized, but on the condition that credit bureaus establish and publish a toll-free telephone number that consumers can call to have their names removed from lists provided for such direct marketing purposes.[13]

The 1996 Reform Act sought to enhance the accuracy of credit reports by requiring credit reporting agencies to delete any disputed data that they cannot verify within 30 days, as well as comply with a variety of new procedural requirements for correcting data and notifying recipients of credit reports of disputed or inaccurate data.[14] Essentially, the 1996 amendments gave consumers greater power to challenge and correct erroneous information in their credit reports. The amendments also expanded the legal obligations of users of credit reports and, for the first time, imposed obligations on furnishers of credit information.

[12] 15 U.S.C. § 1681a(d)(2)(A)(iii).

[13] Id. § 1681b(c)(5).

[14] Id. § 1681i(a).

Recognizing the inherently national nature of credit markets and credit reporting, and to preserve its carefully crafted balance between consumers' competing interests in access to accurate credit information and privacy, Congress preempted the states from enacting laws or regulations dealing with the subject of the 1996 amendments. Specifically, Congress prohibited state laws dealing with:

1. Sharing of information—not just from credit reports—among affiliates (except for two provisions of Vermont law[15]);
2. Use of credit report data for prescreening;
3. Notices to be included with prescreened solicitations;
4. Summary of consumer rights to be provided to individuals;
5. Responsibilities of persons who take adverse action based on a credit report.
6. Time to complete reinvestigations of disputed credit report information;
7. Furnisher responsibilities (except for provisions of California[16] and Massachusetts law[17]); and
8. Time periods for determining the obsolescence of information in consumer credit reports.[18]

Given the dramatic changes taking place in technologies, commerce, and markets, Congress provided that these preemption provisions expire on January 1, 2004.[19]

C. The Fair Credit Reporting Act Balance

The credit reporting system works—and consumers benefit—in large part because of the careful balance the FCRA creates between accessible, accurate information and individual privacy. That balance is reflected in two features of the law as amended in 1996.

1. A Focus on Harm

The FCRA provides significant privacy protections that focus on preventing harm from the subsequent use of credit reports. In particular, the FCRA prevents harm by facilitating the accuracy of collected information, and imposing limits on its subsequent use. It is important to note that the law neither limits the *collection* of information nor does it allow individuals to control the collection of information about themselves. The FCRA allows the market to determine what kinds of data are useful for assessing borrower risk (subject, of course, to other relevant laws such as the Equal Credit Opportunity Act).

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[15]Vermont Stat. Ann., tit. 9, §§ 2480e(a), 2840e(c)(1).

[16]Cal. Civ. Code § 1785.25(a).

[17]Mass. Gen. Laws Ann. ch. 93, § 54A(a).

[18]15 U.S.C. § 1681t.

[19]Id. § 1681t(b)(1)(C).

This feature is critical for the integrity of the reporting system. The value of credit report data derives from the fact that it is obtained routinely, over time, from objective sources other than the consumer that is the subject of the report. Allowing individuals to control the types of information collected would mean that the complete historical data necessary to make a credit report reliable would not be available when it was needed to secure credit. In fact, even if the report were complete, its validity would be suspect if the subject *could* have selectively blocked data. In the words of FTC Chairman Muris: The credit reporting system "works because, without anybody's consent, very sensitive information about a person's credit history is given to the credit reporting agencies. If consent were required, and consumers could decide—on a creditor-by-creditor basis—whether they wanted their information reported, the system would collapse."[20]

However, when it comes to the *uses* to which credit reports may be put, the FCRA provides important, targeted protections. These protections are designed to prevent harmful or risky uses of credit information, while still ensuring that the information is available to serve consumer interests and protect the safety and soundness of the credit system. Credit report data may be used only for a "permissible purpose." *Those purposes reflect the consumer's interest*, whether standing alone (e.g., "in accordance with the written instructions of the consumer") or shared with a business (e.g., "determining a consumer's eligibility for credit, insurance, or employment" or "for a legitimate business purpose in connection with a transaction involving the consumer," or "evaluating consumer eligibility for, or the risk associated with, an existing account"), or reflecting an overriding public interest (e.g., "as required by court order").[21]

The focus on consumer interest and consent in the transfer of credit-related information explains why information that concerns only "transactions or experiences between the consumer and the person making the report" is excluded from the law.[22] For example, information that a bank card issuer has on its customers *based on its own experience* (e.g., balance, available credit, payment history, transaction records) can be used internally (and across corporate affiliates), without limits imposed by the FCRA. Such information results from a relationship to which the consumer has consented and involves the interaction of two parties—the consumer and the card issuer—both of whom have a legitimate interest in being able to use the information.

As of 1996, the FCRA also permits the sharing of credit report information across corporate affiliates as well as its use to prescreen candidates for credit or insurance offers. The law requires that consumers be given the opportunity to opt out of that sharing, because these particular uses of credit information involve businesses initiating contact by making an offer directly to consumers, rather than consumers applying for credit or some other service from a business.[23] Both prescreening and affiliate-sharing create significant benefits for consumers and

[20]Muris, supra.

[21]15 U.S.C. § 1681b(a).

[22]Id. § 1681a(d)(2)(A)(i).

[23]Id. §§ 1681a(d)(2)(A)(iii), 1681b(c)(5).

the economy (discussed in greater detail below), which is why Congress allowed them under FCRA and blocked the states from interfering with them. Nevertheless, because both practices reflect uses of credit report information that are not initiated by consumers, Congress amended the FCRA to confer a powerful privacy right on consumers: the right to block such sharing in advance.[24]

2. Preemption

The second feature of the careful balancing of consumer desire for privacy and consumer demand for goods and services is the 1996 amendments' preemption of certain state laws and regulations. Preemption is a powerful tool, and Congress applied it selectively to those elements of FCRA most important to the national character of the credit reporting system or most vulnerable to state regulation.

As a result, Congress ensured that:

- Individuals would have the same substantive rights irrespective of the state in which they live;

- Furnishers of credit information would not be driven from the voluntary reporting system by overly burdensome compliance requirements or the threat of liability from separate or even inconsistent state laws;

- The content of credit reports would be consistent across the country and the fundamental unfairness to both consumers and creditors of relevant information being reported under one state's laws but withheld under another's would be avoided;

- The credit reporting system would not be burdened by the difficulty—if not impossibility—and expense involved in determining the state of residence, and therefore the state law applicable to, each individual being considered for the billions of offers made to consumers each year; and

- Affiliated companies would be able to share information freely, pursuant to federal law, without having to contend with regulatory barriers erected by state and local governments.

[24]Congress reserved "opt-in"—the most burdensome and costly of privacy protections—for the narrowest of circumstances, where privacy interests and the risk of harm to individuals might legitimately be thought to be at their highest: the use of medical information in a credit report furnished in connection with employment, credit, insurance, or direct marketing; the use of credit reports for employment purposes; and the procurement or preparation of "investigative reports." Id. §§ 1681b(g), 1681b(b), 1681d(a).

States are free to regulate other aspects of the credit reporting system, and they continue to play an important role in enforcement and education, but in the eight areas specified in the statute, federal law alone controls through the end of 2003.[25]

III. The Impact of a Robust, National Credit Reporting System

The balance struck initially by the FCRA in 1970, and amended in 1996, has facilitated the most robust credit information system in the world. In turn, that system has generated extraordinary benefits for individual consumers, businesses, and the U.S. economy. Consider six examples:

A. Consumer Access to Credit

Consumer spending accounts for over two-thirds of U.S. gross domestic product, and is a key driver of U.S. economic growth. Consumer credit markets underpin much of that growth. In 2001, 75 percent of U.S. households participated in the consumer credit markets and held some type of debt. Nearly a third of all households had automobile loans or leases. Sixty-eight percent of U.S. households owned their own homes, and nearly two-thirds of these homeowners had some type of mortgage loan.[26] About 73 percent of all households owned at least one general purpose credit card (e.g., Visa, MasterCard, Discover, American Express).[27] Across 190 million individual credit reports on file with the major U.S. repositories, the average U.S. consumer-borrower had eleven open accounts (seven credit cards, four installment or real-estate-secured loans).[28] Credit market participation is remarkably wide and deep.

The growth in the national credit reporting system has increased the number of Americans who now qualify for credit, insurance, and other financial services, and increased the confidence of providers in meeting the needs of previously underserved populations. More complete, reliable, and widely available personal information allow businesses to provide credit and services to less well-off individuals, as well as to people located in small towns and rural areas who otherwise have limited access to those opportunities. Put simply, *accessible credit information "democratizes" financial opportunity*: because of ubiquitous credit reporting, U.S. consumers can get credit, insurance, investment opportunities, and a host of other financial services based on their individual records, not their name or how long they have known their banker or broker. In addition, they can rent apartments, purchase cell phone and cable TV

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[25]This paper addresses preemption under the FCRA only. There are other provisions of federal law that may preempt state and local regulation of information flows, at least in the financial services sector. See, e.g., National Bank Act, 12 U.S.C. § 24(Seventh), construed by 12 C.F.R. § 7.4006, and Gramm-Leach-Bliley, 15 U.S.C. §§ 6801, 6701(d)(2)(A).

[26]Federal Reserve Board, 2001 Survey of Consumer Finances.

[27]Ana M. Aizcorbe, Arthur B. Kennickell, and Kevin B. Moore, "Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances," *Federal Reserve Bulletin*, Jan. 2003, pp 1-32.

[28]Consumer Data Industry Association, Washington, DC.

services, and rent automobiles without either large deposits or an established relationship with the service provider, all because their reputation for paying as agreed is documented through their credit report.

Consumers in the United States enjoy far greater access to credit than is the case in other countries with restrictive credit reporting laws. For example, economist Walter Kitchenman writes, in Europe "consumer lending is not common, and where it exists, it is concentrated among a few major banks in each country, each of which has it own large databases."[29] In fact, European consumers, although they outnumber their U.S. counterparts, have access to *one-third* less credit as a percentage of gross domestic product.

The impact on U.S. consumers of new restrictions on, or a state-by-state approach to, credit reporting would likely be significant. Economists John Barron and Michael Staten have conducted a study that simulates the effect in the United States of alternative reporting scenarios from Australia, which allows the reporting of negative information only, and various Latin American countries which developed fragmented, industry-specific reporting systems.[30] Their results demonstrate that when risk assessment tools have less information available to them, creditors are less effective at matching loans to creditworthy borrowers. More loans go to borrowers who will default. In addition, more borrowers are rejected who would have repaid. For example, creditors constrained to use the sharply limited credit bureau data present under Australian rules would extend new credit to 11,000 fewer consumers for every 100,000 applicants than would be the case if they were allowed to use the more complete data available under U.S. law. The negative impact is greatest for those who are young, have short time on the job or at their residence, have lower incomes, and are more financially vulnerable.

B. More Efficient Markets and Accurate Decision-Making

The U.S. credit reporting system facilitates accurate and efficient decision-making. The fact that credit reports include information about consumers from a wide range of sources throughout the nation, collected over time, and updated daily, is critical to evaluating individuals' creditworthiness. Rather than relying on data from a single source or that presents a snapshot of the individual at a single moment in time, creditors and other businesses and employers can see a far more complete picture.

Such a complete credit report helps lenders pierce the "fog of uncertainty" that characterizes the risk assessment for a potential new borrower. Lending markets almost always display an information asymmetry between borrowers and lenders. Borrowers typically have more accurate information than lenders about their likelihood of repaying a loan. Lenders have

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[29]Walter F. Kitchenman, Open Consumer Data: Do Benefits Outweigh Privacy Concerns?, presentation to the Merchants Research Council Fall Conference, Coeur d'Alene, ID, Sept. 26-29, 1999.

[30]John M. Barron and Michael E. Staten, "The Value of Comprehensive Credit Reports: Lessons from the U.S. Experience," in Margaret Miller, ed., *Credit Reporting Systems and the International Economy* (forthcoming, MIT Press, 2003).

an obvious incentive to evaluate the borrower's creditworthiness, and the outcome will affect whether to approve the loan as well as its price. Borrowers have an incentive to signal their true risk (if it is low) or disguise it (if is high). Given the amount of the loan principal at stake, both parties have incentives to incur costs (often large ones) to reduce the information asymmetry, and these actions have significant consequences for the operation of credit markets. The emergence of the third-party credit bureau to compile borrower credit histories and distribute them to lenders significantly lowers the cost to all parties of measuring borrower risk.[31]

The result is more accurate and responsible financial decision-making. Federal Reserve Board Governor Edward Gramlich put it this way: "Information about individuals' needs and preferences is the cornerstone of any system that allocates goods and services within an economy." The more such information is available, he continued, "the more accurately and efficiently will the economy meet those needs and preferences."[32]

Credit reporting also provides an early warning system that alerts creditors when a consumer may be becoming overextended. This, in turn, contributes to a sounder financial services sector, decreased risk of consumer bankruptcy, and greater consumer and lender confidence. "Because of credit bureau data," Kitchenman writes, financial institutions "avoid making bad loans in the first place, and they ensure that existing customers are not overextended. Collections efforts reap maximum recoveries."[33] In short, access to personal information facilitates accurate decision making about creditworthiness and helps to minimize fraud. *As a result, delinquency rates are very low in light of the risks involved, especially in the face of such high penetration of credit products.* In the second quarter of 2000 only 2.8 percent of all mortgage holders in the United States were delinquent more than 30 days.[34] Only 4.6 percent of all credit card borrowers were more than 30 days delinquent on their accounts.[35] Although these delinquency rates have risen somewhat during the recent economic downturn and relatively slow recovery, there is no evidence that they pose any major risk to the banking system. Indeed, a scan of 190 million credit reports revealed that 60 percent of U.S. borrowers had *never* had a payment delinquent 30 days or more in the previous seven years.[36] The FDIC reported in late 2002 that although credit card delinquencies had risen, "the profitability of credit-card lending continued to improve, as net interest margins remained high, and income from fees and securitization increased."[37] The easy and quick availability of information is critical to this result. As Federal

[31]For the seminal article on the role of credit bureaus in making credit markets more efficient see Marco Pagano and Tullio Japelli, "Information Sharing in Credit Markets," *Journal of Finance*, Dec., 1993, pp 1693-1718.

[32]*Financial Privacy*, Hearings before the Subcomm. on Financial Institutions and Consumer Credit of the Comm. on Banking and Financial Services, House of Representatives, 106th Cong., 1st Sess. (July 21, 1999) (statement of Edward M. Gramlich).

[33]Kitchenman, *U.S. Credit Reporting*, supra, at 8.

[34]Source: authors' calculations utilizing TrenData, an aggregated credit report database product of Trans Union, LLC.

[35]Id.

[36]Consumer Data Industry Association, Washington, DC.

[37]The FDIC Quarterly Banking Profile, Third Quarter 2002, pp 2-3.

Reserve Board Chairman Alan Greenspan has noted, access to personal information makes individual financial institutions "more creditworthy and efficient," and the U.S. financial services sector "more transparent and stronger in general."[38]

The need for information is so great, that if changes in the FCRA were to limit its availability, creditors would simply have to rely on less accurate proxies. The market determines the value of personal information. It is impossible to legislate that value away. Instead, *restrictions on the collection of useful data simply boost the incentives to devise proxies for the attributes the restricted data were useful for measuring.* These proxies are necessarily less accurate or more expensive (or they would have been utilized in the first place), and quite possibly more intrusive from the standpoint of personal privacy.

C. Enhanced Competition

Because it dramatically reduces the cost of assessing the risk of new borrowers, credit report information encourages entry by new lenders and greater competition. The credit card industry provides a prime example of the pro-competitive effects of nationwide credit reporting. Through the late 1970s, most credit cardholders acquired their cards through their local financial institutions, often by picking up applications at a branch. Choice was limited to the number of issuers in the local area who happened to offer a card product. Customers in smaller towns had fewer choices than residents of large cities. Local institutions faced little threat of entry into the market by financial institutions outside the state or region, a fact that was reflected in higher prices and little variance in card features.

All of this began to change in the early 1980s. A key legal decision in 1978 gave national banks the ability to launch national credit card marketing programs at far lower cost than before.[39] The ability under the FCRA to acquire information about potential cardholder prospects, irrespective of location, made it possible for companies—both new and established—to enter new geographic markets, often with astounding speed. In particular, the use of prescreening to target qualified applicants accelerated card offerings and competition. New "monoline" entrants, like MBNA and First USA, and later Capital One, used credit reports and other externally acquired information to identify and target low-risk borrowers for their low-rate cards throughout the United States. By the mid-1980s, retailers and manufacturers, such as Sears (Discover card), General Motors, AT&T, and General Electric also began introducing their own bank credit cards as unique alternatives to the traditional Visa and MasterCard products being offered by banks. These entrants combined data about existing customers of their corporate affiliates with information from credit reports and other external sources to identify and reach likely prospects. Many of these new products came without an annual fee and gave consumers an opportunity to earn cash rebates or free products and services each year depending upon their

[38]Remarks by Alan Greenspan at the Conference on Bank Structure and Competition of the Federal Reserve Bank of Chicago, Chicago, IL (May 6, 1999).

[39]Marquette National Bank of Minneapolis v. First of Omaha Service Corp., 439 U.S. 299 (1978).

charge volume. Thanks to the success of those new market entrants, cards offering frequent traveler miles, rebates and other consumer benefits have become commonplace.[40]

The wave of new entrants to the bankcard market put great downward pressure on the finance charge rate and annual fees charged by existing issuers. Incumbent issuers were forced to make a choice: either leave their rate unchanged and risk defection of their best customers to the new, low-rate entrants or cut finance charge rates and fees. In late 1991 American Express became the first major issuer to unveil a tiered pricing structure for its Optima product to slow customer defections. This was the beginning of sophisticated risk-based pricing within major credit card portfolios. Shortly thereafter, Citibank announced a similar pricing structure for its Classic cardholders, who had been paying 19.8 percent. Citibank officials estimated that by the end of 1992, nearly ten million Citibank Classic cardholders had benefited from the new tiered rate structure. The proportion of all revolving balances in the United States being charged an APR greater than 18.0 percent plummeted from 70 percent to 44 percent in just 12 months.

The ability of new entrants to use personal information to establish and cultivate relationships with customers thousands of miles away has transformed the competitive landscape in the United States, injecting intense price and service competition into the credit card market which had not been historically noted for either. In contrast, laws that would inhibit the assembly of comprehensive credit reports act as a barrier to competition by giving the dominant incumbent lender a monopoly over the information it possesses about its customers, and denying new market entrants the information needed to provide and market competitive services. Such laws "raise barriers to entry by smaller, and often more innovative, firms and organizations.[41]

D. Reduced Costs

In the United States, comprehensive credit reports have improved the competitiveness and efficiency of credit markets, led to powerful improvements in risk-management technology (like credit scoring), and brought consumers more product choices, lower prices and more equitable treatment. Interestingly, to the extent credit reports enable lenders to do a better job of assessing and pricing borrower risk, they reinforce borrower incentives to manage credit wisely and avoid delinquencies and defaults. *All of this ultimately lowers the cost of credit to consumers.*

Reliable, centralized, and standardized consumer credit information also makes it possible to pool consumer loans and then sell them to investors. This process—known as securitization—makes more capital available to consumers and greatly reduces the cost of credit. A Tower Group consulting study concluded that U.S. mortgage rates are two full percentage

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[40] This account draws heavily on Barron and Staten, supra.

[41] Robert E. Litan, *Balancing Costs and Benefits of New Privacy Mandates*, AEI-Brookings Joint Center for Regulatory Studies Working Paper 99-3, p 11 (1999).

points lower than in Europe because it is possible to securitize and sell mortgage loans.[42] *Consequently, American consumers save as much as $120 billion a year on nearly $6 trillion of outstanding mortgages because of the efficiency and liquidity that credit report data make possible*.[43] In addition, there is growing, cross-country empirical evidence that the increased efficiency of capital markets is a powerful determinant of growth. Improved risk sharing—by spreading risks over a larger pool of capital and a larger number of investors—lowers the cost of capital, and leads to greater investment.[44]

E. Speed and Convenience

The depth of information in U.S. credit reports enhances the speed of credit, insurance, and other financial service decisions. Even very significant decisions about financing a college education or a new home or writing automobile or homeowners insurance are often made in a matter of hours or minutes, instead of days and weeks as is the case in most other countries, because credit history data is readily accessible. A survey of auto lenders in the United States revealed that in 2001, 84 percent of automobile loan applicants received a decision within an hour; 23 percent of applicants received a decision in less than 10 minutes.[45] Many retailers open new charge accounts for customers at the point of sale in less than two minutes. These short turnaround times are unheard of in most other countries where restrictive laws often prevent credit bureaus from storing sufficient information on consumer borrowing and payment behavior to support rapid and accurate decision-making.

F. Consumer Mobility and Choice

Information facilitates consumer mobility. Another benefit to consumers of this information-based financial system is the ease of obtaining financial services when moving or doing business far from home. "Portable [credit] histories mean that both people and capital are more mobile, which is an important advantage in a more competitive global business environment."[46] The availability of that information, which facilitates both speedy and nationwide access to financial services, also helps U.S. consumers avoid or more rapidly overcome the dislocations that are the inevitable result of a more global economy, freer trade, and a rapidly changing job market.

In addition, because credit reporting facilitates national competition, the entry of new competitors, and consumer mobility, it also increases the range of credit products and services

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[42]Walter Kitchenman, *U.S. Credit Reporting: Perceived Benefits Outweigh Privacy Concerns*, The Tower Group, 1999.

[43]If mortgage interest rates are 2 percent lower as a result of securitization, 2 percent of $6 trillion in outstanding mortgages equals a $120 billion savings in interest each year.

[44]Geert Bekaert, Campbell Harvey, and Christian Lundlbad, "Does Financial Liberalization Spur Growth?" NBER Working Paper No. 8245, National Bureau of Economic Research, Apr. 2001.

[45]Consumer Bankers Association, 2002 Automobile Financing Survey.

[46]Kitchenman, *U.S. Credit Reporting*, supra, at 1.

from which consumers can choose. This effect is apparent even within individual companies. A 2001 Federal Reserve Board study noted, for example, that "[m]any card issuers that in the past offered programs with a single interest rate now offer a broad range of card plans with differing rates depending on credit risk and consumer usage patterns."[47]

G. Summary

The U.S. credit reporting system has benefited all consumers by facilitating access to more credit and financial services, especially for traditionally underserved populations. It has improved the accuracy of financial decision-making, with substantial benefits not only for individual consumers, but for the entire economy. Ubiquitous credit information has significantly enhanced competition, improved access, and lowered prices by making it possible for existing financial institutions to compete for customers nationally, and by leveling the playing field so that new entrants could overcome the advantage of established lenders in assessing new customers. The credit reporting system has significantly reduced costs for mortgages, credit card, and other financial services. Accessible credit information has dramatically improved consumer convenience, making possible the "miracle" of instant credit; consumers can even apply for a mortgage or auto loan by phone or via the Internet and get a decision within seconds. And the U.S. system of credit reporting greatly enhances consumer mobility and choice.

IV. The Current Debate

As the January 1, 2004, deadline for preemption to expire nears, some privacy advocates and legislators have proposed not reinstating preemption in the eight "core" areas of FCRA, so that states would be free to impose additional requirements on the credit reporting system as they see fit. California and North Dakota have already begun debating legislation that would regulate uses of information in ways currently preempted by the FCRA, and a number of California municipalities have already adopted similar ordinances, despite the fact that they are currently preempted.[48]

Alternatively, others have proposed enacting new federal requirements—as the "price" for reimposition of preemption—that would prohibit the sharing of credit report data across affiliates and/or the use of prescreening for target marketing unless an individual provides explicit consent (i.e., opts-in). Although most advocates concede that there has been little or no documented "harm" resulting from these uses of credit information per se, they worry that consumers are not widely aware of their existing rights to opt-out of these uses; that the use of

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[47] *The Profitability of Credit Card Operations of Depository Institutions*, Board of Governors of the Federal Reserve System, June 2001.

[48] California SB 1 (Speier) (introduced 2003); North Dakota HB 1287 (Kasper) (introduced 2003); Daly City Ordinance No. 1295 (Sep. 9, 2002), as amended by Ordinance No. 1297 (Nov. 12, 2002); Contra Costa County Ordinance No. 2002-30 (Sep. 24, 2002), as amended by Ordinance No. 2002-44 (Nov. 5, 2002); San Mateo County Ordinance No. 4126 (Aug. 6, 2002), as amended by Ordinance No, 4144 (Nov. 5, 2002); San Francisco City Ordinance No. 237-02 (Dec. 20, 2002).

credit information to target offers for financial products and services may foster consumer unease about the ways data about them is used; that targeted marketing of products may exclude some less-qualified consumers from opportunities; and that greater sharing and use of credit report information increase the risk of it falling into the hands of the government or of perpetrators of fraud, identity theft, and other crimes. As a result, they argue that it is time to redraw the balance reflected in the current law.

A. The Role of Preemption in Credit Reporting

1. National Markets and Competition

Many of the dominant social and economic themes of the past 20 years involve breaking down barriers to commerce and creating new opportunities for consumers. Technology has played a significant role in eliminating geographical barriers, for example, by making national credit reporting possible and by allowing consumers to access information and to obtain products and services without regard for location. Today, for example, many Americans use the Internet to access Web sites in states and countries they will never physically visit, and more than two-thirds of Americans shop via telephone, mail, and the Internet with businesses they may never see in person.

New laws have also contributed to reducing barriers. The Gramm-Leach-Bliley Financial Services Modernization Act, for example, eliminated decades-old legal restraints on the provisions of financial services and products.[49] No longer is a consumer forced to obtain insurance, investment advice, and banking services from separate establishments. Instead, the law has opened up these markets to expanded competition. Similarly, the Health Insurance Portability and Accountability Act, as its title indicates, was designed to facilitate the portability of health information so that as individuals move, travel, and change jobs, their health information will follow seamlessly from institution to institution and from state to state.[50]

Consumers have become more mobile. Forty-two million Americans—approximately 16 percent of the U.S. population—move each year. As of 1998, there were 6 million vacation or second homes in the United States, often in states different than the owners' primary homes.[51] A growing number of consumers live in one state and work in another. This is especially true in major urban centers, such as New York, New Jersey, and Connecticut, or Virginia, Maryland, and the District of Columbia, where population is most concentrated.

Credit reporting contributes to breaking down barriers and opening up markets to national and global competition. Credit reporting today is inherently national. The value of the entire

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[49] 106 Pub. L. No. 102, 113 Stat. 1338, tit. V (1999) (codified at various sections of 15 U.S.C.).

[50] 105 Pub. L. No. 104-191, 262(a), 110 Stat. 1936 (1996) (codified at various sections of 18, 26, 29 and 42 U.S.C.).

[51] *Use and Misuse of Social Security Numbers*, Hearings before the Subcomm. on Social Security of the House Comm. on Ways and Means, May 11, 2000 (statement of Stuart K. Pratt).

system depends upon data being collected about borrowers who travel and use credit nationwide, and collected from creditors who are located throughout the country and deal with customers nationwide. This is why credit bureaus have undergone such consolidation and integration during the past half-century.

Virtually all of the benefits to individuals and the economy from the current U.S. reporting system result from its national character. National credit reporting made possible national competition in the market for credit and other financial services. That competition depends on the ability of banks and other card issuers to enter distant markets and provide customer service across state lines. Capturing credit data on a state-by-state basis provides little value because the vast majority of consumers deal with creditors from out of state.[52] Compartmentalizing credit histories state-by-state would leave holes (potentially large ones) in a consumer's credit file. *All of the benefits of the U.S. consumer credit system depend on the existence of a single, national regulatory framework.*

Federal Reserve Board Chairman Alan Greenspan stressed the importance of centralized credit reporting in recent testimony before Congress. According to the Chairman, "100 years ago, when we just had small banks dealing with individual customers, you knew what the credit quality of your loans was. You knew the families to whom you were lending. You knew the businesses. And you didn't need a data bank."

Today, however, "as we became ever larger and far more complex and as our financial system, especially that which relates to consumer credit, became huge in the post-World War II period, there was no other way to handle a fair evaluation of the credit standing of individual borrowers unless it was, in one way or another, more automated." That, according to Chairman Greenspan, requires that we "build up some means of history that would essentially enable us to, as bankers say, to make judgments without knowing the person personally and not having in front of them a great deal of information, especially because you may not have any way of doing that."

"These data systems," Chairman Greenspan stressed, are "essential, in my judgment, to enable consumers to have access to credit." The national, data-based credit reporting system has had a "dramatic impact, I think, on consumers and households and their access to credit in this country at reasonable rates. That system cannot function without data, without the credit histories of individual borrowers." As a result, the Chairman concluded, "I should certainly hope that it is maintained."[53]

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[52]A simple example illustrates the point. Not a single one of the ten largest bank card issuers is located in Texas, the second-most populous state in the U.S. Those top ten issuers held 83 percent of all bank card receivables at the end of 2001. Consequently, it is quite likely that 80 percent or more of Texans with bank cards are borrowing from and making payments to one or more out-of-state financial institutions. This is the rule rather than the exception, and reflects the national character of U.S. credit markets. *Card Industry Directory*, 2003 Edition, Thomson Media, New York, 2002, p 17.

[53]*Federal Reserve's Monetary Policy Report*, Hearings before the House Comm. on Financial Services, Feb. 12, 2003 (testimony of Alan Greenspan).

Moreover, national credit reporting reflects consumer expectations. When a consumer applies for a credit card, an auto loan, or a mortgage, he/she does not expect that the information that may be considered when evaluating those applications will differ depending upon the state in which the creditor is located. Put another way, a consumer's reputation for creditworthiness should not depend on the state in which he/she lives. For example, a Texas resident would probably be unhappy to learn that she would qualify for more credit or better terms if she lived in South Dakota than she does in Texas. She would be even more unhappy to learn that the only reason was because her home state prohibited creditors from seeing her full credit history.

Consumers have come to expect that their credit information is protected by the same standard, no matter the location of the service provider or of the consumer, and without regard for whether the service is being provided through a physical store, by phone or mail, or online.

2. The Burden of State and Local Regulation of National Credit Reporting

The cost of determining which state law or laws applied, and of complying with those laws, could easily undermine the credit reporting system. That system deals in huge volumes of data—over 2 billion trade line updates, 2 million public record items, an average of 1.2 million household address changes a month, and over 190 million individual credit files. Its viability depends on exceptional efficiency and low marginal costs of updates, which, in turn, keep the cost of providing credit reports low. *In the face of greater centralization and unification of markets, and the increased mobility of both consumers and the goods that they desire, crafting, implementing, complying with, and enforcing 51 separate privacy laws will always be more expensive than is the case with a single law.* And that number may be far higher: already Daly City, Contra Costa County, San Mateo County, and San Francisco have adopted their own ordinances regulating the sharing of financial information with affiliates and third parties—four separate laws, in addition to applicable federal and state laws, within one 20-mile area. If state and local laws are inconsistent, compliance costs are greatly exacerbated. If those laws actually conflict, those costs may be extraordinary.

Worse still, it may be impossible for a business to comply with the conflicting provisions of state credit reporting laws in all of the states in which it operates. This is especially true online. The Internet crosses state boundaries and has facilitated truly national (in many cases, global) markets. Yet the technologies of the Internet make it *impossible* to identify in which state users are located. Even offline, however, businesses face a significant compliance challenge when faced with inconsistent state requirements. An ironic example comes from the recent experience of gourmet ice cream manufacturer Ben & Jerry's with food labeling. Although a vocal opponent of genetically altered milk, and one of the first U.S. companies to voluntarily label its products as containing only milk from untreated herds, the company had to abandon this practice—even though it and its customers desired it—"because of the difficulty of complying with multiple state labeling requirements."[54]

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[54]Dan L. Burk, "The Milk Free Zone: Federal and Local Interests in Regulating RecombinantbST," 22 *Columbia Journal of Environmental Law* 227, 299 (1997).

3. The Need for Uniformity

The need for a single standard in the core areas of credit reporting is so great that if Congress fails to maintain one through federal legislation, it will likely emerge from the states. When the costs and complexity of complying with state-by-state legislation are high, then in the face of multiple legal standards, the most restrictive tends to dictate business practices. By complying with the most restrictive law, a business hopes to comply with the less restrictive ones as well.

In the case of credit information, states that adopt the most restrictive laws (and that are too populous or important for a business to simply cease to operate in), will set the de facto privacy standard for all other states. In the absence of express federal preemption, the most restrictive state privacy regime will ultimately effectively preempt both the privacy laws of other states and the federal standard as well. This is the irony of the current preemption debate. *The question isn't whether there will be de facto preemption, but rather from what source it will come: Congress or one state legislature imposing its laws on the entire country.*

Howard Beales, head of the FTC Bureau of Consumer Protection, noted this point when he was a professor at George Washington University. Addressing the specific subject of product advertising, which is similar to credit reporting in terms of its national reach and high cost of entry, Beales wrote that "[t]he high costs of developing advertising and the lack of any marketing reason to distinguish between consumers based on their state of residence mean that, as a practical matter, actions by individual states will determine the content of advertising for consumers nationwide." As with credit reporting, "*it is the most restrictive judgment, rather than the most accurate, that will effectively govern,*" Beales noted. "*If the most restrictive judgment" prevails, Beales concluded, "consumers are the likely losers*. . . . Indeed, it is hard to imagine a system that is more likely to encourage advertisers"—or credit bureaus, he might have added—"to avoid altogether the kinds of objective product information that are most valuable to consumers."[55]

4. Lack of Preemption Weakens Privacy and Makes It More Costly

Historically, privacy advocates have argued for the need to replace state and local laws with a single, uniform privacy standard. A national standard offers better and more consistent privacy protection. In regard to the privacy of medical records, Helena Gail Rubenstein, from the Massachusetts Group Insurance Commission, has written that "normatively, privacy advocates and data users agree that any health information system that must operate within the confines of fifty different sets of ground rules cannot operate efficiently."[56]

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[55]J. Howard Beales, III, "What State Regulators Should Learn From FTC Experience in Regulating Advertising," *Journal of Public Policy & Marketing*, vol. 10, no. 1, Spr. 1991, p 101 (emphasis added).

[56]Helena Gail Rubenstein, "If I am Only for Myself, What Am I? A Communitarian Look at the Privacy Stalemate," 25 *American Journal of Law and Medicine* 203 (1999).

Health privacy expert Larry Gostin elaborates on the burden to consumers and businesses of multiple state privacy standards for health care information:

> The absence of a uniform health information policy imposes hardships on virtually all concerned. Health care institutions, insurance companies, and self-insured employers who transmit health data through interstate commerce often do so without clear guidance regarding which state's laws govern or which state's courts have proper jurisdiction to resolve disputes that may arise. Without the ability to know and to rely on uniform regulation of information, patients lack the basis for meaningful consent to disclosure. Lack of uniformity adversely affects the integrity of health data, and the quality of care itself, by undermining efforts to automate health records.[57]

The absence of preemption, according to Gostin, "is self-defeating. It simply pushes the privacy battle into state legislatures and redirects the resources of the provider and research communities to costly lobbying efforts in the fifty state capitals. What will result is a patchwork of rules, as each state makes its own peace with the various interest groups." *The absence of preemption, he concluded, in a world in which "data needs do not recognize state boundaries" and businesses "operate in multiple states," is to "increase the cost" to everyone who pays for goods and services in the modern economy.*[58]

It is not clear why credit reporting should be different—why consumer privacy would be enhanced by "a patchwork of rules," rather than a uniform national law. How are consumers served, for example, by receiving different notices of their rights under the FCRA or by waiting different amounts of time for reinvestigations of disputed data to be completed, depending upon the state or county or city in which they are located?

In the face of the clearly demonstrated benefits of a national credit reporting system, subject to a federal regulatory framework, and their historical support for national privacy standards, it would seem incumbent on advocates of change to make the case why state-by-state or even city-by-city regulation of credit reporting would enhance consumer privacy. To date, they have not done so.

Advocates of state regulation of credit reporting argue that one or more states might prove more politically hospitable than Congress to greater restrictions on the collection and use of credit information. Given the necessity of a national standard, they may well hope that the adoption of a more restrictive law by a populous state would lead to a more restrictive national standard. This could occur either because that state's standard would become the de facto

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[57] Lawrence O. Gostin, et al, *Legislative Survey of State Confidentiality Laws, with Special Emphasis on HIV and Immunization,* p 249 (1996).

[58] Lawrence O. Gostin, "Health Information Privacy," 80 *Cornell Law Review* 451 (1995) (emphasis added).

national standard, because the adoption of that standard by a state, or even the threat of such an action, would drive industry to Congress, willing to accept the greater restriction as a national standard in exchange for preemption. In either case, the ultimate goal appears to be a more restrictive standard nationwide, rather than a mélange of state and local laws.

This political strategy for achieving that regulation ignores the significant costs of overlapping or inconsistent state and local regulation in the meantime, the specter of conflicting state or local standards during any transition period to a national standard, and the fundamental question of whether Congress or individual states are better suited to write the laws by which the national credit reporting system operates.

B. What is at Risk if Preemption Expires?

Some privacy advocates and legislators have advocated new restrictions on the use of credit report information, whether by the states or, by Congress as the "price" for reimposition of preemption. The most commonly proposed new restrictions in currently preempted areas include expanding the responsibilities of furnishers of credit file information, reducing the length of time that information may be included in credit reports, and conditioning the sharing of credit report data among affiliates and prescreening for target marketing on individual opt-in. In addition, some privacy advocates have proposed new restrictions on the use of personally identifiable information for marketing generally, even though unrelated to the FCRA, as a condition for renewing preemption. We address what is at stake in each of these proposals below.

a. Furnisher Responsibilities

In 1996, Congress excluded the states from regulating the responsibilities of furnishers of credit information. This reflected a significant vulnerability of the current credit reporting system. Because no one is *required* to provide information to credit bureaus, if furnishers of information faced significant compliance burdens or liability, as would be the case if complying with separate and even inconsistent state laws, they would be more likely to stop contributing the information. Voluntary reporting has already proved fragile as some financial institutions seek to withhold information about their best customers that might be used by competitors to try to attract those customers. Some credit grantors, for example, choose to report derogatory information only (e.g., delinquencies, charge-offs) or choose not to report at all.

The industry and regulators have long fought this practice, because even the absence of a small amount of relevant information from credit reports could dramatically reduce their usefulness and lead to less accurate credit decisions and less access to credit for people who need it most. In fact, in 2000 the Federal Financial Institutions Examination Council sent a letter to banks warning that incomplete credit bureau information can "cause them to make incorrect lending decisions and can hurt their financial soundness and cause "subprime borrowers who make payments on time unfairly [to] be charged higher interest rates when they seek credit in the future because their credit records don't include information showing their responsible prior payments."[59]

Imposing liability for errors or significant additional burdens on the furnishers of consumer data to credit bureaus would encourage some (perhaps many) firms to curtail or cease reporting. *They would no longer enhance the quality and depth of the bureau information by contributing their portfolio experience.* The predictive accuracy of scoring models would quickly deteriorate if non-participation became commonplace. Increased or disparate standards of furnisher liability would be inconsistent with current regulatory initiatives to encourage robust reporting, and could easily undermine the value of credit reporting.

b. Obsolescence Determinations

The 1996 amendments also precluded states from regulating when data would be considered "obsolete" and therefore could not be included in credit reports. Currently, derogatory information must be excluded from credit reports after seven years (with the exception of a notice of bankruptcy, which may remain for ten years). Proponents of accelerated deletion argue that the old information is "stale" and therefore may no longer be relevant to determining an individual's creditworthiness.

The available evidence, however, suggests that these arguments are wrong. Derogatory information continues to distinguish levels of credit risk "even as the information ages."[60] The results of one 1990 study are particularly interesting. The study found that "significantly more people who declare bankruptcy have older public record derogatory information but none in recent years, than do all people. As a result, if creditors are not allowed to know of public record derogatory information that is four years old or older, they may lose an important predictor of future bankruptcy."[61]

Since storage of old information entails positive costs, simple economics suggests that bureaus will retain data only so long as its value (enhanced prediction of risk) exceeds the storage cost. If creditors find old derogatory information is useful, then they will pay more for files that have it (or purchase reports more frequently). Laws that prohibit the use of such information degrade the reporting system's value for predicting risk. Moreover, they impose a fundamental unfairness, because each credit applicant will know of his/her past behavior, but creditors will not.

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[59]"It's Essential That Lenders Report Credit Data," *The Commercial Appeal* (Memphis, TN), Jan. 23, 2000, p C2.

[60]Fair, Isaac Companies, *The Associated Credit Bureaus, Inc. Study on Adverse Information Obsolescence Phase 1*, Sep. 1990, p 3.

[61]Fran Lyons and Lee Allen, "Importance of Aged Public Record Derogatory Information," *Dialogue*, MDS Group, Fall 1990, p 6.

c. Opt-In for Prescreening, Affiliate-Sharing, and Marketing Generally

The 1996 amendments to the FCRA explicitly authorized the sharing of consumer report information among affiliated companies and with anyone for the purpose of marketing credit or insurance opportunities to consumers, provided that consumers are given an opportunity to opt out of that sharing.[62] Congress thought these activities too important to subject them to divergent state regulation. In fact, Congress went so far as to preempt all state and local regulation of information-sharing—not just the sharing of information from credit reports—among affiliated companies. Congress ensured, however, that consumers would have the opportunity to opt out of these uses of credit data.

Specifically, creditors who use credit report data to prescreen must inform consumers who receive offers of their right to opt out of having credit report data supplied for prescreening in the future. This opt-out system is maintained by the credit bureaus and applies to all future prescreening. Creditors who wish to share credit report data among affiliates must inform customers and give them an opportunity to opt out prior to beginning the sharing. As a practical matter, this notice is usually provided in account opening forms or billing statements. The opt-out is company-specific; it does not prohibit information-sharing among another group of affiliates.

Privacy advocates propose altering the balance struck in 1996 by shifting to an opt-in regime, that is, requiring companies to obtain explicit consumer consent prior to using personally identifiable information for prescreening, affiliate-sharing, and perhaps marketing generally.

i. Opt-In is a High-Cost Means of Giving Consumers Choice

An opt-in system for giving consumers choice over information usage is always more expensive for firms (and through them to consumers) than opt-out because it requires each company that wishes to use personal information to target its marketing efforts to gain explicit consent from each consumer prior to making any offers. In contrast, opt-out is less costly because it infers permission if consumers don't explicitly object.

The difficulty of contacting all consumers individually *and of obtaining a response from each of them* is a significant contributor to the cost of opt-in and the primary drawback of an opt-in approach. For example, according to the U.S. Postal Service, 52 percent of unsolicited mail in this country is never read.[63] If that figure translates to opt-in requests, then more than half of all consumers in an opt-in system would never learn of the opportunity to opt in and the consequences of not doing so. Moreover, even if an unsolicited offer is read, experience with company-specific and industry-wide opt-out lists demonstrates that less than 10 percent of the U.S. population ever opts out of a mailing list—often the figure is less than 3 percent.

[62] 15 U.S.C. §§ 1681a(d)(2)(A)(iii), 1681b(c)(5).

[63] "Briefs," *Circulation Management*, May 1999 (referring to the U.S. Postal Service's *Household Diary Study* (1997).

In 1997, U.S. West (now Qwest Communications), one of the largest telecommunications companies in the United States, conducted one of the few affirmative consent trials for which results are publicly available. The company tested a variety of methods for seeking permission from its customers to utilize information about their calling patterns (e.g., volume of calls, time and duration of calls, etc.) to market new services to them. The task of reaching customers proved daunting. It required an average of *4.8 calls* to each consumer household before the company even reached an adult who could grant consent. In one-third of households called, U.S. West *never* reached the customer, despite repeated attempts. Just contacting customers cost approximately $20 per positive response in the telemarketing test and $29-$34 per positive response in the direct mail test. This led the company to conclude that opt-in was not a viable business model because it was too costly, too difficult, and too time intensive.[64]

Opt-in is especially inefficient in the context of credit granting because it requires that every consumer be contacted, even though only a portion will in fact qualify for an offer. Those who do qualify may have to be contacted *twice*—once to obtain permission to use the data and again to make the offer. Since consent for affiliate-sharing is company-specific, those contacts must be multiplied across the thousands of U.S. businesses that wish to share credit information with affiliates. The ordinances recently adopted by California municipalities would increase these contacts and other burdens on consumers even more, by requiring that opt-in be renewed. The cost of these additional contacts will be borne by consumers, directly in the form of more unsolicited contacts, and indirectly in the form of higher prices for products and services to cover the cost of millions of additional letters and telephone calls.

The consequence of not receiving or not responding to the opt-in request is the elimination of that consumer from all prescreening and all information-sharing among that group of companies, even by creditors unknown to the consumer or for products and services perhaps not yet even in existence. The greatest cost of opt-in to consumers, therefore, may be the opportunity cost of not being considered for future offers.

The difficulties of reaching consumers are exacerbated in the credit reporting context by the fact that credit bureaus usually have no relationship or direct contact with the consumer. Individuals are less likely to pay attention or respond to requests for consent from companies with which they have no dealings. This makes opt-in an especially great impediment to new and smaller market entrants, who lack extensive customer lists of their own or the resources to engage in mass marketing to reach consumers likely to be interested in their products or services. If information for targeting offers is unavailable because the cost of soliciting opt-in consent is too great or because too few customers have received and responded to opt-in requests, new competitors may be unable to

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[64]Ex parte letter from Kathryn Krause to Dorothy Attwood (Sep. 9, 1997), in the proceeding In the Matter of Implementation of the Telecommunications Act of 1996; Telecommunications Carriers' Use of Customer Proprietary Network Information and Other Customer Information; Implementation of Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended, 63 Fed. Reg. 20,326 (1998) (FCC, second Report and Order and Further Notice of Proposed Rulemaking). See also brief for Petitioner and Intervenors at 15-16, U.S. West v. FCC, 182 F.3d 1224 (10th Cir. 1999) (No. 98-9518).

market their products and services at all. The promise of explicit consent in the opt-in regime in fact results in nothing to consent to at all. Put simply*, the consensus of studies and company experience to date is that conditioning the use of information on opt-in consent is tantamount to banning the use outright.*

ii. The Impact of Opt-In on Prescreening and Other Target Marketing

A practical example may help illustrate the harmful impact of opt-in applied to prescreening and other target marketing. A recent study sought to calculate the cost of specific forms of opt-in restrictions on the operations of MBNA Corporation, a diversified, multinational financial institution that services 15 percent of all Visa/MasterCard credit card balances outstanding in the United States.[65] The company, which has no retail offices, makes extensive use of direct marketing to attract customers.

MBNA relies heavily on personal information to sort through the nearly 1 *billion* prospect names that it receives annually from more than 4,700 affinity groups for which the company issues credit cards. From those lists the company would typically identify approximately 400 million names of people who were most likely to be both qualified for and interested in a credit card solicitation.

The case study found that restrictions on third-party information-sharing for marketing would result in MBNA's marketing materials being *27 percent less well targeted*. In a typical year this translates to *more than 100 million people who would have received solicitations who were either less qualified or less interested than other consumers who did not receive offers*. Moreover, an pt-in regime would translate into an *18 percent lower response rate* and a *22 percent increase in direct mail costs* per account booked. There would also be an additional *8 percent reduction in the company's net income* because of increased defaults and reduced account activity, resulting from less qualified people receiving and acting on credit card solicitations. These costs would be incurred despite the fact that as of the end of 2000, *less than 2 percent* of MBNA's customers had taken advantage of the company's voluntary opt-out from receiving any type of direct mail marketing offers.

The MBNA example illustrates opt-in's effect on target marketing generally. Target marketing relies on data about consumers to allow a business to send an offer to an individual specifically identified as likely to be interested. The alternative is to market randomly, contact everyone in an entire geographic area, or rely solely on mass media advertising to reach likely customers. Target marketing enhances competition, expands choice and lowers prices, all because it dramatically reduces the costs of soliciting new customers. But, target marketing is impossible without access to information, and opt-in acts as an effective ban on that information

[65] Michael E. Staten and Fred H. Cate, "The Impact of Opt-In Privacy Rules on Retail Credit Markets: A Case Study of MBNA," __ *Duke Law Journal* __ (forthcoming 2003).

Access to third-party information and the use of that information for target marketing helps level the playing field for new market entrants. What is the risk? With target marketing, consumers who receive offers for products or services they don't want can discard them. In the face of such demonstrated benefits and negligible risk of harm, Congress chose in 1996 to encourage the use of credit report information for prescreening and preempted states from interfering with that activity. Seven years later, we see no compelling case for new restrictions.

iii. Opt-In and Affiliate-Sharing

Businesses create affiliates for a number of reasons, many of which have to do with tax, insurance, and regulatory requirements. Often these affiliate relationships are invisible to the customer. For example, most retailers provide specialized products and services such as fine jewelry, optometry, photo studios, product repair and installation, restaurants, and catalogs through separate affiliates, but they share one brand name, accept the store charge card, participate in the same loyalty programs, and offer the same warranties. To the consumer, the use of affiliates enhances convenience; to the retailer, it is an operational and regulatory necessity. Similarly, financial institutions, while appearing to the customer as one unified operation, often provide retail banking, credit card, investing, mortgages and loans, check printing, and other services through separate affiliates.

The ability to share credit report data across affiliates facilitates cross-selling, which heightens competition. Because the recipients of those offers are already customers of at least one affiliate that cross-selling is often anticipated and even expected by customers. For example, a banking customer who maintains a high balance on a credit card is benefited when informed that she could reduce the interest she is paying by transferring the balance to a secured home equity loan. Most customers don't care that the credit card and the secured loan are provided by different affiliates, they just appreciate saving money.

The ability of affiliates to share credit report and other data is critical to evaluating customer needs and their qualifications for new offers. Credit reports provide a view of consumers across business relationships and over time. No single business has such a broad picture of its customers. That broad view is at the heart of "relationship management," not just in financial services, but in myriad industries. The impact of opt-in is greater in the context of affiliate-sharing than in prescreening generally, because it confounds customer expectations and interferes with relationships between businesses and their customers.

Currently, the FCRA preempts states from regulating the sharing of not only credit report data among affiliates, but of *any* information. As a result, not just credit data are at stake if Congress fails to reenact preemption applicable to affiliate-sharing or if it adopts an opt-in requirement applicable to affiliate-sharing; all data shared among affiliates is at risk. California, for example, has considered for the past two years legislation that would restrict the sharing of all personal financial information across affiliates, and, as noted, a series of California municipalities have enacted ordinances prohibiting information-sharing among affiliates unless customers opt in and renew their consent annually.

The MBNA experience provides useful insight into the many types and uses of information currently shared by affiliates throughout the financial services sector. Examples of data shared across affiliates include data on customers whose applications for one product were denied, but who might qualify for other products; aggregation of account balances to qualify the customer for lower fees or more personalized service; consolidated customer service so that the client calls one phone number or visits one web site to manage all of his accounts; early warning about customers who may be overextended or are likely to default, to intervene to help the customer avoid bankruptcy; spotting patterns that might indicate a customer is a victim of identity theft; and protecting the company against fraud. Opt-in for affiliate-sharing would interfere with all of these activities, since all depend on sharing data across affiliates.[66]

iv. The Impact on Privacy

Given the many ways in which prescreening, affiliate-sharing, and target marketing benefit consumers, what justifies imposing the burden and cost of opt-in on consumers and business? Privacy advocates have suggested four possibilities, which we address briefly in turn.

Some privacy advocates argue that the sharing of credit and other information increases the risk of fraud and identity theft. There is surprisingly little research on either the prevalence or causes of identify theft. The evidence that is available offers little if any support of a causal link between the use of credit report data for prescreening and target marketing and the frequency of identity theft. In fact, it appears that most cases of identity theft involve a friend, family member, or co-worker.[67]

A closer look at prescreening and affiliate-sharing reveals them to be unlikely contributors. Virtually all prescreening is done at the credit bureau: creditors specify criteria and the credit bureau creates a list of consumers meeting those criteria. The bureau releases only the list, not the criteria or any credit information, directly to a mailing house, so no credit data ever leave the credit bureau. Some privacy advocates point to the risk that prescreened credit offers will be stolen from mailboxes and used for identity theft. This risk, however, has nothing to do with whether credit report information—or any financial information—is used to generate the offer, and, in any event, would be presented equally by bills, account statements, and many other types of mail. Affiliate-sharing, by definition, involves information that is already possessed by the company. Any "sharing" is wholly within that company, and often consists not of transferring copies of data, but of merely storing data in a database accessed by various affiliates.

[66]This is especially true with fraud detection and prevention efforts, because people who intend to defraud a creditor or default on an obligation are unlikely to opt-in to the sharing of information that will make that conduct easier to detect.

[67]*Identity Theft*, Hearings before the House Committee on Commerce Subcommittees on Telecommunications, Trade & Consumer Protection and on Finance and Hazardous Materials, April 22, 1999 (statement of Charles A. Albright, Chief Credit Officer, Household International, Inc.).

Should evidence emerge suggesting that information-sharing among businesses contributes to identity theft, this would cause concern about all information-sharing, not just for prescreening or among affiliates. The most immediate solution would be, as it is today, to target the fraudulent activity itself—through stiffer penalties, more vigorous enforcement, greater coordination among enforcement agencies, and improved consumer education. Identity theft is a serious and growing crime, but to try to prevent it by restricting the flow of information is no more reasonable than trying to limit auto accidents by banning cars from highways.

Some privacy advocates also charge that the sharing of credit and other information could lead to redlining and perfect price discrimination. Most acknowledge that this is not the case today, but they allege that sufficiently targeted marketing could result in fewer opportunities and higher prices for some groups. However, an understanding of the economics of competitive markets reveals the opposite to be true. One of the permissible and desirable uses of credit report data is to make distinctions among consumers based on accurate, relevant information about their creditworthiness. This benefits many consumers, by allowing them to enjoy lower interest rates on mortgages and credit cards because of their good credit history and the reduced risk they present of defaulting in the future. Credit report data thus reduce redlining, by providing creditors with more precise tools for measuring risk than geography or aggregate information.

Credit report data also reduce redlining in another critical way: they facilitate competition for the credit needs of all consumers. As we have seen, the surge in credit data has made it possible for more Americans in all income brackets to obtain mortgages, auto loans, and credit cards than was possible in the absence of that information. If lawmakers are concerned that the price for some groups is too high, the best way to bring the price down *and* ensure the continued supply of the product is to stimulate competition. New limits on the use of credit data have the opposite effect. For example, limits on prescreening would almost certainly result in fewer offers being sent to customers, thereby decreasing competition.

Many privacy advocates argue that some information (e.g., medical or transactional information) is too sensitive to share without a consumer-initiated purpose. This may be true, and may therefore help to explain why credit reports do not contain medical or transaction-specific information.[68] The FCRA reflects this same concern by prohibiting the use of medical information, for example, in a credit report furnished in connection with employment, credit, insurance, or direct marketing.[69] Opt-in is also required under the new health privacy regulations for medical information to be used for marketing.[70] The sharing of financial information with third parties for marketing requires opt-out consent under Gramm-Leach-Bliley.[71] Congress should avoid enacting new restrictions unless there is evidence that additional protection is

[68]If an individual obtained credit from a health care provider, his/her credit report would likely reflect the extension of credit, but not its purpose.

[69]15 U.S.C. § 1681b(g).

[70]45 C.F.R. § 164.508(a)(1).

[71]15 U.S.C. § 6802(b).

necessary and that existing laws are failing to provide that protection. To date, no one has demonstrated either case.

Finally, a growing argument for new privacy laws is that prescreening, affiliate-sharing, and the sharing of information for marketing in general facilitate annoyances like telemarketing calls and unsolicited commercial mail (i.e., junk mail) and e-mail (i.e., spam). In a society that values freedom of expression, annoyance alone is a problematic justification for the effective ban on target marketing that opt-in would create. In the words of the U.S. Court of Appeals for the Tenth Circuit, striking down an opt-in rule as unconstitutional: "Although we may feel uncomfortable knowing that our personal information is circulating in the world, we live in an open society where information may usually pass freely. A general level of discomfort from knowing that people can readily access information about us does not necessarily rise to the level of substantial state interest under [the constitutional test applicable to commercial speech] for it is not based on an identified harm."[72]

There are, of course, many alternative ways of addressing the annoyance of unsolicited communications. The 1991 Telephone Consumer Protection Act regulates telemarketing and requires every telemarketer to maintain an opt-out list.[73] Twenty-two states have adopted do-not-call lists that allow consumers to opt out of virtually all commercial telemarketing. Both the FTC and the Federal Communications Commission are currently considering opt-out lists that would apply nationwide. Twenty-two states have also adopted restrictions on commercial e-mail. These and other initiatives amply demonstrate that it is possible to restrain unsolicited commercial contacts without resorting to opt-in. Moreover, it is ironic to try to remedy the annoyance of those contacts by restricting the information that is used to target them only to people whose past behavior suggests they are likely to be interested. In the absence of that information, targeting will be less accurate or nonexistent, with the result that consumers can expect more contacts of less interest.

This short survey of privacy concerns is not meant to suggest that they are not real or not serious, but rather that there is little evidence that opt-in would be effective in solving them or would be worth the exceptional costs it would create.

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[72]U.S. West, Inc. v. FCC, 182 F.3d 1224, 1235 (10th Cir. 1999), cert. denied, 528 U.S. 1188 (2000).

[73]47 U.S.C. § 221.

V. Recommendations

A. Eliminate Sunset of 1996 FCRA Preemption

Congress struck a critical balance in the 1996 FCRA amendments between consumers' interest in reaping the benefits of accessible credit files and their interest in privacy. That balance is reflected in the combination of preemption and opt-out provisions for prescreening and affiliate-sharing. Efforts to fundamentally alter that balance by not reenacting preemption and/or by conditioning prescreening and affiliate-sharing on opt-in threaten to impose considerable costs on consumers, business, and the economy, while not increasing privacy protection.

This is the irony of the current legislative debate. Privacy advocates propose to undo the 1996 balance in the interest of enhancing consumer privacy. Yet, how is privacy enhanced by a patchwork of state and local laws rather a uniform federal standard? How is privacy enhanced by effectively prohibiting the targeting of firm offers of credit or insurance or the cross-selling of products and services to consumers who are qualified for and likely to be interested in the offers, and instead requiring that such offers be sent randomly or not at all? How is privacy enhanced by adopting the same legal standard—opt-out and opt-in both give the consumer the legal right to control future uses of their credit report data—but enshrining it in a mechanism that is inherently more expensive and less efficient to operate?

For the reasons outlined throughout this paper, *the authors recommend that Congress eliminate the January 1, 2004, sunset provision from the amended FCRA*, so that the balance worked out in 1996 and subsequently demonstrated to generate enormous benefits for consumers, remains intact.[74] Congress should do this not as a trade-off for some new restriction on the productive use of credit files, but rather because it is in the best interest of the public and a critical step in support of economic growth and prosperity.

B. Avoid Unnecessary Impediments to the Use of Information

The authors therefore also recommend that *Congress avoid imposing new restrictions on the content and use of credit data, especially concerning information-sharing among affiliates and prescreening, without first requiring evidence that (a) such restrictions are necessary to remedy a specific harm, and (b) that the remedy does not impose greater costs than the asserted harm.* Based on the studies and other information we have examined, we do not see the need for new restrictions on information-sharing among affiliates and prescreening, and we are struck by the high costs such restrictions seem likely to impose on consumers, business, and the economy.

This does not mean that no adjustments in the FCRA are necessary or desirable, or that the balance between privacy and consumer benefits could not be fine-tuned. We offer two recommendations that we believe would be an important step in that direction, without imposing significant new costs or burdens.

[74] 15 U.S.C. § 1681t(b)(1)(C).

C. Make Opt-Out Notices Work

Privacy and consumer advocates have argued that one reason more people do not exercise their right to opt out of prescreening and affiliate-sharing is that they are unaware that the right exists. The FCRA requires that consumers be informed of that right and of simple ways to exercise it—for example, a single 800-number to opt out of all three credit bureaus providing credit reports for prescreening. Nevertheless, opt-out notices can be hard to locate and decipher.

The authors propose that Congress amend the FCRA to require that:

1. All offers targeted through the use of credit report information must contain a clear, simple notice of the consumer's right to opt-out of prescreening (if the information was obtained pursuant to the FCRA prescreening provision) and/or of affiliate-sharing (if the information was obtained pursuant to the FCRA affiliate-sharing provision), and indicating how that right can be exercised.

2. Any organization that shares credit report information with affiliates must prominently display a clear, simple notice to that effect at certain places where a consumer can open an account or otherwise do business with the organization. The notice should inform customers of their right to opt out of affiliate-sharing, and allow consumers to exercise that right at certain places where a consumer can open an account or otherwise do business with the organization. For example, a financial institution that shares credit information with affiliates and allows consumers to open or access an account via a website, must display that notice on the website and provide a mechanism for customers to opt-out via that website. Policymakers should also further explore ways of making the notice process work in an efficient and non-burdensome manner for both consumers and institutions.

We also recommend that Congress delegate to the FTC and other appropriate financial regulators the authority to enact such rules as are necessary to implement these provisions in the most efficient, straightforward manner possible. This authority should include an express instruction to work with industry and consumer groups to draft or endorse one or more model notices that would explain the consumers' legal rights as well as the potential consequences of opting out.

D. Make Privacy Notices Work

There is no reason why efforts to improve the clarity and visibility of notices should be limited to FCRA notices. Privacy notices—the mainstay of the Gramm-Leach-Bliley financial privacy and HIPAA medical privacy frameworks—have triggered a much smaller response from consumers than their proponents anticipated. For example, under the requirements of Gramm-Leach-Bliley, by July 1, 2001, tens of thousands of financial institutions had mailed approximately two billion notices. If ever consumers would respond, this would appear to be the occasion**.** The notices came in an avalanche that seems likely to have attracted consumer attention, the press carried a wave of stories about the notices and about state efforts to supplement Gramm-Leach-Bliley's privacy provisions, privacy advocates lauded the opt-out opportunity and offered online services that would write opt-out requests for consumers, and the information at issue—financial information—is sensitive and personal to most individuals.

Yet the response rate was negligible. The available published information indicates that fewer than 5 percent of consumers responded to the deluge of notices by opting out of having their financial information shared with third parties. For many financial institutions, the response rate was lower than 1 percent.[75] A late September 2001 survey revealed that 35 percent of 1001 respondents could not recall receiving a privacy notice, even though the average American had received 20.[76] The consumer response to the GLB notices is consistent with response rates to other privacy-related opt-out opportunities, such as the FCRA's opt-out provisions already noted; the Direct Marketing Association's mail, telephone, and e-mail opt-out lists; and other company-specific lists.

Privacy advocates tend to lay responsibility for this at the feet of industry, arguing that if the industry had tried harder the notices would have been better.[77] There is little evidence to support this claim, but even if true, it only partially explains the problems with privacy notices. The complexity of privacy notices seems in large part to have reflected the complexity of the law and regulations requiring them, the specificity required of notices, and the fact that the FTC and state attorneys general interpret notices as contracts.

It should also be noted that there is real disagreement about what makes a good privacy notice. On June 18, 2001, at a hearing on financial privacy of the California General Assembly's Committee on Banking and Finance, the Committee Chairman distributed American Express' privacy notice and challenged the financial services industry representatives in the audience to live up to the standard set by this "model." Two weeks later, on July 9, 2001, *USA Today* editorialized in favor of clearer privacy notices, citing American Express' notice—the same

[75]"Survey: Compliance with GLB Act Costs Smaller Banks More Money," *Consumer Financial Services Law Report*, Feb. 14, 2002.

[76]Star Systems, *Financial Privacy: Beyond Title V of Gramm-Leach-Bliley,* p 9 (2002).

[77]In light of the low response rate, an alternative explanation that is at least as compelling is that consumers saw the notices but either didn't care enough one way or the other to exercise their opt-out right, or to take the time to digest the information presented.

notice lauded only two weeks earlier—at its first example of a notice that was difficult to comprehend.[78] It is little wonder that FTC Chairman Muris has noted:

> The recent experience with Gramm-Leach-Bliley privacy notices should give everyone pause about whether we know enough to implement effectively broad-based legislation based on notices. Acres of trees died to produce a blizzard of barely comprehensible privacy notices. Indeed, this is a statute that only lawyers could love—until they found out it applied to them.[79]

If notice to consumers is to be the cornerstone of privacy regulation, then privacy notices should be made more clear and attention-getting. The most practical way of doing that, the authors believe, is to require layered notices. The first layer would consist of a clear, simple notice that could be posted in stores and on websites, and printed on forms. That notice would provide basic, standardized information about an entity's privacy practices: whether personal information is collected, used for any purposes unrelated to providing the requested product or service, shared with third parties for any purposes unrelated to providing the product or service, or used for marketing. This short notice would also provide a very brief summary of consumers' rights or options and indicate where to go for the complete, longer notice and to exercise those rights or options.

The key to making the layered notice system work is for (a) the initial notice to be short, clear, and prominently displayed; (b) it to provide the critical information that consumers—not industry or lawmakers—are most likely to want to know; (c) notices be standardized or at least comparable; (d) notices to clearly instruct consumers clearly as to where to go for an easily accessible copy of the complete privacy policy; and (e) regulators and private litigants to be prohibited from enforcing short notices as contracts, so long as the short notice makes clear where the complete policy can be found, the complete privacy policy is in fact easily accessible, and the short notice reflects a reasonable, good faith effort to accurately reflect the longer policy.

Important initiatives are already under way to create layered notices. The Hunton & Williams Center for Information Policy Leadership, for example, hosts a project which has already developed one model layered notice for financial institutions and is working on a similar notice for health-related entities.[80] The authors recommend that the FTC and other federal regulators work closely with these and other on-going efforts and with businesses and consumer advocates to develop and/or endorse one or more model short notices, and to propose to Congress legislation necessary to make those notices legally workable. By so doing, consumers can enjoy both enhanced privacy and the benefits made possible by robust credit reporting and accessible information.

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[78] "Confusing Privacy Notices Leave Consumers Exposed," *USA Today*, July 9, 2001, p 13A.

[79] Muris, supra.

[80] Drew Clark, "Privacy: Initiative Aims to Label Company Privacy Policies," *National Journal's Technology Daily*, July 29, 2002.

VI. Conclusion

Thirty-two years' experience with the FCRA has demonstrated it to be a remarkable success for individuals, businesses, and the economy as a whole. Since 1996, an important part of the Act's carefully crafted balance has been federal preemption. This recognizes the national (and, in fact, increasingly global) nature of our economy, the inherently national character of credit reporting, and the significant impediments and costs that state or local regulation could impose. By providing that preemption would sunset on January 1, 2004, Congress signaled an intent that the amended operation of FCRA be reviewed and evaluated to determine whether the balance struck in 1996 yielded the intended benefits.

All of the available evidence indicates that the answer is "yes." The balance struck by Congress has generated an extraordinary range of benefits for the public—including greater and faster access to more credit at a lower price, a more sound and efficient financial services sector, and enhanced competition. Moreover, it has protected individuals' privacy and provided tools for individuals to exercise additional control over the use of information about them should they so desire.

The benefits—including protection for personal privacy—that the FCRA has fostered would be significantly undermined by abandoning preemption in favor of state-by-state or city-by-city regulation of credit reporting. Moreover, those benefits would be seriously threatened by adopting new restrictions on the composition of credit files, their use for prescreening, or the sharing of information among affiliates. Conditioning these or other uses of information on opt-in consent are tantamount to prohibiting them outright, simply because of the practical impediments, costs, and consumer inconvenience of obtaining a response from consumers individually.

In the face of such considerable and widely shared benefits that result from the U.S. credit reporting system, and the significant impediments to those benefits and other costs that abandoning preemption or requiring opt-in would impose, Congress should reenact preemption and avoid adopting new restrictions on credit reporting unless presented with clear evidence of a demonstrated need.