Study B-400 September 19, 2003

First Supplement to Memorandum 2003-30

Financial Privacy (Comments of Financial Institutions Committee of State Bar Business Law Section)

Attached to this memorandum is a copy of a letter from Elizabeth A. Huber of the Financial Institutions Committee of the Business Law Section of the State Bar Association, distributed and considered at the Commission meeting on September 19, 2003.

Respectfully submitted,

Nathaniel Sterling
Executive Secretary

Hudson Cook, LLP
Attorneys at Law

2361 Rosecrans Avenue, Suite 355, El Segundo, California 90245
(310) 536-9099 • (800) 390-8288 • Fax: (310) 536-7644
www.hudco.com

Offices in: California, Connecticut, Maryland, New York, Virginia, Washington DC

Sharon J. Bangert ✳
Michael A. Benoit ✦
A. James Chareq □<
Robert A. Cook ✳
David S. Darland ✳✳^
Anne P. Fortney ^▲
D. Brent Gunsalus ✳✳^
Elizabeth A. Huber ^†
Thomas B. Hudson ✳^
Elena A. Lovoy ★□⊙
Wingrove S. Lynton ✳
Timothy P. Meredith †◇
L. Jean Noonan ✳
Aline C. Ryan ✳
Grace Sterrett ◇
Alicia H. Tortarolo †
Daniel O'C. Tracy, Jr. ✳
Elizabeth C. Yen >

Admitted in Alabama ★
Admitted in California †
Admitted in Connecticut >
Admitted in District of Columbia ^
Admitted in Hawaii ▲
Admitted in Illinois □
Admitted in Indiana <
Admitted in Louisiana ⊙
Admitted in Maryland ✳
Admitted in New York ◇
Admitted in Ohio ✦
Admitted in Virginia ✳✳

September 17, 2003

Nathaniel Sterling, Executive Secretary
California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94353-4739

Re: Study of Personal Information Relating to Financial Transactions

Dear Mr. Sterling:

Thank you for taking the time to speak with me recently regarding the passage of Senate Bill 1, the California Financial Information Privacy Act. As practitioners have begun working through the new law in order to render advice to clients, we have identified some ambiguities in the law that make interpretation difficult. Although you may have already identified some of these items, we bring these to your attention for the purpose of aiding the Commission with its review of the new law. I would like to thank the Financial Institutions Committee of the Business Law Section of The State Bar of California, particularly that committee's retiring member, Steven Strange, Sr. Counsel and Sr. Vice President for Manufacturers Bank, Los Angeles, for most of these thoughtful comments.

Definition of "Financial Institution"

Subdivision (c) of new California Financial Code Section 4052 defines "financial institution" as any institution the business of which is engaging in financial activities as described in Section 1843(k) of Title 12 of the United States Code and *doing business in this state.* There are questions about that part of the definition that requires the financial institution be "doing business in this state." Does this include financial institutions that have only minimum contacts with California required to sustain jurisdiction in California courts, or is it intended to apply only to institutions having a higher degree of contact with the state, akin to "transacting intrastate business" under Corporations Code Section 191, and at least with respect to traditional financial institutions, transacting "core banking business" under Financial Code Section 3800?

Sharing Among Affiliated Financial Institutions

Subdivision (c) of new California Financial Code Section 4053 does not restrict or prohibit sharing nonpublic personal information between a financial institution and its wholly owned (directly or indirectly) financial institution subsidiaries, or between financial institutions that are wholly owned by the same financial institution or same holding company, or among the insurance and management entities of a single insurance holding company, notwithstanding the consumer's right to opt out of such sharing among "affiliates," provided certain conditions are met. One of those conditions is that the financial institution disclosing the nonpublic personal information and the financial institution receiving it be "regulated by the same functional regulator." Are two affiliated state-chartered banks, each regulated by a state-banking department, albeit from different states (e.g., one by the California Department of Financial Institutions and one by another state banking department), "regulated by the same functional regulator?"

Another of those conditions is that the financial institution disclosing the nonpublic personal information and the financial institution receiving it are both principally engaged in the same line of business, meaning either (A) Insurance, (B) Banking, or (C) Securities. It appears that the "same line of business" condition could mean that a financial institution that is a California Finance Lender ("CFL") Licensee regulated by the California Department of Corporations and its parent, a federally-chartered bank regulated by its federal regulator, would qualify, since both financial institutions are engaged in the same business that is typical of banking, i.e., the lending of money, even though the CFL licensee is not a depository institution (it relies on its parent for the "same functional regulator" criterion). Is this a correct interpretation?

For the sharing of nonpublic personal information subject to this exception "between" affiliated financial institutions that are parent and subsidiary, may the information flow both ways, e.g., from the parent to its subsidiary, and from the subsidiary to the parent?

The flow of information issue also applies to sharing between a financial institution and nonaffiliated financial institution under the "joint offering" exception, although sharing under this relationship requires the consumer be given the right to opt out of that information sharing. Cal. Fin. Code § 4053(b)(2).

The Form of "Opt Out" Notice[1]

Subdivisions (d)(1) and (2) of California Financial Code Section 4053 pertain to the requirements for the "opt out" notice to the consumer. The financial institution may use the form set forth in subdivision (d)(2) (the statutory form), or it may it may use a form that meets certain elements set forth in subdivision (d)(1) (the "custom" form). If the financial institution uses the statutory form, it shall be conclusively presumed to have satisfied the notice requirements. If a financial institution uses the custom form, it does not enjoy that presumption, although it may achieve a rebuttable presumption of having complied if it submits the custom form to the financial institution's functional regulator and obtains its approval, and files the custom form with the Office of Privacy Protection.

Several questions arise in regard to the statutory form:

- What requirements for formatting and layout apply to the statutory form? Several of the requirements listed in connection with the custom form relate to formatting, e.g., bold type or type size, (specifically, subsections (B), (C), (K) and (L) of subdivision (d)(1)) but these subsections apply only to the custom form. If a financial institution chooses to use the statutory form, may it look to these requirements as a guide to such matters? If not, what are the standards?

- The custom form may be a "separate notice" or may be combined with the information required for the federal privacy notice. Cal. Fin. Code § 4053(d)(2)(D)(ii). May the statutory form be combined with (although segregated from) the privacy notice required by federal law under Title V of the Gramm-Leach-Bliley Act, or must it be on a separate piece of paper?

- The text of the statutory form may only be altered to delete the instructions and any header, box, and accompanying sentence that do not reflect the financial institution's practices. Cal. Fin. Code § 4053(d)(2). May the statutory form carry the financial institution's logo, and may it include additional instructions to the consumer, such as to use a toll-free fax number provided by the financial institution to allow the consumer to exercise his or her opt-out right? Or will these additions transmute an otherwise statutory form into a custom form?

- The statutory form includes two bold type headings – one of which is "Restrict Information Sharing With Companies We Own or Control (Affiliates)." This language does not, on its face, encompass (1) a holding company that owns the financial institution, or (2) affiliates of the holding company that owns the

[1] Of sharing (1) among affiliates, (2) between nonaffiliated financial institutions engaged in "joint marketing," and (3) between affinity partners.

financial institution. If the consumer selects this category and returns the notice as an opt-out form, has he or she opted out of information sharing with the institution's holding company or holding company affiliates? Also, has he or she opted out of information sharing with franchisor or franchisee affiliates that are covered by the second sentence of Financial Code Section 4052(d), or are those affiliates covered by the other heading – "Restrict Information Sharing With Other Companies We Do Business With ... ." May a financial institution with a holding company or an institution with franchise relationships use the statutory form under these circumstances, or is use of the statutory form by such an institution misleading, thus requiring the financial institution to change the form? If so, do such changes turn the statutory form into a custom form?

Timing for Exercising the "Opt Out"

A financial institution is required to provide a consumer annually with a notice of his or her right to opt out of information sharing with certain classes of business, and if the financial institution has not provided a consumer with this annual notice, then prior to the disclosure of nonpublic personal information to such classes, the financial institution is required to provide a consumer with a notice of his or her right to opt out of information sharing with such classes. Cal. Fin. Code §§ 4053(b), 4053(d)(3). In this last instance, the financial institution must wait a period of at least 45 days from the date of providing the notice before disclosing nonpublic personal information about the consumer, unless the consumer has exercised his or her right to opt out of that sharing (which the consumer may exercise at any time). The sending of the annual notice does not appear to have a "wait period" associated with it. Because the sending of the annual notice is "pursuant to subdivision (d)" must the financial institution wait the 45 days after sending the annual notice before sharing information, or is a lesser number of days permissible, so long as the period is "reasonable"?

The operative date of the new law is July 1, 2004. Cal. Fin. Code § 4060. If, prior to the operative date, a financial institution gives a consumer, at the time of an initial transaction by the consumer, the notice of his or her right to opt out of certain information sharing (either the statutory form or a custom form), and assuming the consumer doesn't opt out, may the financial institution share information about the consumer beginning 45 days thereafter? Likewise, a financial institution may define the 12-consecutive month period for purposes of the required annual mailing. Cal. Fin. Code § 4053(d)(5). If a financial institution wishes to define the 12-consecutive month period as the calendar year, does an annual mailing sent before the operative date i.e., between January 1, 2004 and June 30, 2004, satisfy this requirement for 2004?

If the financial institution does not have a continuing relationship with the consumer, other than the initial transaction in which the financial product or service is

provided, no annual notice requirement exists. If the financial institution wishes to share nonpublic personal information with certain classes of business, it must at the time of the initial transaction provide the consumer with the opt out notice. Cal. Fin. Code § 4053(d)(5). If the financial institution engages in an initial transaction with a consumer but does not, until some later time, wish to share nonpublic personal information, may it do so as long as it provides to the consumer such notice at least 45 days prior to disclosure of such information, or is it prohibited from doing so because it did not provide the consumer with the opt out notice "at the time of the initial transaction"? If the transaction was entered into prior to the consumer moving into the state of California, what are the financial institution's obligations?

Inaccurate Information on Consumer Opt-Out Forms

If provided by the financial institution, the consumer may complete and return the notice (either the statutory form or a custom form) to opt out of certain information sharing by the financial institution. Cal. Fin. Code § 4053(d). The statutory form calls for the consumer to provide his or her account or policy number on the opt-out form. If the consumer provides incorrect account or policy number information, or incomplete or missing account or policy number information, is the consumer's opt-out notice effective? What is the financial institution to do in this case?

Exceptions

Some issues arise in connection with the exceptions from having to obtain either the consumer's consent acknowledgment to information sharing ("opt in"), or the notice of and the right to direct that information not be shared ("opt out"). Under subdivision (b)(1) of Financial Code Section 4056 nonpublic personal information may be released if it is:

- Necessary to effect, administer, or enforce a transaction requested by the consumer, or
- In connection with servicing or processing a financial product or service requested or authorized by the consumer, or
- In connection with maintaining or servicing the consumer's account with the financial institution, or
- In connection with maintaining or servicing the consumer's account with another entity as part of a private label credit card program or other extension of credit on behalf of that entity, or

- In connection with a proposed or actual securitization or secondary market sale, including sales of servicing rights, or in connection with similar transaction related to a transaction of the consumer.

Under the fourth exception above, is a financial institution permitted to transmit nonpublic personal information to another financial institution that is the card issuer for the first institution under a private label arrangement? It would seem that the card issuer would be permitted to release nonpublic personal information to the institution for whose customers the cards are issued as well. Is this a correct interpretation? Does the last phrase "similar transaction related to a transaction of the consumer" mean that the transaction is similar to a proposed or actual securitization or secondary market sale, or does it cover transactions that are similar to the other permitted releases as well?

Under subdivision (b)(2) of Financial Code Section 4056, nonpublic personal information may be released, notwithstanding Sections 4052.5, 4053, 4054 and 40546, with the consent of or at the direction of the consumer. Since the exceptions in Section 4056 explicitly override Section 4053, what is the interplay between a "consent" under Section 4056(b)(2) and the "consent acknowledgment" and the specific requirements in Section 4053(a)(2)?

Under subdivision (b)(13) of Section 4056, nonpublic personal information may be released if it is "from a consumer report reported by a consumer reporting agency." This language must not mean that information in a consumer report may be released to any affiliated or nonaffiliated third party without having to comply with the opt-in or opt-out requirements in every instance – must not the information in the consumer report be released under the federal Fair Credit Reporting Act, or as otherwise authorized or permitted by law?

We appreciate the opportunity to comment upon the various issues of interpretation of the provisions of the California Financial Information Privacy Act. Please do not hesitate to let me know if you have any questions about the information contained in this letter. Thank you.

Very truly yours,

Elizabeth A. Huber, Esq.
Hudson Cook, LLP

HC#43162

cc: John Hancock, Financial Institutions Committee, Business Law Section
Steven Strange, Sr. Counsel and Sr. Vice President, Manufacturers Bank
The State Bar of California: Saul Bercovitch, Larry Doyle, Susan Orloff