American Insurance Association

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FINANCIAL SECURITY FOR LIFE

Alliance of American Insurers ®

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BY HAND DELIVERY

June 28, 2002

The Honorable Timothy J. Muris
Chairman
Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Washington, DC 20580

Re: Determination Filing by Vermont Department of Banking, Insurance, Securities and Health Care Administration ("BISHCA") under Section 507 of Gramm-Leach-Bliley Act

Date of Filing: November 21, 2001

Dear Chairman Muris:

The American Insurance Association, American Council of Life Insurers, Alliance of American Insurers, National Association of Independent Insurers, and National Association of Mutual Insurance Companies (collectively "the Insurance Trades"), in accord with our telephonic discussion on April 11, 2002 with Ms. Loretta Garrison of the Federal Trade Commission ("Commission"), respectfully submit this letter as a substantive follow-up to our earlier February 28 request that the Commission either defer action on the above-referenced determination petition filed by BISHCA or, in the alternative, reject the petition.

In brief, the Insurance Trades' February 28 letter informed the Commission of a pending challenge in Vermont state court to BISHCA's promulgation of an "opt-in" insurance privacy regulation, IH-2001-01 ("Regulation"), on the grounds that the insurance industry regulation (1) exceeds BISHCA's statutory authority; (2) is arbitrary, capricious and contrary to the intent of the Vermont legislature; and (3) is contrary to the Vermont Constitution. We also described the factual context of the Regulation's issuance, providing details that might not immediately be apparent to those not involved in contesting its promulgation.

Both the structure of the preemption provisions of GLBA and relevant case law support our February 28 request, which we renew here. Subsection 507(a) of GLBA states that there will be no federal preemption of "any [state] statute, regulation, order, or interpretation" except to the extent that the state standard is "inconsistent" with subchapter I of Title V, "and then only to the extent of the inconsistency." 15 U.S.C. § 6807(a). Subsection 507(b) provides that state standards are not inconsistent if they afford a person greater protection than that provided under subchapter I of Title V, but leaves the authority for making that determination to the Commission either on its own motion or by petition of an interested party. 15 U.S.C. § 6807(b). As a result, the full impact of § 507 on state privacy standards is to preempt those standards that are inconsistent with §§ 501 through 506 and 508-509 to the extent of the inconsistency, but to protect those standards that the Commission determines provide greater privacy protection than the standards of subchapter I of Title V, keeping in mind the overarching financial services modernization purpose of GLBA.

Under the § 507 framework, BISHCA's "opt-in" insurance privacy regulation fails on a number of different levels. First, the Regulation fails to qualify as a valid "regulation" eligible for a § 507 determination, as it was issued without statutory authority and in contravention of the Vermont Constitution. Second, the "opt-in" provisions of the Regulation are plainly inconsistent with the "opt-out" framework of Title V, and do not provide greater protection than that afforded by GLBA. As a result, the Regulation is preempted under § 507(a). Third, the Regulation effects an unconstitutional infringement of commercial speech. These points are presented in greater detail below. Any one of them constitutes sufficient reason for the Commission either to stay its § 507 determination requested by BISHCA until the conclusion of the Vermont litigation or to decline to issue such a determination.

BISHCA's Insurance Privacy Regulation Was Promulgated Without The Requisite Statutory Authority

Notwithstanding the lengthy statutory string-cite in BISHCA's recent letter to the Commission, no Vermont law gives BISHCA authority to impose an opt-in system for nonpublic personal financial information on insurance licensees. In particular, there is no such direction given in the insurance law, and to extend a provision of the banking law to apply to insurance distorts the intent of the law. Promulgation of a rule in the absence of legislative authority or in a manner that is contrary to legislative intent violates the constitutional "separation of powers" doctrine. Indeed, the Vermont Supreme Court has held that regulatory activity relying solely on broad enabling, policy or purposes statements in legislation extends beyond the scope of the actual authority granted, and is therefore void.[1] The suit brought by the Insurance Trades against BISHCA in Vermont state court challenges, among other things, BISHCA's authority to issue IH-2001-01. For this reason, a Commission determination on whether the Regulation is consistent with the GLBA at this time is premature. The BISHCA request is without basis and the Commission should exercise caution under § 507 to ensure that it does not issue a determination on a rule that may be subsequently rendered moot or invalid.

The Insurance Trades' request for caution here is analogous to the federal courts' exercise of their equitable power to decline jurisdiction over cases where the state court has primary authority to render a decision and that decision may dispense with the federal determination.[2] The Insurance Trades assert that once the state court determines the validity of IH-2001-01, that determination will govern whether there is a proper rule before the Commission pursuant to § 507 of GLBA. Until such time, any Commission decision will not only be premature, it will be merely advisory in nature.[3]

"OPT-IN" IS INCONSISTENT ON ITS FACE WITH THE OPT-OUT FRAMEWORK ESTABLISHED BY GLBA

According to U.S. Supreme Court federal preemption cases, a state privacy rule is "inconsistent" with GLBA if the state standard frustrates the Congressional purpose for enacting the legislation or makes compliance with both state and federal law impossible.[4] Assuming arguendo that the Vermont state courts ruled it valid, the "opt-in" system advanced by BISHCA satisfies both tests for inconsistency.

A state rule will frustrate the purpose of federal legislation if it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[5] That standard is certainly met here. The privacy provisions of GLBA, set forth in Title V, are part of an overall statutory effort to modernize the financial services

[1] See Lemieux v. Tri-State Lotto Commission, 164 Vt. 110, 666 A.2d 1170 (1995) (rule promulgated by Commission invalid because it exceeds the scope of the authorizing statute); In re Club 107, 152 Vt. 320, 566 A.2d 966 (1989) (court finds no support for Liquor Board regulation in authority either expressly or impliedly granted by the Legislature); In re Agency of Administration, 141 Vt. 68, 444 A.2d 1349 (1982) (Environmental Board's action falls outside the scope of legislative grant of authority).

[2] See, e.g., Railroad Commission of Texas v. Pullman Co., 312 U.S. 496 (1941).

[3] While some may assert that the Insurance Trades are being inconsistent in our handling of the issue because we have not yet challenged a parallel "opt-in" insurance privacy regulation in New Mexico, we believe there are marked differences between the New Mexico Insurance Division's promulgation of a privacy rule and BISHCA's attempt to wrest control of the legislative function. The New Mexico insurance privacy regulation relies on a regulatory enabling law adopted by the legislature, which provided that rules must "meet any applicable federal requirements." NMSA 1978, § 59A-2-9.3.

[4] See Crosby v. National Foreign Trade Council, 530 U.S. 363, 372-373, 120 S. Ct. 2288, 2294 (2000).

[5] Hines v. Davidowitz, 312 U.S. 52, 67 (1941) (emphasis added).

sector and to facilitate the introduction of products and services by financial institutions such as insurance companies. Indeed, the preamble to GLBA characterizes the statute as "[a]n Act [t]o enhance competition in the financial services industry by providing a prudential framework for the affiliation of banks, securities firms, insurance companies, and other financial service providers, and for other purposes." Emphasizing the importance of financial services modernization, Title I of GLBA repeals the Glass-Steagal Act and permits the cross-industry affiliations described in the preamble.

An "opt-in" approach like the one contemplated by BISHCA undermines the overall objective of enhancing competition and facilitating affiliations by making it more difficult to utilize information obtained from customers for marketing products and services. The result is especially frustrating for insurance licensees that are forced by the nature of the insurance regulatory system to seek operational uniformity among 55 U.S. insurance regulatory jurisdictions. Such a radical departure from GLBA's "opt-out" framework undermines the ability of licensees to develop a uniform national approach to privacy compliance. For this reason alone, IH-2001-01 frustrates the overarching purpose of GLBA.

The "opt-in" under IH-2001-01 meets the "impossibility" standard as well. Satisfaction of this standard requires an "inevitable collision between the [state and federal] schemes of regulation."[6] As detailed in the comparison of opt-in and opt-out standards below, there can be no collision of privacy systems that is more inevitable. The opt-out mechanism, as envisioned under GLBA, permits a financial institution to disclose nonpublic personal financial information to non-affiliates for marketing purposes unless the insurance consumer affirmatively chooses to "opt-out" of that sharing activity and instructs the licensee accordingly. Consequently, the flow of products and services derived from marketing disclosures is preserved unless the consumer values non-disclosure in this area over the benefits that result from those disclosures.

The "opt-in" scheme envisioned by BISHCA would prevent the flow of consumer benefits resulting from marketing disclosures and would assume that Vermont consumers favor non-disclosure over these benefits unless a Vermont consumer affirmatively gave his or her permission to disclose nonpublic personal financial information for a non-excepted marketing purpose. More importantly for our analysis, IH-2001-01 flatly prohibits the "opt-out" standard required by GLBA. As such, it is impossible to comply with both the federal and state standards.

COMPARISON BETWEEN OPT-IN AND OPT-OUT STANDARDS

An opt-in standard does <u>not</u> provide greater privacy protection than the opt-out system under GLBA. In fact, the use of an opt-in approach may not be in a consumer's

[6] <u>Florida Lime & Avocado Growers, Inc. v. Paul</u>, 373 U.S. 132, 143 (1963).

best interest.[7] This is not only a critical component of the constitutional review discussed in this letter, but it goes to the heart of the practical controversy.

Requiring a consumer to specifically authorize information disclosures in advance does not provide greater privacy protection, it only provides an automatic standard. It actually provides less choice to consumers because it assumes without basis that consumers value sharing restrictions over the benefits of product and service choice facilitated by reasonable sharing for marketing purposes. In fact, studies have found that, unless specifically prompted, consumers do not mention privacy among their major concerns. It would seem presumptuous to deny consumers the choice of a wider array of products and services developed from market research because privacy advocates assume that consumers care about this issue to the exclusion of all others.

Aside from the eroding effect on consumer choice in the insurance marketplace, there are a number of additional reasons why the "opt-in" approach to privacy regulation should be rejected, and BISHCA's petition dismissed. First, consumers retain the same level of control over the use of their personal information under either system because both systems leave the final decision to the consumer. This responds to concerns over the need to vest control of personal information use in the individual, rather than the company.[8]

Second, an "opt-in" system is inherently more costly to implement and administer than an "opt-out" approach because it requires companies to make specific contact with each individual consumer in order to secure consent instead of informing all consumers at once of the informational use and allowing those consumers to decide whether to opt-out.[9] More fundamentally, an opt-in approach reduces a company's ability to engage in target marketing based on personal information and ultimately increases the amount of direct marketing material sent to consumers (which in turn generates an added cost ultimately funded by those same consumers through increased product price).[10]

Third, an opt-in system actually generates more contacts with each customer. Marketing campaigns that lack adequate information to address offers to people who would find them attractive end up sending offers to people who are not interested in the offer. As a result, studies indicate that customers viewed an opt-in approach as more intrusive than other alternatives.[11]

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[7] Professor Fred Cate of the Indiana University School of Law has written a number of articles cataloguing the detrimental impact of shifting to an "opt-in" privacy system. A document completed on behalf of the Financial Services Coordinating Council ("FSCC") identifies a number of reasons why the "opt-in" approach to privacy regulation should be rejected. A number of the points reflected in the discussion here are distilled from Professor Cate's study. See, Cate, Fred. H., "Opt-In Exposed" (FSCC 2001).
[8] Id. at 2 (quoting S. 30, 107th Cong. § 2 (2001); H.R. 89, 107th Cong. § 2(b)(1) (2001); H.R. 347, 107th Cong. § 2(b)(1)(A).
[9] Id. at 2
[10] Id. at 3-4.
[11] Id. at 4 (citing to U.S. West, Inc. v. Federal Communications Commission, 182 F.3d 1224, 1239 (10th Cir. 1999), cert. denied sub nom., Competition Policy Institute v. U.S. West, Inc., 530 U.S. 1213 (2000)).

Fourth, the opportunity for consumers to "opt-in" to information disclosures is a fiction. Where the cost of obtaining specific consumer consent outweighs the economic viability of a product or service offering, many businesses will decide not to offer the product or service, and the consumer's choice of products and services will decline.[12] Further, where information disclosures are prohibited absent an opt-in consent and those disclosures subsidize other important uses of information (such as to detect and prevent fraud), these other uses of information will also decline.[13]

Fifth, "opt-in" assumes that all consumers do not want their personal information shared for marketing purposes and that those consumers value non-disclosure above all other factors, including maximization of product choice, low cost, and efficient delivery of services. On the other hand, as Professor Cate aptly notes, "[a]n opt-out system presumes that consumers do want the convenience, range of services, and lower costs that a free flow of personal information facilitates, and then allows people who are particularly concerned about privacy to block the use of their information."[14]

Sixth, an "opt-in" regime may stifle competition by raising artificial entry barriers to additional competitors. Potential competitors often rely on the free flow of information to market their products and services effectively. Where that information flow slows to a trickle or is cut off, smaller businesses will be unable to afford the costs of entering the market and will be unable to defray the costs through outsourcing that function.[15] In fact, Professor Cate asserts that privacy laws like the European Union's Privacy Directive (discussed below), give "a dominant incumbent a monopoly over the information it possesses about its customers."[16]

Seventh, experience with the European Union Privacy Directive (which has been characterized as an "opt-in" system") counsels against an opt-in privacy approach. Ernst and Young compared the opt-in structure of the European Union Directive to the opt out structure found in GLBA.[17] Their analysis concluded that the "opt-in" approach provides customers no greater protection than GLBA, and that an opt-in structure results in lost benefits. Such lost benefits fall into three broad categories: (1) companies' increased costs of doing business; (2) companies' increased investment of time; and (3) consumers' lost opportunities, which can be expressed both in terms money and time.[18] Professor Cate comes to a similar conclusion in his review of a

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[12] Id. at 5.
[13] Id. at 6. The value of third party data for fraud identification and prevention is also articulated by others. See, Johnson and Varghese, "The Hidden Costs of Privacy: The Potential Economic Impact of 'Opt-in' Privacy Laws in California" (The Direct Marketing Association, the Information Services Executive Council and the California Chamber of Commerce 2002).
[14] Id. at 7 (emphasis in original).
[15] Id. at 8-9.
[16] Id. at 12.
[17] Ernst & Young, "High Cost, Low Benefit: The European Union Privacy Directive and the Potential Impact of a Similar Law in the United States" (FSCC 2001). The EU Directive 95/46, "On the Protection of Individuals with Regard to the Processing of Personal Data and on the Free Movement of Such Data," was adopted on October 24, 1995.
[18] The study states, "These lost customer benefits encompass a wide variety of services. They include money currently saved due to outsourcing to third parties, relationship pricing, and proactive offers. In

Consumers International study. He says that the more restrictive EU opt-in ironically failed "to provide a higher standard of privacy protection" and "to quell consumer fears."[19]

THE VERMONT "OPT-IN" REGULATION UNCONSTITUTIONALLY RESTRICTS COMMERCIAL SPEECH

The "opt-in" feature of IH-2001-01 places serious and unconstitutional restrictions on the commercial speech rights of insurance licensees. The U.S. Court of Appeals' decision in U.S. West, Inc. v. Federal Communications Commission[20] supports this contention. In that case, U.S. West challenged rules promulgated by the Federal Communications Commission pursuant to the Telecommunications Act of 1996.[21] Those rules imposed "opt-in" consent requirements on "customer proprietary network information" ("CPNI," which includes "when, where, and to whom a customer places calls"[22]) used to market "categories of services to which the customer d[id] not already subscribe."[23] The Tenth Circuit found that U.S. West's marketing activities with respect to CPNI constituted commercial speech subject to protection under the First Amendment to the United States Constitution,[24] and that the FCC's "opt-in" regulatory scheme restricted the ability of U.S. West to engage in that speech. As a result of the apparent regulatory infringement on U.S. West's free speech rights, the Tenth Circuit did not analyze the regulation under a typical administrative review standard, but subjected the regulation to the four-part test set forth in Central Hudson Gas & Elec. Corp. v. Public Serv. Comm'n of N.Y.[25] :

(a) Is the commercial speech lawful and not misleading?
(b) Is there a substantial state interest in regulating the speech?
(c) Does the regulation directly and materially advance that interest?
(d) Is the regulation no more extensive than necessary to serve that interest?[26]

Significantly, the Court stated:

> "In the context of a speech restriction imposed to protect privacy by keeping certain information confidential, the government must show that the dissemination of the information desired to be kept private would inflict

addition, they include current time savings from information sharing due to efficiencies achieved by call centers, Internet based services, third party services, proactive offers and pre-filled applications." Id. at p. v ("Executive Summary").

[19] Cate at 11.

[20] 182 F.3d 1224 (10th Cir. 1999), cert. denied sub nom., Competition Policy Institute v. U.S. West, Inc., 530 U.S. 1213 (2000).

[21] 47 U.S.C.A. § 222(c)(1).

[22] U.S. West, 182 F.3d at 1228, n. 1.

[23] Id. at 1230.

[24] Id. at 1233 ("It is well established that nonmisleading commercial speech regarding a lawful activity is a form of protected speech under the First Amendment, although it is generally afforded less protection than noncommercial speech.").

[25] 447 U.S. 557, 562-563, 100 S.Ct. 2343 (1980).

[26] Id. at 564-565 (quoted in U.S. West, 182 F.3d at 1233).

specific and significant harm on individuals, such as undue embarrassment or ridicule, intimidation or harassment, or misappropriation of sensitive personal information for the purposes of assuming another's identity.... A general level of discomfort from knowing that people can readily access information about us does not necessarily rise to the level of a substantial state interest under Central Hudson for it is not based on an identified harm." (Emphasis added.)[27]

Ultimately, the Court determined that the FCC failed the Central Hudson test, concluding:

"It is difficult, if not impossible, for us to conduct a full and proper narrow tailoring analysis, given the deficiencies that we have already encountered with respect to the previous portions of the Central Hudson test. Nevertheless, on this record, the FCC's failure to adequately consider an obvious and substantially less restrictive alternative, an opt-out strategy, indicates that it did not narrowly tailor the CPNI regulations regarding customer approval.... [T]he FCC record does not adequately show that an opt-out strategy would not sufficiently protect customer privacy. The respondents merely speculate that there are a substantial number of individuals who feel strongly about their privacy, yet would not bother to opt-out if given notice and the opportunity to do so. Such speculation hardly reflects the careful calculation of costs and benefits that our commercial speech jurisprudence requires."[28]

Subjected to similar scrutiny, BISHCA's "opt-in" privacy rule fails the Central Hudson test. First, it is not based on specific record evidence amounting to anything more than anecdotes or conjecture. Second, it fails to consider either the costs or burdens imposed by an "opt-in" system or the less restrictive GLBA "opt-out" alternative. Third, it has no relevant supporting statutory basis. Accordingly, the Regulation violates the First Amendment rights of insurance companies.

* * *

Based on all of the concerns discussed herein, the Insurance Trades continue to urge the Commission either to stay its § 507 determination in this matter until the conclusion of the Vermont litigation or to decline to issue such a determination altogether. The undersigned representatives of the Insurance Trades appreciate the

[27] U.S. West, 182 F.3d at 1235.

[28] Id. at 1238-1239 (emphasis added). But c.f. Bellsouth Corp. v. Federal Communications Comm'n, 144 F.3d 58 (D.C. Cir. 1998) (implementation of structural separation requirements of Telecommunications Act, restricting ability of petitioner's operating companies to provide electronic publishing, survived intermediate scrutiny standard governing review of free speech restrictions), cert. denied, 526 U.S. 1086 (1999); Trans Union Corp. v. Federal Trade Commission, 245 F.3d 809 (D.C. Cir. 2001) (Commission's ban on sale of target marketing lists pursuant to federal Fair Credit Reporting Act did not violate credit reporting agency's First Amendment rights), cert. denied, 122 S. Ct. 1286 (2002).

opportunity to comment on this important matter and would be happy to address any additional questions that the Commission may pose.

Respectfully submitted,

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