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Financial Privacy Developments: FACTA and Short Form Notices

Fair and Accurate Credit Transactions Act (FACTA): Congress Revises the FCRA

Financial privacy continues to be an important and swiftly developing area of regulation. This newsletter relates two important developments that occurred at the end of 2003 - new amendments to the Fair Credit Reporting Act and a call from regulators to consider changes to privacy notices required by Gramm-Leach-Bliley.

Background

Since its enactment in 1970, the Fair Credit Reporting Act (FCRA) has played an important role in regulating "consumer reports," which, subject to specified exceptions, include communications of information about consumers' eligibility for credit. Although amendments to the FCRA have been relatively frequent in recent years, the last major amendments were made in 1996. The latest round of major amendments is set forth in the Fair and Accurate Credit Transactions Act of 2003 (FACTA), which was passed by Congress on November 22, 2003 and signed into law on December 4, 2003.

The FACTA amendments create many issues – but also many opportunities – for users, furnishers, and consumer reporting agencies. Many of its most important provisions call for regulations to be issued by the Federal Trade Commission (FTC), the Federal Reserve Board (Board), and other agencies in many instances. (These regulations cover such basic issues as the effective dates of many provisions, as discussed below.) Informed and active participation in the regulatory process will therefore be critical to shaping the implementation of the amended FCRA in the months and years ahead.

The FCRA frequently prevents financial institutions from transferring consumer financial information both to affiliated companies and to nonaffiliated third parties because otherwise they would become consumer reporting agencies (CRAs), which the FCRA subjects to extensive obligations. FACTA now further limits certain uses of information shared between affiliated companies unless the consumer is offered an opportunity to opt out, as discussed below.

States such as California have begun to enact legislation that purports to regulate the sharing of information among affiliated companies, imposing significant compliance obligations on national financial institutions. The 1996 FCRA amendments contained provisions expressly preempting certain state laws, including a broad preemption of state law affecting the sharing of information among affiliates. This key provision was due to sunset on January 1, 2004, prompting Congressional action to permanently extend the provision, and in the process, review the FCRA. The FACTA amendments are the results of this review.

A summary of several of the most significant compliance issues presented by FACTA appears below. First, this summary addresses how the bill alters the FCRA's preemption of state law. Next, the summary discusses of an important new restriction on affiliate sharing. Following this, the summary addresses the bill's identity theft provisions. And finally, the summary addresses other requirements, unrelated to identity theft, that the FACTA amendments impose on users of consumer reports. Where preceded by "FACTA," citations refer to the sections of the new bill. Otherwise, citations refer to sections of the existing FCRA.

Does the newly amended FCRA continue existing preemption provisions?

Yes, the new law removes the sunset provisions added in 1996 along with the FCRA's express preemption provisions, making the its current preemption permanent, including the preemption of state laws regulating the exchange of information among affiliates and prescreening. FACTA § 711(3). There is a strong argument that state laws regulating the exchange of information between affiliated companies, such as California's S.B. 1, are and continue to be preempted by the FCRA. Vermont, the lone exception carved out from preemption in 1996, remains unaffected. Because they are not within the scope of any of the FCRA's preemption provisions, state laws generally requiring consumer consent before requesting consumer reports also remain unaffected to the extent they do not impact affiliate sharing.

Does the revised FCRA preempt any other state laws?

Yes, FACTA contains new provisions that preempt some state laws concerning identity theft. State identity theft laws are preempted if they conflict with the provisions of the revised FCRA or pertain to conduct regulated by the specific sections of the FCRA concerning identity theft. FACTA §§ 711(2)-(3). Consequently, state laws imposing additional duties on furnishers to react to identity theft may be preempted, while state laws aimed at prosecuting identity theft may not. For example, California recently enacted a statute requiring those doing business in California to notify California residents if their data security has been breached. Cal. Civ. Code. § 1798.82. The new FACTA amendments arguably preempt this law because it imposes reporting duties beyond what the revised FCRA requires in response to an identity theft. *Cf*. FACTA § 114. Additionally, the revised FCRA now requires the disclosure of credit scores and the issuance of "risk based pricing notices." States are restricted from imposing more stringent requirements in these areas as well. (However in the case of credit scores, the bill carves out a number of existing state laws.) FACTA §§ 212(e); 311(b). The substantive aspects of these provisions are discussed below.

How does FACTA affect the ability of affiliates to share information for marketing purposes?

The revised FCRA limits affiliates' ability to use information transferred pursuant to the transaction or experience or affiliate opt-out exceptions when that information will be used to make solicitations for marketing purposes. FACTA § 214(a). Affiliated companies may now share such information for marketing purposes only if they conspicuously disclose that this information will be used for marketing and offer consumers a right to opt out. For these purposes, solicitation excludes "communications that are directed at the general public." *Id*.

Nonetheless, the FACTA amendments leave intact the affiliate sharing exception added in 1996, permitting affiliates to share information that did not qualify as transaction or experience information if the consumer was offered an opportunity to opt out. Thus, affiliates can continue to share pursuant to the existing opt-out provision (section 603(d)(A)(iii)) for purposes unrelated to marketing.

There are important exceptions to this restriction as well, including the solicitation of customers that have a pre-existing relationship with the marketing entity, exchanges used to facilitate communications related to employee benefit plans, exchanges to facilitate performing certain services on behalf of another affiliate, using information in response to consumer-initiated communications, solicitations authorized by the consumer, or exchanges needed to comply with state insurance laws pertaining to unfair discrimination. *Id*. Pre-existing relationship is defined broadly and could encompass more than where a creditor has an explicit contract with a consumer, potentially narrowing new marketing provision's impact.

It is also important to note that FACTA only further restricts information *transferred* among *affiliated* companies and does not restrict transaction and experience information transferred to a *nonaffiliated third party*. Information sharing with nonaffiliated third parties continues to be regulated by the Gramm-Leach-Bliley Act financial privacy provisions that may require providing customers with notice and the opportunity to opt-out of sharing transaction and experience information with third parties, including affinity partners, if not otherwise permitted by law.

What do the FACTA provisions targeted at preventing identity theft mean to creditors and users of consumer reports?

FACTA has a number a sections designed to address the growing problem of identity theft. Taken as a whole, these sections impose new burdens not only on CRAs, but also on creditors in their role as users of consumer reports and as furnishers of information to CRAs.

CRA Obligations

- Add fraud alerts to reports at the request of consumers if they have good faith belief that they have been identity theft victims and have proof of their identity. FACTA § 112.[1]
- Include the consumer's telephone number or other reasonable contact information if the fraud alert placed in the consumer's file is an extended alert.
- The consumer can also trigger this duty with an initial alert if the consumer specifies a telephone number where he or she should be contacted for verification. *Id*.
- Block information that consumers allege occurred as the result of identity theft or similar fraud within four business days of appropriate proof by the consumer.[2] The CRA must then notify the furnisher providing the blocked information, triggering the furnisher's duty to prevent repollution, as discussed below. FACTA § 152.
- Implement procedures for coordinating the investigation of identity theft allegations by consumers, FACTA § 153, and truncate a consumer's social security number in consumer reports upon request. FACTA § 115.
- Finally, the FTC in consultation with the federal banking agencies and the NCUA must prepare a summary of rights for identity theft victims that CRAs must provide when consumers contact a CRA alleging that they have been victims of identity theft. FACTA § 151(a).

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1 Initial alerts last for only 90 days and can be initiated by the consumer over the telephone. Extended alerts can last up to seven years, but require filing an identity theft report. An identity theft report must be made to a government agency and subjects the filer to penalties for false statements. This provision also requires CRAs to notify each other of the filing of a fraud alerts and to coordinate identity theft complaint investigations and creates a similar alert for active duty military personnel. *Id*.

2 To trigger this duty the consumer must provide the consumer with (1) appropriate proof of the consumer's identity, (2) an identity theft report, and (3) identification of the information resulting from identity theft. What constitutes an identity theft report is to be defined by the Federal Trade Commission. FACTA §152. The blocking provision then requires the CRA to notify the furnisher of the blocked information promptly that such a block has been placed. The CRA may then only rescind that block in limited circumstances, namely where the consumer reports that the block was requested in error, when the CRA determines that the consumer has made a material misrepresentation about the circumstances giving rise to the block, or that the consumer has kept the proceeds from the allegedly fraudulent transaction. *Id*.

Furnisher Obligations

- Take steps to prevent the repollution of consumer reports. When a furnisher receives notice through a CRA that an alleged identity theft has occurred, the furnisher must have reasonable procedures to prevent the furnisher from refurnishing the information.[3] FACTA § 154(a).
- Not sell or transfer debt that has been identified as resulting from identity theft.[4] FACTA § 154(b).
- If a consumer submits an identity theft report to a furnisher, then the furnisher may not transfer any information to a CRA unless the furnisher knows that information is correct. FACTA § 154(a).

Creditor Obligations

- If a consumer's file contains a fraud alert, that alert constitutes notice to creditors that the consumer does not authorize an extension of new credit, other than under an existing open-end credit plan, unless the creditor takes reasonable steps to establish the identity of the consumer. Among other things, where the CRA is required to include a consumer's telephone number, the creditor is required to contact the consumer at that number. *Id*.
- Disclose their relevant business transaction records to those investigating an alleged identity theft, including the victim, any federal or state officer specified by the victim, and any law enforcement official. A creditor, however, may refuse to disclose records to the victim if it determines, in good faith, that it does not have a high degree of confidence of the requestor's true identity or that the request is based on a misrepresentation of fact. FACTA § 151.[5]
- Additionally, the new bill directs the federal banking regulators, the National Credit Union Administration ("NCUA"), and the FTC to create a set of guidelines, so called "red flags," to detect identify theft. Financial institutions and other creditors will then be required to protect consumers' accounts when these "red flags" are triggered. FACTA § 114. Among other things, the new guidelines must contain rules establishing procedures relating to the issuance of substitute credit cards and debit cards. If a card issuer receives a request for an additional card within 30 days after notification of that customer's change in address, the issuer must establish and follow reasonable procedures, such as notice to the former address, to ensure that the requester of the card is in fact the issuer's customer. *Id*.

Merchant Obligations

- FACTA requires merchants to truncate credit card and debit card numbers on receipts. Anyone who issues electronically printed receipts from credit card or debit card transactions must, within 1-3 years depending on the type of cash register, truncate all but the last five digits of any credit card or debit card number that might be found on such receipts. FACTA § 113. A number of states, such as New York and California, have existing requirements to truncate credit card numbers. Because this section is not effective concurrently with FACTA's preemption, it is possible that FACTA preempts these state requirements before imposing its own requirements, temporarily creating a gap in protection.

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3 The bill also specifically requires debt collectors who are notified by a consumer that the debt at issue is allegedly the result of identity theft must report that allegation to the originating creditor and, upon request by the consumer, provide all other information to which the consumer is entitled by applicable law, as if the consumer were not an identity theft victim, in order to dispute the debt. FACTA § 155

4 However, the prohibition has three exceptions, transfers related to an obligation to repurchase because of identity theft, transfers related to the securitization of debt, and transfers incident to a merger or sale of substantially all of an entity's assets. FACTA § 154(b).

5 This section also limits creditors' liability in several ways. It provides an absolute defense from any civil liability from any disclosures made pursuant to this section. Likewise, this section specifically states that it imposes no new recordkeeping requirements on creditors. And finally, in the event that a business fails to disclose, the section allows creditors to assert an affirmative defense that it made a reasonably diligent search of its records and that the records requested either do not exist or are not reasonably available. FACTA § 151.

What else do the FACTA amendments require of consumer report users?

The revised FCRA has a number of new requirements for users of consumer reports, namely:

- Risk based Pricing Notices
- Negative Information Disclosures
- Disclosure of Credit Scores
- Increased Prescreening Opt-Out Effectiveness
- Accuracy and Record Disposal Requirements

Risk Based Pricing Notices. "Risk based pricing notices" will be required when a creditor offers a consumer a credit product, based in whole or in part on a consumer report, on terms that are materially less favorable than the "most favorable terms available to a substantial proportion of consumers from or through that [creditor]." FACTA § 311.[6] These notices must state that the consumer was offered these terms based on information from a consumer report, identify the CRA furnishing the report, state that the consumer may obtain a copy of this report from that CRA free of charge, and include the contact information specified by the CRA. Additionally, the provision directs the FTC and the Federal Reserve Board to jointly promulgate regulations addressing the particular content, timing, and method of delivery of such notices. *Id*. There is no private right of action available with respect to such notices and they may only be enforced by a creditor's applicable federal agency.[7] *Id*.

Negative Information Disclosures. Financial institutions (as defined in the Gramm-Leach-Bliley Act) that regularly extend credit and furnish information will be required to make written disclosures to consumers when furnishing negative information to CRAs informing consumers that such information has been provided. The Federal Reserve is directed to develop a model disclosure for such notices, but use of the model is not required, and only one disclosure during the life of the relationship suffices for all negative information arising out of the same transaction or account. Financial institutions that maintain "reasonable policies and procedures" to comply with this disclosure requirement have a safe harbor. FACTA § 217. California currently has a substantially similar statute. *Cf*. Cal. Civil Code § 1785.26. However, FACTA has a slightly different formulation of "negative information" and will require a different model disclosure. Because this section is within FACTA's preemption, these differences will likely require some changes in the practice of California lenders. Furthermore, there is no (federal) private right of action provided.

Disclosure of Credit Scores. Certain creditors must also provide credit scores to consumers as part of the transaction. Any person that makes or arranges a loan secured by one to four units of residential real property must provide consumers with the credit score they obtained from a CRA and the date that score was created. If the lender uses an automated underwriting system, the lender generally may satisfy this requirement by supplying the consumer with a credit score from a CRA and its key factors. Likewise, to the extent the lender uses a score not developed by a CRA, the lender may choose to disclose a score obtained from a CRA rather than the proprietary score. FACTA § 212(c). Lenders must also include a prescribed notice along with the scores disclosed. Nonetheless, the revised FCRA explicitly limits lenders' liability to the duty to disclose and not to the contents of the credit score that they provide. *Id*.

Extension of Opt-out Effectiveness. FACTA expands the effectiveness of oral prescreening opt outs from two years to five years.[8] FACTA § 213(a).

[6] A creditor does not need to provide a risked based pricing notice if the consumer applied for the specific material terms provided or if the creditor otherwise must provide an adverse action notice under section 615(a).

[7] Nevertheless, the lack of a federally provided private right of action does not necessarily preclude state law from providing for such liability. *See, e.g.*, Cal. Bus. & Prof. Code § 17200. Whether the FCRA's new preemption provisions will preclude these types of actions is debatable.

Accuracy and Disposal Requirements. Finally, the new law requires the federal banking agencies, the NCUA, and the FTC to promulgate new regulations establishing guidelines to maintain the accuracy of information that creditors furnish to CRAs and regulations to enforce those guidelines. FACTA § 312(a). This makes substantial changes to the duty of furnishers with regard to the information they furnish. First, it changes the standard of belief regarding the accuracy of information in section 623(a)(1) from "knows or consciously avoids knowing" to "knows or has reasonable cause to believe that the information is inaccurate." FACTA § 312(b). Reasonable cause is further defined as having knowledge, other than allegations by the consumer, which "would cause a reasonable person to have substantial doubts about the accuracy of the information." *Id*. The federal banking agencies, the NCUA, and the FTC are also required to promulgate regulations establishing circumstances in which consumers should be able to dispute information directly with furnishers, rather than a CRA. These regulations must require a consumer to issue of notice of dispute, for the furnisher to conduct an investigation, and then for the furnisher to report the results to the consumer. FACTA § 312(c). Likewise, the federal banking agencies, the NCUA, and the FTC must promulgate regulations creating standards for the proper disposal of consumer information. FACTA § 216.

Does FACTA affect an employer's ability to investigate employees?

The revised FCRA relaxes restrictions on employee investigations. The employee's consent is no longer required to provide an employer with the results of an employee investigation conducted by a third party as long as the investigation involves suspected misconduct in employment, compliance with federal, state, or local laws or self regulatory organization ("SRO") regulations, or preexisting written policies of the employer and the results are only communicated to the employer, federal, state, or local officers, to any SRO, or as otherwise required by law. FACTA § 611. Adverse action notices must still be provided but the names of sources of information need not be revealed.

These changes confirm the courts' narrowing in recent years of a 1999 FTC staff opinion letter Vail, later adopted by the FTC, which concluded that when an employer hires an outside party to investigate allegations of employee misconduct, and the outside party reports on its investigations to the employer, that party may be converted into a CRA, with all the attendant obligations and exposures.

Does FACTA expand furnisher and user liability?

The bill also alters the statute of limitations applicable to the FCRA, overturning *Andrews v. TRW*, 534 U.S. 19, (2001). In *Andrews,* the Supreme Court held that the current two-year statute of limitations in the FCRA cannot be tolled by the discovery rule generally because the statute only allows tolling for willful violations. Once the FACTA amendments are effective, a consumer must bring suit within the earlier of two years from discovery of a violation or within five years of the violation, without regard to discovery. FACTA § 156.

On the other hand, FACTA retains and expands the prior limits on furnisher liability. Going forward, the FCRA provisions creating private rights of action to recover civil damages do not apply to any part of Section 623(a) – which is much expanded under FACTA – except in the event that a state official brings an action on behalf of state residents after a furnisher has violated an injunction. The same rule applies to the provisions, discussed above, which call for guidelines and regulations for furnisher accuracy, as well as the "red flag" provisions. Moreover, those provisions may only be enforced by certain state officials and by federal agencies.

[8] This provision also directs the FTC to engage in a public awareness campaign to increase public awareness about the right to opt out of prescreening solicitations. FACTA § 213(d).

What is the effective date of these changes?

Much of the revised FCRA depends on regulations or model forms to be issued by one or more federal regulators. Unless otherwise specified, such as in the affiliate sharing provision, regulations establishing the effective date of each provision must be issued in final form within two months of enactment, with effective dates set as soon as possible but no later than ten months after the issuance of the applicable final regulation. The affiliate sharing regulations must be issued in final form within nine months of enactment.

Because the bill is silent as to when some of its statutory components become effective, the Board and the FTC jointly issued a proposed regulation and an interim final rule on December 15th to set effective dates for the FACTA amendments. Under the interim final rule, the FACTA preemption provisions became effective on Dec. 31, 2003. The proposed rule sets an effective date of either March 31, 2004 or December 1, 2004 for most provisions. See the table below for the effective date of key provisions.

Effective Date	Requirement[9]
December 31, 2003 (Interim Final Rule)	• Extension of existing FCRA preemption rules. • Preemption of areas covered by the FACTA amendments.
March 31, 2003 (Proposed Rule)	• All new FCRA definitions • Limiting of furnisher liability • New statute of limitations • Relaxed restrictions on employee investigations
December 1, 2004 (Proposed Rule)	• Fraud alerts • Information blocking • Prevention of repollution rules and related identity theft provisions • Enhanced prescreening opt out notice • Negative information disclosure • Risked based pricing notices • Affiliate sharing

Short Form GLB Notices:
Agencies Propose New Form for Notices

There are also potential changes on the horizon for the GLB Act privacy notices. All of the federal agencies that promulgated GLB Act privacy regulations issued a joint notice of advanced proposed ruling making ("ANPR") on December 23 about creating short form and standardized privacy notices.[10] This notice solicits comments in three categories to improve the privacy notices currently required by the GLB Act and the agencies' implementing regulations. The agencies are also requesting comments on model language and model forms that financial institutions have found effective and any research and documentation that commenters have on the effectiveness (or lack thereof) of privacy notices in meeting consumer expectations.

After many widespread accounts about consumer confusion concerning existing privacy policies, the agencies have indicated that they expect consumer testing to play an important role in the

[9] This does not include any part of a provision that must be implemented by separate regulation. Those regulations will set the effective date of the pertinent provision.

[10] The notice and a press release detailing its contents may be found at http://www.federalreserve.gov/boarddocs/press/bcreg/2003/20031223/.

development of any alternative type of privacy notice. Assuming this rulemaking goes forward, it represents an important opportunity to influence agency thinking on financial privacy.

Short Form Notice. First, the ANPR requests comments on whether to allow a "short form" notice, that would describe the most important privacy practices of a financial institution, the customer's right to opt out from certain sharing, how to opt out, and then direct a consumer as to how he or she could obtain the full privacy notice. The scope of information that would be contained in a short form notices and when such a notice would satisfy a financial institution's duty to provide initial and annual privacy notices.

Costs and Benefits. Second, the ANPR seeks to explore the costs and benefits of requiring or promoting a standardized privacy notice. Standardization could be implemented in a number of ways, ranging from a mandatory notice for all financial institutions, a model notice and safe harbor of institutions using the model, or a set a guidelines or best practices for use by financial institutions. The ANPR requests comments on the feasibility, scope, and usefulness of such standardization and the various ways it might be implemented.

Consumer Usefulness. Third, the ANPR requests comments on what privacy notice formats are most useful to the consumers, including appropriate font size and layout, forms that institutions believe work well, and additional language that consumers might find helpful in a privacy notice.

The ANPR includes four model privacy notices for discussion, including a (1) standardized notice and opt-out, (2) a standardized notice with opt out that can be modified to describe the range of affiliated and nonaffiliated companies with which financial institutions share information, (3) a framework that to be used to format privacy notices, and (4) standardized opt out notice. The agencies currently propose that this standardized opt out form appear as the first page of a privacy notice but they would not prescribe the content of such notices.

For further information on these or other financial services matters, please contact one of the lawyers:

Philip D. Anker	+1 (202) 663-6613
Gregory A. Baer	+1 (202) 663-6859
Ursula Bass	+1 (202) 663-6203
Clare D. Bracewell	+1 (202) 663-6944
Russell J. Bruemmer	+1 (202) 663-6804
J. Beckwith Burr	+1 (202) 663-6695
David M. Capps	+44 (0) 20 7872-1080
Kelly Cochran	+1 (202) 663-6995
Simon Firth	+44 (0) 20 7872-1036
Franca Harris Gutierrez	+1(202) 663-6557
Wilhelm Hartung	+44 (0) 20 7872-1075
Stephen R. Heifetz	+1 (202) 663-6558
Michael Hershaft	+1 (202) 663-6427
Kirk Jensen	+1 (202) 663-6182
Andrew Kales	+1 (202) 663-6811
Satish M. Kini	+1 (202) 663-6482
Christopher R. Lipsett	+1 (212) 230-8880
David A. Luigs	+1 (202) 663-6451
Martin E. Lybecker	+1 (202) 663-6240
Jeanine Magurshak	+1 (202) 663-6867
James H. Mann	+1 (212) 230-8843
David Medine	+1 (202) 663-6220
Eric Mogilnicki	+1 (202) 663-6410
Charles Platt	+1 (212) 230-8860
Matthew P. Previn	+1 (212) 230-8878
Daniel H. Squire	+1 (202) 663-6060
Natacha Steimer	+1 (202) 663-6534
Todd Stern	+1 (202) 663-6940
Manley Williams	+1 (202) 663-6595