

Testimony

Of

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System to Consumers and the U.S. Economy”

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Mr. Chairman, Ranking Member and Members of the Subcommittee,

I commend you for convening this hearing on the national credit reporting system and would like to thank you for the honor and opportunity to testify. My name is Joel R. Reidenberg. I am a Professor of Law at Fordham University School of Law where I teach courses in information privacy, international trade and comparative law. As a law professor, I have written and lectured extensively on the regulation of fair information practices in the private sector. My bibliography includes scholarly articles and two co-authored books on data privacy.¹ Of specific relevance to today's hearing, I have studied and written about the Fair Credit Reporting Act ("FCRA") as well as assisted the Federal Trade Commission in its successful litigation against Trans Union's illegal disclosure of credit report information for marketing purposes.² I am a former chair of the Association of American Law School's Section on Defamation and Privacy and have also served as an expert advisor on data privacy issues to state and local governments, to the Office of Technology Assessment in the 103rd and 104th U.S. Congresses and, at the international level, to the European Commission and foreign data protection agencies. I appear today as an academic expert on data privacy law and policy and do not represent any organization or institution with which I am or have been affiliated.

My testimony will focus on three points: (1) the US credit reporting system needs strong privacy protections to preserve a robust national information economy; (2) the substantial weaknesses in the FCRA introduced in 1996 with the provisions on affiliate sharing and unsolicited offers pose a threat to a safe and sound credit reporting system; (3) Congress must continue to assure the integrity of the credit reporting system through stronger fair information practice standards.

Strong Privacy Protections are Essential for the Credit Reporting System

The FCRA was enacted in 1970 as a response to significant abuses in the nascent credit reporting industry. Decisions affecting citizens' lives were being in secret with bad data. Congress heard extensive testimony during the late 1960s on the unfair and abusive information practices that voluntary industry guidelines failed to prevent. These included the release of credit information to non-credit grantors, the dissemination of inaccurate credit information, the inability of consumers to gain access to their credit reports, and the difficulty of consumers to obtain correction of erroneous information.³

In enacting the original FCRA, Congress wanted to assure the efficiency and integrity of the U.S. banking system. The statute became the cornerstone of US privacy law. Congress recognized that fair information practices were essential for vibrant credit markets and expressly sought "to prevent an undue invasion of the individual's right of privacy in the collection and dissemination of credit information."⁴ At the time, the FCRA was an extraordinary and unique statute precisely because the law set a new standard for strong privacy protection. The FCRA established a then-novel system of opt-in permission for the dissemination of credit report information. The statute defined a specific set of permissible purposes for which the disclosure of credit report information was authorized. These purposes related directly to the reasons for which data

was collected and are generally limited to the extension of credit, insurance or employment. Any other disclosure of credit report information requires the written consent of the consumer. Among other important innovations for fairness, the law created transparency in the industry by granting a consumer the right of access to credit report information and by requiring the industry to identify the recipients of credit reports. The law further provided rights for consumers to dispute inaccurate information contained in their credit reports.

The fairness rules and opt-in approach contained in the original FCRA enabled the credit reporting industry to progress from its fragmented, chaotic and abusive period in the late 1960s to a successful, respected component of the U.S. information-based economy. The FCRA obligations, in effect, created today's thriving national infrastructure of credit reporting.

From the start, however, Congress recognized that the credit reporting industry would be likely to evolve significantly and that even greater privacy and fairness could benefit the banking industry. As a result, Congress permitted the states to enact stronger privacy protections for credit reporting since stronger state statutes promoted the main goals of the original FCRA. In fact, most subsequent fair information practice legislation for the private sector in the United States expressly waived, in whole or in part, federal pre-emption such as the Financial Services Modernization Act, the Health Insurance Portability and Accountability Act, the Cable Communications Policy Act, and the Video Privacy Protection Act. By 1996, when Congress adopted a number of significant amendments to the FCRA, the credit reporting industry had grown dramatically and, indeed, operated nation-wide in a seamless fashion notwithstanding diversity at the state level.

Among the 1996 FCRA amendments, Congress included a partial pre-emption clause that only precludes states for another eight months from implementing certain types of stronger credit reporting provisions. The 1996 amendments specifically exempted the stronger California, Massachusetts and Vermont statutes from pre-emption.⁵ To my knowledge, no industry group has examined the effects of these three stronger state statutes on either the credit markets in those states or on the nation-wide industry. This is not surprising. A rudimentary look at federal statistics suggests that credit decisions in these states benefit both lenders and consumers. Consumer bankruptcy filings per household, a basic sign of bad credit decisions, are markedly better for these three states with more protective credit reporting statutes. Vermont ranks 50th with the lowest rate of consumer bankruptcies in the nation, Massachusetts is 49th and California comes in below the median at 27th.⁶ Mr. Chairman, your state, Alabama, without a stronger law, has a much higher rate of consumer bankruptcy and is ranked as the 5th highest in the nation.⁷ Similarly, federal statistics on interest rates seem to indicate that states with stronger credit reporting laws have lower rates. The most current annual federal mortgage loan data indicates that the effective rate on a conventional mortgage for 2002 was 6.25% in California, 6.43% in Massachusetts and 6.59% in Vermont.⁸ All were below the national median and California had the lowest rate in the nation. Your state, Mr. Chairman, had an effective rate of 6.65% meaning that your constituents

appear to be paying higher mortgage rates than those in more privacy protective states. While these statistics leave out important elements for a thorough assessment of the impact of stronger state laws such as a correlation with state unemployment data for bankruptcy filings and non-interest transaction costs for home mortgage loans, the data does show that the horror stories circulating about the pre-emption provisions make good theater, but reflect poor research.⁹

The bottom line is that strong privacy protections are essential for public confidence in the integrity of financial services in the United States. For information used to make financial decisions about consumers, citizens believe that fairness requires opt-in permission. In 2001, citizens in North Dakota had the first and only opportunity in the nation to take a real position at the polls on the dissemination of their personal financial information. The North Dakota state legislature had just watered down financial privacy from an opt-in rule on data sharing to an opt-out rule. The citizens of North Dakota revolted. By an overwhelming 72% majority, the voters of North Dakota approved a referendum restoring the old opt-in rule and rebuking the legislature's weakening of privacy standards. Strong privacy clearly matters to voters and to the health of our financial and credit system.

Substantial Weaknesses and Threats to a Safe and Sound Credit Reporting System

The basic tenet of fair information practices is that information collected for one purpose should not be used for different purposes without the individual's consent. Deviations from this key standard threaten a safe and sound credit reporting system in the United States. The circulation of credit report information outside the core permissible purposes increases the risk of identity theft, decreases the accuracy and reliability of credit information and decreases the public's trust in the credit industry.

Unfortunately, the 1996 Amendments deviated from the FCRA's historical commitment to opt-in with respect to two critical areas: affiliate sharing and pre-screening. The amendment to the definition of a "consumer report" allowed organizations to escape the fair information practice obligations of the FCRA for information that would otherwise be covered if such data were to be disseminated to affiliates provided that consumers have a one-time chance to opt-out. The amendments also authorized a narrowly drawn exception from the written consent requirements so that the FCRA now permits pre-screening of credit report information to make unsolicited, firm offers of credit or insurance. Congress accepted this deviation from the core purposes only with additional safeguards including record-keeping obligations, transparency obligations and easy opt-out procedures. Congress thought it would still protect what Senator Proxmire sought to preclude when he introduced the original FCRA: "the furnishing of information to Government agencies or to market research firms or to other business firms who are simply on fishing expeditions."¹⁰

Industry practices, however, try to exploit and circumvent the careful protections of the FCRA. For example, under the guise of pre-screening offers of credit, a major national wireless phone company shamelessly rummages through consumer credit reports

to find marketing prospects for phone service and free phones. Other major national companies sell detailed personal financial information to government agencies and private sector organizations for the purpose of making decisions that will affect those individuals without conforming to the FCRA. These practices resemble the very abuses that Congress sought to prevent through the FCRA.

The creeping data leakage of credit information for secondary purposes of affiliate sharing, unsolicited offers and non-credit decision making undermines confidentiality and security of personal information. In terms of affiliate sharing, the successful liberalization of the financial services sector since the enactment of the FCRA means that the definitional exemption has far reaching implications today. Large organizations engaged in exactly the same behavior that Americans find troubling-- the dissemination of confidential personal information for a wide range of activities unrelated to the purpose of collection-- escape the obligations of consumer reporting agencies and the opt-in rule. With respect to unsolicited offers of credit and insurance, the deviation from the core permissible purposes has proven unjustified. A lobbying paper sponsored by an industry group, the Privacy Leadership Initiative, admits that the average response rate to credit card offers in 2000 was only 0.6 percent.¹¹ I am not aware of any publicly disclosed information showing substantially higher response rates for pre-screened lists. Consumers simply are not interested in these offers. Yet, this type of secondary use of credit information creates an important leakage of data from confidential and secure credit reporting.

Some have argued that strong credit reporting rules overseas substantially hinder the “miracle of instant credit” and result in much higher interest rates. These arguments have no apparent basis in demonstrated fact or analysis. No other country to my knowledge has a comparable statute governing only credit report information. Comprehensive data privacy laws applicable to most processing of personal information do exist outside the United States such as those in Canada, in the United Kingdom and throughout Europe under European Directive 95/46/EC. These laws typically apply to credit reporting and are generally more protective of consumers than the FCRA. However, foreign consumer credit markets are structured by banking law, bankruptcy law, real estate law, and consumer protection laws that often deviate significantly from the US legal system. The attribution of differences in credit markets to general data privacy laws without examination of the direct regulatory constraints on credit relationships and loan security is specious and a misrepresentation of foreign privacy law.

Other countries with comprehensive data protection statutes such as Canada demonstrate that robust credit information services can co-exist with strong, comprehensive data privacy laws. In fact, one major US credit reporting agency operating in Canada offers a typical credit report for Canadians that contains information strikingly similar to the typical report for Americans. In the United Kingdom where a comprehensive data privacy law also applies, major credit card companies also offer instant approvals for platinum cards.

In short, the FCRA needs to restore its original ground-breaking protections for consumer privacy to ensure public confidence and the integrity of the credit report information.

Recommendations for Future Action

1. Legislate higher standards of privacy to assure the integrity of the credit reporting system and public trust by specifically returning pre-screened offers to the opt-in approach of the original FCRA or by allowing the states to establish higher standards.
2. Expand the definition of “consumer report” in the FCRA to cover affiliate sharing or allow the states to modify the definition.
3. Extend the protections of the FCRA to the dissemination of personal information collected for the purpose of making any type of financial decision about the consumer so that similar activities affecting consumers do not escape fair information practice standards

¹ Paul M. Schwartz & Joel R. Reidenberg, DATA PRIVACY LAW (Michie: 1996); Joel R. Reidenberg and Paul M. Schwartz, ONLINE SERVICES AND DATA PROTECTION LAW: REGULATORY RESPONSES (EUROPE: 1998); Joel R. Reidenberg, *Privacy Wrongs in Search of Remedies*, 54 HASTINGS L. J. -- (forthcoming); Lorrie Cranor & Joel R. Reidenberg, *Can user agents accurately represent privacy notices?*, TPRC 30th Research Conference Paper # 65 (2002) available at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=328860> ; Joel R. Reidenberg, *E-commerce and Trans-Atlantic Privacy*, 38 HOUSTON L. REV. 717 (2001); Joel R. Reidenberg, *Resolving Conflicting International Data Privacy Rules in Cyberspace*, 52 STANFORD L. REV. 1315 (2000); Joel R. Reidenberg, *Restoring Americans' Privacy in Electronic Commerce*, 14 BERKELEY TECH. L. J. 771 (1999); Joel R. Reidenberg, *Setting Standards for Fair Information Practice in the U.S. Private Sector*, 80 IOWA L. REV. 497 (1995); Joel R. Reidenberg & Francoise Gamet-Pol, *The Fundamental Role of Privacy and Confidence in Networks*, 30 WAKE FOREST L. REV. 105 (1995); Joel R. Reidenberg, *Rules of the Road on Global Electronic Highways: Merging the Trade and Technical Paradigms*, 6 HARVARD J. LAW & TECH. 287 (1993); Joel R. Reidenberg, *The Privacy Obstacle Course: Hurdling Barriers to Transnational Financial Services*, 60 FORDHAM L. REV. S137 (1992); Joel R. Reidenberg, *Privacy in the Information Economy-- A Fortress or Frontier for Individual Rights?*, 44 FED. COMM. L. J. 195 (1992). Copies of most of my articles may currently be found on my web site at: <<http://reidenberg.home.sprynet.com>>

² In re: Trans Union, FTC Docket No. 9255, *aff'd* Trans Union Corp. v. FTC, 245 F.3d 809, 811 (D.C. Cir., 2001) *cert denied*, 122 S. Ct. 2386 (2002).

³ See e.g. S. Rep. 91-517, 91st Cong., 1st Sess. (1969); Hearings on Commercial Credit Bureaus before the House Special Subcommittee on Invasion of Privacy of the Committee on Government Operations, 90th Cong., 2nd Sess., March 12-14, 1968; Hearings on Fair Credit Reporting S. 823 before the Senate Subcommittee on Financial Institutions of the Committee on Banking and Currency, 91st Cong., 1st Sess. (May 19-23, 1969)

⁴ S. Rep. 91-517, 91st Cong., 1st Sess. 1 (1969)

⁵ 15 U.S.C. 1681t(b)(1)(F)

⁶ American Bankruptcy Institute, US Bankruptcy Filing Statistics: Households per filing, Rank (2003) (using “statistics based on data from the Administrative Office of the U.S. Courts (2002 bankruptcies) and the U.S. Bureau of the Census.”) available at <http://www.abiworld.org/stats/householdrank.pdf>

⁷ Id.

⁸ Federal Housing Finance Board, Periodic Summary Tables: Table IX—Terms on Conventional Home Mortgages 2002 available at <http://www.fhfb.gov/MIRS/mirstbl9.htm>

⁹ See also, Robert Gellman, No Fair Fight over FCRA Provisions, DM News, May 5, 2003, pp. 12-13.

¹⁰ Cong. Rec. Senate, Jan. 31, 1969 (statement of Sen. Proxmire) reprinted in Hearings on Fair Credit Reporting S. 823 before the Senate Subcommittee on Financial Institutions of the Committee on Banking and Currency, 91st Cong., 1st Sess., at 436 (May 19-23, 1969)

¹¹ Michael E. Staten & Fred H. Cate, Paper prepared for the Privacy Leadership Initiative “The Adverse Impact of Opt-In Privacy Rules on Consumers: A Case Study of Retail Credit,” at 25 (April 2002).