Study B-400 January 30, 2004

First Supplement to Memorandum 2004-9

Financial Privacy (Recent Developments)

This supplemental memorandum reports recent developments relating to the financial privacy study.

FCRA Preemption

Bank of America, N.A. v. City of Daly City, 279 F. Supp. 2d 1118 (ND Cal 2003) — holding that local ordinances governing financial privacy are preempted by the Fair Credit Reporting Act to the extent they seek to limit information sharing by a bank with its affiliates — has been appealed to the United States Court of Appeals for the Ninth Circuit. Docket #03-016689.

The case is currently being briefed. In the ordinary course of events it would not be decided before the end of the year. The clerk's office informs us there has been no motion to expedite. Given the fact that the local ordinances are invalidated by SB 1 effective July 1, 2004, one wonders whether the appeal will be dismissed ultimately as moot.

It is also noteworthy that the local ordinances, while based on SB 1 as it was introduced, regulate affiliate sharing in a significantly different manner than does SB 1 as enacted. Depending on the court's analysis and legal bases for its opinion, the decision on the local ordinances may have greater or lesser significance for SB 1 preemption issues.

In any event, the fact of the appeal underscores the staff's suggestion in Memorandum 2004-9 that the Commission not recommend revision of SB 1 to reflect federal preemption until the scope of preemption can be determined with a greater degree of certainty.

National Bank Act Preemption

The Office of Comptroller of the Currency has issued final rules under the National Bank Act that broadly preempt state law seeking to control activities of a national bank. The preemption rules are addressed to state law that obstructs, impairs, or conditions a national bank's ability to fully exercise its deposit-taking

power (12 CFR § 7.4007), its non-real estate lending power (12 CFR § 7.4008), or its power to conduct activity authorized under federal law (12 CFR § 7.4009).

The catch-all regulation reads:

> **§ 7.4009. Applicability of state law to national bank operations**
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> (a) *Authority of national banks.* A national bank may exercise all powers authorized to it under Federal law, including conducting any activity that is part of, or incidental to, the business of banking, subject to such terms, conditions, and limitations prescribed by the Comptroller of the Currency and any applicable Federal law.
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> (b) *Applicability of state law.* Except where made applicable by Federal law, state laws that obstruct, impair, or condition a national bank's ability to fully exercise its powers to conduct activities authorized under Federal law do not apply to national banks.
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> (c) *Applicability of state law to particular national bank activities.*
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> (1) The provisions of this section govern with respect to any national bank power or aspect of a national bank's operations that is not covered by another OCC regulation specifically addressing the applicability of state law.
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> (2) State laws on the following subjects are not inconsistent with the powers of national banks and apply to national banks to the extent that they only incidentally affect the exercise of national bank powers:
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> (i) Contracts;
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> (ii) Torts;
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> (iii) Criminal law;
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> (iv) Rights to collect debts;
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> (v) Acquisition and transfer of property;
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> (vi) Taxation;
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> (vii) Zoning; and
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> (viii) Any other law the effect of which the OCC determines to be incidental to the exercise of national bank powers or otherwise consistent with the powers set out in paragraph (a) of this section.

It is perhaps significant that the regulation neither expressly preempts nor expressly exempts a state law governing information sharing by a national bank with its affiliates or others. Historically, OCC has been vigorous in its effort to preclude application of state law that may in any way limit the activities of a national bank.

Both the deposit taking regulation (12 CFR § 7.4007) and the lending regulation (12 CFR § 7.4008) specifically preempt a state limitation concerning "disclosure requirements". Arguably that language could preempt a state law requiring a national bank to give a privacy notice to its customers, as well as a state law limiting the right of a national bank to disclose customer information to a third party.

On the other hand, all three regulations (12 CFR §§ 7.4007-7.4009) specifically exempt state law governing "torts" and "acquisition and transfer of property". That language could be construed to preserve state law protecting the privacy of a consumer's nonpublic personal information.

All that can be said with confidence is that OCC has staked out its general position on preemption. How the general position will apply to the specifics of state regulation of financial privacy is unclear. The staff has suggested in Memorandum 2004-9 that, until the preemption pattern of the National Bank Act and other functional regulatory regimes becomes clear, we should simply identify the potential problem for the Legislature, and allow events to unfold.

Privacy Practices of Financial Institutions

The Consumer Federation of California Education Foundation has issued a *Financial Privacy Report Card* (January 2004). The report surveys the privacy practices of 55 of the largest financial institutions doing business in California. The report is noteworthy because it is the first attempt systematically to survey the information sharing practices of financial institutions.

(The Gramm-Leach-Bliley Act requires the Secretary of the Treasury, in conjunction with the Federal Trade Commission and other federal regulators, to make a study and report to Congress with findings and conclusions on information sharing practices of financial institutions, and the risks and benefits of those practices. 15 USC § 6808(a). The report was due January 1, 2002; to our knowledge it has never been released.)

The Consumer Federation report indicates that all but a handful of the largest financial institutions share customer information with their affiliates. The great majority of them give their customers no opt out opportunity.

Most of the financial institutions also share customer information with other financial institutions for joint marketing purposes. Again, they do not typically offer their customers an opt out opportunity.

With respect to information sharing with unrelated third parties, most of the financial institutions do not engage in this practice (although a substantial minority does). Of those that do share customer information with unrelated third parties, a few offer their customers an opt in opportunity; the rest share information unless the customer opts out.

A few of the major financial institutions offer their customers significantly greater control over disclosure of nonpublic personal information than GLB

requires. The full Consumer Federation report is available on the internet at www.consumerfedofca.org/edufund.html.

Respectfully submitted,

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