WILMER, CUTLER & PICKERING

Financial Institutions Group Newsletter

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California Enacts Restrictive Financial Privacy Law: Goes Beyond Gramm-Leach-Bliley

On August 27, 2003, California Governor Gray Davis (D) signed into state law a major financial privacy bill that its backers hope will become a national model. The "California Financial Information Privacy Act" represents a last-minute compromise between a segment of the financial services industry and privacy advocates.

Background

Banks, insurance companies, and securities firms have been opposing efforts by CA state Senator Jackie Speier (D) to enact financial privacy legislation. Although similar legislation had been defeated in each of the previous three years, a federal court ruling last month and an impending California ballot initiative gave both privacy advocates and the financial services industry an incentive to compromise. The federal court ruling came in a lawsuit challenging strict financial privacy ordinances enacted in three California municipalities. The judge struck down the affiliate sharing portion of those ordinances as preempted under the federal Fair Credit Reporting Act. This ruling signaled that other California laws, such as the one just signed, might meet the same fate. Knowing that key provisions of this new law might be knocked out made it easier for parts of the financial services industry to sign on. The industry also feared enactment of a ballot initiative with even harsher restrictions than the Speier bill. Embattled Governor Gray Davis, who has been a lukewarm supporter of financial privacy legislation, has signed the bill.

Does the new law permit financial institutions to share information with nonaffiliated third parties?

The centerpiece to the California Financial Information Privacy Act is the requirement that banks, credit card companies, insurance companies, and securities firms receive customers' explicit consent (opt-in) before sharing nonpublic personal financial information with non-affiliated companies. As with the Gramm-Leach-Bliley Act, there are provisions for joint marketing arrangements with nonaffiliated financial institutions.

Opt-in. The law requires a financial institution to obtain a customer's written consent in a separate document before the financial institution may disclose or share the customer's nonpublic personal information with any nonaffiliated third party. Specific criteria are established in the law for opt-in notices. Financial institutions may not discriminate against or deny products or services to customers who decline to opt-in unless the product or service cannot be provided without the customer's consent.

What are the new rules for sharing financial information with affiliates?

A key part of the compromise that led to passage of this legislation was elimination of the requirement in earlier versions of the bill that consumers be permitted to opt-out of all affiliate sharing of financial information. As passed, customers generally

will be able to opt-out of having their financial information shared among company affiliates. However, the new law would permit affiliate sharing of financial information without requiring that a company notify its customers or get their permission if it met certain criteria relating to corporate structure and lines of business. Here's how and when information may be shared:

- **Opt-out.** The new law requires a financial institution to give consumers annual written notice and an opportunity to opt-out before the institution can disclose nonpublic personal information to affiliates. Financial institutions are required to provide customers each year with a prescribed form (which states "IMPORTANT PRIVACY CHOICES FOR CONSUMERS"), or a similar document that meets certain requirements regarding information sharing practices among affiliates and third party financial institutions. This notice must be sent in an envelope that states on the outside in 16-point boldface type:

  "IMPORTANT PRIVACY CHOICES"

  unless the envelope also includes bills or account statements.

- **No-opt.** The law allows the sharing of nonpublic personal information without opt out restrictions, provided that the following criteria are met:

  (1) The sharing is between a financial institution and its wholly owned financial institution subsidiaries, financial institutions that are each wholly owned by the same financial institution or holding company;
  (2) The same functional regulator regulates the financial institution disclosing the information and the financial institution receiving it;
  (3) The financial institution disclosing the information and the financial institution receiving are both principally engaged in the same line of business. The line of business may be one and only one of the following: insurance, banking, or securities; and
  (4) The businesses must share a common brand within their trademark, service mark, or trade name.

Accordingly, insurance affiliates might be permitted to share among themselves, but a securities firm could not use this provisions as the basis for sharing with its banking affiliate.

Large financial institutions must give customers a self-addressed envelope with pre-paid postage in their privacy notice mailings to use for opting out unless the institution offers at least two free ways to respond to the notice (*e.g.*, toll-free telephone number, interactive Web site). In that case, the institution need only provide the self-addressed return envelope that smaller financial institutions must provide.

Are affinity partners and private label programs treated as third parties?

The new law clarifies that, if a customer has not opted out of the sharing of non-public personal information, a financial institution that has a non-retail affinity partner may share specified information with its partner. With regard to affinity credit card products, this information would be limited to a customer's name, address, telephone number, e-mail address, and information about transactions with the partner. As a general matter, a financial institution may share information with affinity partners where the sharing of information is necessary to complete a transaction, provide customer rewards or for other limited purposes. Private label card issuers may provide the retailer whose name is on the card lists of cardholders and a record of their transactions with that retailer without regard to the customer's opt-out choices.

When does the new law take effect and what are the penalties for violating it?

Effective **July 1, 2004**, the new California privacy law provides for a civil monetary penalty of up to $2,500 per violation for an entity that negligently discloses or shares nonpublic personal information. Whereas negligent violations would be subject to an aggregate cap of $500,000, there is no limit for reckless or intentional violations. Moreover, the law provides that penalties will be doubled if a violation leads to identity theft. The civil penalties may be assessed and recovered in a civil action by the CA Attorney General or the appropriate functional regula-

tory. The new law also specifically preempts all local ordinances in California relating to the use and sharing of nonpublic personal information.

Are there special rules for small banks?

Smaller banks are less likely to have affiliates and, therefore, are unlikely to qualify for the law's opt-out exception. The compromise that was reached would permit lenders to share, without restrictions, a customer's nonpublic personal information with affiliates or nonaffiliated third parties to perform various business- or professional-related services. The types of activities that were contemplated here include printing, customer surveys, mailing, and data processing.

Is the new law preempted by federal law?

The new law goes further than the federal requirements established four years ago by the Gramm-Leach-Bliley Act ("GLBA"), which requires only an opt-out for information sharing among nonaffiliated third parties, while allowing institutions to share information freely among affiliates. However, GLBA permits states to enact stricter laws. A challenge under the Fair Credit Reporting Act, which preempts state laws relating to affiliate sharing, is more likely. National banks can also be expected to attempt to enlist the support of the Office of Comptroller of the Currency in asserting this law is preempted under the National Bank Act.

Will this new law have any impact on the congressional efforts to extend FCRA preemption?

Proponents of the new California privacy law have announced that they will now focus their energy on the U.S. Congress in pursuit of a new national privacy standard that is modeled after the California law. This debate is expected to take center stage at the Senate Banking and the House Financial Service Committees which are actively considering legislation that would extend Fair Credit Reporting Act (FCRA) preemption provisions that otherwise expire at the end of this year. At a minimum, privacy advocates will endeavor to get Congress to grandfather California's new privacy law as an exemption to the FCRA preemption provisions that prevents states from passing laws that would limit affiliate sharing of information. Given the size of California and its importance to many financial institution's portfolios, this may effectively transform California's new law into a national standard.

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