No. 04-16334

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

AMERICAN BANKERS ASSOCIATION,
THE FINANCIAL SERVICES ROUNDTABLE, and
CONSUMER BANKERS ASSOCIATION,

Plaintiffs-Appellants,

v.

BILL LOCKYER, in his official capacity as Attorney General of California,
HOWARD GOULD, in his official capacity as Commissioner of
the Department of Financial Institutions of the State of California,
WILLIAM P. WOOD, in his official capacity as Commissioner
of the Department of Corporations of the State of California, and
JOHN GARAMENDI, in his official capacity as Commissioner
of the Department of Insurance of the State of California,

Defendants-Appellees.

On Appeal from the Final Judgment and Denial of Injunction of the
United States District Court for the Eastern District of California
Case No. S-04-0778 MCE KJM

BRIEF OF AMICUS CURIAE CITIZENS FOR A SOUND ECONOMY SUPPORTING APPELLANTS AND URGING REVERSAL

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CORPORATE DISCLOSURE STATEMENT

Citizens for a Sound Economy operates as a nonpartisan education and advocacy organization under Section 501(c)(4) of the Internal Revenue Code. It has a parent organization, FreedomWorks, which also operates as a nonpartisan education and advocacy organization under Section 501(c)(4) of the Internal Revenue Code. Citizens for a Sound Economy has not issued shares or securities that are publicly traded.

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STATEMENT OF INTEREST

Citizens for a Sound Economy ("CSE") is a nonprofit, nonpartisan organization with approximately 360,000 members nationwide, including more than 31,000 in the State of California, and is a strong proponent of consumer privacy. CSE's mission is to educate citizens regarding, and to promote the adoption of, market-based solutions to public policy questions that inure to the benefit of consumers and citizens generally. All parties have consented to CSE filing this amicus curiae brief.

The District Court's conclusion—that the provisions of the California Financial Information Privacy Act (commonly referred to as "SB1"), California Financial Code Division 1.2, regulating the sharing of information among affiliated financial services companies, are not preempted by the Fair Credit Reporting Act ("FCRA"), 15 U.S.C. §§ 1681 *et seq.*—is inconsistent with both the FCRA's clear and express language and the FCRA's legislative history. In their brief, Plaintiffs-Appellants, American Bankers Association, The Financial Services Roundtable, and Consumer Bankers Association, eloquently and persuasively analyze the relevant statutes and precedents to demonstrate that the FCRA preempts the affiliate sharing provisions of SB1.

CSE strongly supports Appellants' analysis. CSE believes that within the framework of the FCRA, the United States economy has developed an efficient and highly integrated system of information availability and use that allows businesses to provide consumers with a wide array of financial products and services in an efficient manner and at competitive prices. CSE is concerned that the District Court's decision undermines the benefits of affiliate information sharing currently enjoyed by both consumers and businesses, and will lead to higher prices and a more limited availability of financial services. The District Court's decision already is forcing businesses throughout the nation to change their programs for providing financial services to consumers in California and, in doing so, to change their operations nationally.

SUMMARY OF ARGUMENT

Federal preemption of state laws respecting the sharing of information among affiliated financial services companies benefits both businesses and consumers. These benefits accrue from the efficient use of information about consumers and their financial choices. The history of federal regulation of information sharing among affiliated financial services companies clearly demonstrates that Congress intended to regulate affiliate information sharing in a narrow and limited fashion under the FCRA, while also broadly preempting any state laws that would impose requirements or prohibitions concerning affiliate information sharing. Affiliate information sharing is fundamentally different from the sharing of information with nonaffiliated third parties.

Affiliate information sharing strengthens the United States economy and confers immeasurable benefits on consumers. In addition, affiliate information sharing is a necessary incident to the federal regulatory structure that encourages, and often requires, financial institutions to provide financial services through separate legal entities.

The District Court's decision—that California may regulate affiliate information sharing—is already forcing businesses throughout the nation to change their programs for providing financial services to consumers in California in a manner that will harm consumers and the economy. If other states were to follow suit, the ensuing disuniformity would cause confusion and increase costs for all concerned.

ARGUMENT

The District Court failed to properly apply the preemption provisions of the FCRA, at least in part, because it did not fully appreciate the efforts of Congress to protect the sharing of information among affiliated financial services companies from requirements or prohibitions imposed by the states and the important role that information sharing plays among affiliated financial services companies.

I. CONGRESS HAS CONSISTENTLY ACTED TO PROTECT AFFILIATE INFORMATION SHARING FROM STATE REGULATION BECAUSE ONLY UNIFORM FEDERAL REGULATION WILL PERMIT EFFICIENT NATIONAL MARKETS INVOLVING AFFILIATED BUSINESSES.

A. Congress Intended Only National Regulation of Affiliate Information Sharing.

From its origins in 1970, the role of the FCRA has been to facilitate the exchange of information among businesses while protecting consumer privacy. The goal was not to impede the flow of information, because it was widely recognized that the availability and use of information provided benefits to consumers and the economy as a whole. Instead, the FCRA established uniform standards and practices for the rapidly developing credit reporting and credit granting industries. Prior to the enactment of the FCRA, credit reporting and related credit underwriting were developing in an ad hoc manner in which consumers had little control over, or knowledge of, how their credit information was being collected, maintained, or used.

Along with creating needed consumer protections, the FCRA facilitated the emergence of a national credit market. This national credit market has generated extensive benefits for consumers. Previously, consumers were limited in their options when seeking credit. The market was highly localized, and independent evaluations by individual loan officers drove the decision-making process. By standardizing and facilitating the availability and use of information, the FCRA helped to foster the development of credit scoring and has allowed consumers to access a wider array of financial products and services nationwide, while at the same time increasing competition among the providers of those products and services, which has translated into better pricing for consumers.

In light of the growing importance of consumer information in the financial marketplace and the resulting exponential increase in consumer information being collected and used, the FCRA was amended in 1996 ("1996 FCRA Amendments") to augment the rules governing the collection and use of consumer information. Consumer Credit Reporting Reform Act of 1996, Pub. L. No. 104-208, Subtitle D, 110 Stat. 3009 (1996). Again, the goal was not to limit the flow of information; it was to ensure uniform standards, while enhancing the accuracy of credit information and safeguarding individual privacy.

In particular, the 1996 FCRA Amendments expressly permitted financial institutions to share application and other information, such as information related to consumers' eligibility for credit, with affiliates, subject to the consumer's ability to opt out in certain situations. *See, e.g.,* 15 U.S.C. § 1681a(d)(2)(A)(iii). In doing so, the 1996 FCRA Amendments also reaffirmed the ability of financial institutions and others to share other information between and among their affiliates without limitation. To protect this structure for sharing information, Congress broadly and expressly preempted any state law, with the exception of a single Vermont statute, that would impose any "requirement or prohibition" on the exchange of information among affiliates. *Id.* § 1681t(b)(2). *See* L. Richard Fischer, *The Law of Financial Privacy*, ¶ 1.09[2][c], at 1-194-1-195 (3d ed. 2003). Nevertheless, under the 1996 FCRA Amendments, this preemption provision would have sunset on January 1, 2004. 15 U.S.C. § 1681t(b)(2) (2003).

In 1999, Congress revisited the issue of the sharing of consumer information in Title V of the Gramm-Leach-Bliley Act ("GLBA"), Pub. L. No. 106-102, 113 Stat. 1338 (1999). Although the GLBA included the most comprehensive privacy protections for consumer information ever adopted under federal law, it preserved the existing FCRA structure for affiliate information sharing. *See* 15 U.S.C. § 6806 (stating that the GLBA "shall [not] be construed to modify, limit, or supersede the operation of the [FCRA]"); *Law of Financial Privacy*, ¶ 1.09[2][c], at 1-194–1-195. Instead, the GLBA limited only the sharing of information by financial institutions with nonaffiliated third parties. In 2003, Congress reaffirmed its intention to permit the free flow of information among affiliates by amending the FCRA to make permanent the 1996 affiliate information sharing preemption provision. Fair and Accurate Credit Transactions Act of 2003, Pub. L. No. 108-159, § 711(3), 117 Stat. 1952 (2003).

In its opinion, the District Court stated that "[i]t makes no sense" to adopt a preemption provision that applies to information, such as experience information, that is not governed by the FCRA. Memorandum and Order, June 30, 2004, at 10. In 1996, however, the FCRA was the only federal statute governing the use and disclosure of financial information about consumers within the private sector and, therefore, was the most appropriate vehicle for Congress to enact legislation to address and protect the sharing of information among affiliated companies.

B. Affiliate Information Sharing Is Fundamentally Different From Sharing Information with Nonaffiliated Third Parties and Is Thus Regulated Differently.

The sharing of information among affiliates is inherently different from the sharing of information with nonaffiliated third parties, and the economic efficiencies that flow from affiliate information sharing are greater than those that flow from the sharing of information with nonaffiliated third parties. This is why Congress regulated affiliate information sharing narrowly in the FCRA, *see, e.g.*, 15 U.S.C. § 1681a(d)(2)(A), but regulated sharing of information with nonaffiliated third parties quite broadly in the GLBA. *See id.* §§ 6801 *et seq.* It is also why Congress preempted state laws relating to affiliate information sharing in the FCRA, *id.* § 1681t(b)(2), but granted states the right to pass stronger laws governing third-party information sharing in the GLBA. *Id.* § 6807(a).

The quality of all financial decisions improves with the quality and quantity of information available to make those decisions. In the context of retail financial services, this basic proposition leads to the inevitable conclusion that the more information about customers that can be collected and used to provide financial services to those customers, the better the decisions will be and the higher the quality of those financial services.

Customer information has substantial competitive value to financial institutions because it helps them identify and anticipate the needs and wants of customers. Because of this value, financial institutions generally provide customer information to nonaffiliated third parties only under limited circumstances in which disclosing the information outweighs any competitive harm that may result from sharing the information. Typically, when information is shared with third parties, it is subject to requirements that the information be used only for specific purposes, that it not be further disclosed, and that it be returned or destroyed when those purposes have been achieved.

For example, when a financial institution provides customer information to nonaffiliated third parties for purposes such as marketing, the customer information is disclosed because the financial institution has determined that the institution and its customers will benefit from the terms of the particular disclosure. These disclosures typically are made through contracts under which financial institutions, often too small to support specialized affiliates, enter into arrangements that are designed to provide the synergies of affiliation. In addition, customer information may be disclosed under more discrete and limited contracts under which a financial institution may provide more limited information about customers, such as lists of customer names and addresses, to third parties for the marketing of specific products and services.

The disclosures that take place between affiliates in a holding company often are broader and more frequent than disclosures between a financial institution and a nonaffiliated third party. Information about holding company customers and their choices can be collected and analyzed without the constraining effects of competitive concerns and the attendant need to balance the benefits of each disclosure against the potential that the information will be used by others for competitive purposes. Information also can be pooled in a common customer information database that facilitates the coordination of customer service functions among a combination of affiliated financial services companies. In addition, the regular sharing of customer information is one of the key components that enables affiliates within a holding company to protect themselves from both credit and fraud risks, as well as to identify and meet the needs of their collective customer base in the most efficient and economical manner.

II. CONGRESS PREEMPTED STATE LAWS REGULATING AFFILIATE INFORMATION SHARING BECAUSE OF THE IMPORTANCE OF SUCH SHARING FOR THE ECONOMY AND FOR CONSUMERS.

A. Affiliate Information Sharing Strengthens the United States Economy.

Affiliate information sharing is a critical component of economic efficiency and the resulting gains in productivity that spurred much of the economic growth of the late 1990s. As the Board of Governors of the Federal Reserve System ("Board") Chairman Greenspan stated in a 1998 letter to Congress, "[d]etailed data obtained from consumers as they seek credit or make product choices help engender the whole set of sensitive price signals that are so essential to the functioning of an advanced information based economy such as ours." Letter from Alan Greenspan, Chairman of the Board, to Representative Edward Markey at 1 (July 28, 1998). Board Governor Gramlich echoed these views in his 1999 testimony during consideration of the GLBA, stating that "[i]nformation about individuals' needs and preferences is the cornerstone of any system that allocates goods and services within an economy. The more information about needs and preferences that is available, the more accurately and efficiently will the economy meet these needs and preferences." *Financial Privacy: Hearings Before the Subcomm. on Fin. Insts. and Consumer Credit of the House Comm. on Banking* *and Fin. Servs.*, 106th Cong. (Jul. 21, 1999) (testimony of Board Governor Edward M. Gramlich).

The correlation between the increased access to information derived from affiliate information sharing and economic efficiency is clear: greater access to information leads to greater economic efficiency. If a provider of goods or services understands what its potential customers need and want, it will not employ resources to develop, and attempt to sell those customers, products or services that they neither need nor want. Competitive pressures will lead to some or all of the resulting savings being passed on to customers in the form of lower prices, enabling those customers to enjoy higher economic standards of living. In addition, the ability to tailor products or services more precisely to the needs and wants of consumers, and to bring offers of those products and services directly to the consumers that are most likely to choose them, saves consumers search costs and time. Affiliate information sharing helps to provide this information and, therefore, contributes both to higher economic standards of living and to a higher quality of life through increased time for discretionary activities. Conversely, as noted by Board Chairman Greenspan in his 1998 letter to Congress, "[t]oo little information that can be used in marketing leads to a decline in the quality of goods and services offered." Letter from Alan Greenspan at 1.

Individual consumers have long recognized these benefits in their own choices by repeatedly dealing with preferred providers of goods and services who understand the consumer's particular needs and preferences. Thus, consumers regularly do business with neighborhood businesses because of their greater understanding of what individual consumers need and want. Improvements in technology have increasingly allowed large national businesses to provide these same benefits to consumers. Although the mechanism is different in substance, affiliate information sharing by financial institutions is done for the same reason that neighborhood businesses remember their customers' past transactions—to serve those customers better.

Additionally, it is important to recognize that financial markets have become national in scope and that individual state initiatives have disproportionate effects on national markets. Individual state initiatives, such as SB1, require financial services providers to create exception systems to deal with individual state requirements or to modify their entire operating systems to address the unique compliance problems created by a single state. In addition, if states are freed of FCRA constraints, local governments will be as well, unless or until the local governments are preempted by the states. In either case, the costs are often borne by consumers outside the state, as well as consumers inside the state. It also is important to recognize that the advances in productivity and efficiency that fueled the economic growth of the 1990s are integrally related to uses of information, including consumer financial information, and that further limiting the uses of this information can have immeasurable consequences in terms of innovation and efficiency going forward.

B. Consumers Benefit from Affiliate Information Sharing.

Consumers reap immeasurable benefits from affiliate information sharing. For instance, affiliate information sharing provides consumers more efficient access to a greater variety of financial products and services and to products and services more precisely tailored to their needs. In addition, affiliate information sharing permits financial institutions both to reduce the cost and to improve the quality of the services provided. A recent study by the United States Treasury Department highlighted this point, noting that "the sharing of information, within secure parameters reinforced by uniform national standards, has increased the access of more customers to a wider variety of financial services, at lower costs, than ever before." Secretary of the Treasury Department, *Security of Personal Financial Information: Report on the Study Conducted Pursuant to Section 508 of the Gramm-Leach-Bliley Act of 1999* (hereinafter, "*Treasury Study*") at 53 (June 2004). At the same time, in addition to lower prices, consumers can enjoy one-stop shopping for a full range of financial services, including banking, securities, and insurance products.

Banks and their affiliates are increasingly serving customers on a holding company-wide basis, identifying customers on the basis of their overall financial profiles within the holding company, rather than on a company-by-company basis. In this context, the sharing of information among affiliates enables the various affiliates to identify products or services that are likely to meet the needs of their customers, as well as those in which the customers are likely to be interested, while allowing their customers to access those products and services through a single point of contact.

Affiliate information sharing in these circumstances improves product offerings, by identifying the investments that are most suitable for a particular customer and by providing the most attractive rates and terms for those investments. Affiliate information sharing also improves levels of services, such as avoiding the need for a customer to notify multiple affiliates of a change in his or her address, or the need to reprovide information on applications for additional products and services. Affiliate information sharing permits affiliates to avoid paying, and ultimately charging customers for, fees associated with obtaining additional consumer reports or other information about the customer already in the hands of affiliated companies. In addition, affiliate information sharing can reduce the receipt by consumers of unwanted marketing materials by allowing financial institutions to target specifically those consumers that likely would be interested in the particular products or services being offered.

Affiliate information sharing also allows financial institutions to protect against occurrences of, and to reduce losses from, identity theft and fraud. In this regard, a key finding of a recent study conducted by the United States Treasury Department was that:

> Timely business access to ample and accurate information, particularly at point of sale or contract, can be a powerful deterrent to identity theft. Information sharing *per se* is not the cause of identity theft. Rather, inadequate identifying information facilitates identity theft. Gathering customer data for the benefit of the customer is no more responsible for identity theft than depositing money in banks is responsible for bank robberies provided that sound security practices are followed. Financial institutions can help prevent identity theft if they know more about their customer than the thief does.

Treasury Study at 54. Reducing the economic costs associated with identity theft inures to the benefit of consumers, since those costs would ultimately be passed on to consumers.

III. AFFILIATE INFORMATION SHARING IS A NECESSARY INCIDENT TO THE FINANCIAL SERVICES REGULATORY STRUCTURE ESTABLISHED BY CONGRESS.

Federal regulatory structures encourage, and often require, the provision of financial services through different legal entities. At the same time, however, these regulatory structures have long recognized that there are important synergies between highly regulated financial institutions and other companies providing related products or services. Oversight of financial responsibility generally requires that regulated financial institutions be legally separate from other affiliated entities so that capital levels can be measured, activities limited, and assets distributed appropriately in liquidation.

For example, federal law limits the activities that can be conducted by banks. *See, e.g.,* 12 U.S.C. § 24a. Since the Federal Deposit Insurance Corporation insures bank deposits, *id.* § 1815, restricting the activities in which banks can engage limits the risk that the performance of higher-risk non-banking activities will lead to the failure of banks and thereby threaten the federally backed deposit insurance fund. Moreover, since deposit insurance effectively subsidizes the cost of funds to banks, the limitations on the activities that can be conducted by banks also limit the spread of this insurance subsidy.

Outside the area of banking, other federal regulatory regimes also encourage or mandate that certain activities be conducted in separate corporate entities. For example, investment companies, subject to supervision and regulation by the Securities and Exchange Commission, must be established as entities that can be liquidated separately in order to appropriately reflect the risks and rewards of investors. *See* Securities Investor Protection Act, 15 U.S.C. §§ 78aaa *et seq.* Capital requirements for securities brokers and dealers discourage placing general lending activities in these entities. Further, the liquidation scheme for brokers and dealers is incompatible with the liquidation scheme for banks so that, in practice, the same corporate entity cannot be both a registered broker or dealer and a bank. Similarly, insurance laws encourage providing different insurance functions and risks through different entities.

Although regulatory structures may require that certain functions be performed in separate legal entities, Congress and federal regulators also recognize the benefits of affiliation of those entities. For example, most regulated financial institutions are permitted to affiliate freely with other companies. Even where such affiliations have been limited, as in the case of commercial banks, the Bank Holding Company Act ("BHCA"), 12 U.S.C. §§ 1841 *et seq.*, has long recognized the synergies that result from affiliations between banks and other companies. Historically, the BHCA has permitted banks to affiliate with companies engaged in activities that are closely related to banking. *Id.* § 1843(c)(8). These synergies were further recognized in the GLBA which, in addition to adopting broad privacy protections for consumers, tore down the barriers that limited the ability of bank holding companies to provide securities and insurance services, thereby permitting broader affiliations between banks and securities firms and insurance companies. *See, e.g. id.* §§ 24a, 1843(k). These synergies permit greater economies of scale in delivering financial services, including economies in the processing of customer information, more efficient management structures and, most importantly, the ability to share information among the affiliated companies in order to cross-market financial products and services. Significantly, the GLBA, like the FCRA, sought to foster and protect these synergies by placing no additional limitations whatsoever on the sharing of information among affiliates. *See* 15 U.S.C. § 6806.

While congressional recognition of the benefits of affiliation is reflected in the GLBA's expansion of the activities that can be conducted by bank affiliates, the potential benefits of affiliation and affiliate information sharing are even greater in the case of non-bank financial institutions where companies are free to craft affiliate relationships and to maximize the synergies between affiliated companies free of the regulatory constraints that apply to banks. For example, credit card banks, which are not "banks" for the purposes of the BHCA because they do not accept demand deposits or deposits of less than $100,000 and only engage in credit card operations, *see* 12 U.S.C § 1841(c)(2)(F)(i)-(iii), are free to affiliate with a wide range of financial and non-financial companies, as are insurance companies and securities firms. Accordingly, these affiliated companies can use information about customer choices from transactions with all their affiliated companies to tailor both financial and non-financial products to meet the needs of their customers, as well as to forecast the needs of potential customers.

Other statutory provisions have expressly or implicitly recognized the synergies between affiliated providers of financial services that arise from the sharing of customer information, including the 1996 and 2003 amendments to the FCRA. The benefits of affiliate information sharing also have been recognized by the Board in its rules concerning the tying of products and services offered by banks and their affiliates. For example, the combined balance discount exception in the Board's Regulation Y permits a bank to vary the price of a loan or other financial product based on the customer's maintenance of a combined minimum balance in certain products and services designated by the bank that are offered by the bank and its affiliates. 12 C.F.R. § 225.7(b)(2) (2004). The ability to administer this combined balance discount presupposes the ability to share information with affiliates in order to implement the program and is grounded on recognition of the benefits of this type of affiliate cross-marketing.

For these reasons, affiliate information sharing is critical to the operations of holding companies providing financial services. The financial services holding company structure has evolved, in large part, due to regulatory requirements, and the importance of this structure was reaffirmed by Congress in enacting the GLBA. As a result, affiliate information sharing is a necessary incident to the regulatory structure designed by Congress for providing financial services.

IV. THE DISTRICT COURT'S DECISION INCREASES COSTS, DIMINISHES CONSUMER CHOICES, AND CREATES DISUNIFORMITY, ALL CONTRARY TO CONGRESSIONAL INTENT.

Even though SB1 itself recognizes the benefits of affiliate information sharing by exempting from its limitations the sharing of information among commonly owned and branded affiliates that are in the same line of business and that share the same functional regulator, SB1 imposes special obligations on businesses regarding sharing of information between banking, securities, and insurance affiliates, even if they are commonly owned and branded. SB1 also requires that consumers be given special opt-out notices that meet the detailed requirements specified in SB1. The effect of the combination of SB1 requirements is to force financial services companies with California customers to adopt special programs for the use and disclosure of customer information among affiliates. This is precisely the result the FCRA affiliate information sharing preemption provision was designed to avoid.

The effects of the District Court's holding that SB1's affiliate information sharing provisions are not preempted are already being felt by companies throughout the nation that do business with consumers in California. Companies are being forced to reexamine established practices for serving their customers, to restructure relationships, to discontinue existing programs, and to cancel future programs. The full effects of these actions will not be known for some time, and it is unlikely that they will ever be susceptible of precise measurement. Nevertheless, it is clear that the consequences of failing to honor the FCRA affiliate information sharing preemption will be increased costs and diminished choices for California consumers. Moreover, because California as a whole is the largest single consumer market in the country, the adverse effects of the SB1 affiliate information sharing restrictions will be felt by consumers throughout the nation.

By failing to apply the FCRA preemption provision as written, the District Court's decision will likely encourage other states to adopt limitations on affiliate information sharing. California consumer advocates already are urging legislators in other states to do just that. Should this occur, the resulting state laws are likely to differ from SB1, further complicating the delivery of financial services on a nationwide or even regional basis. The result will be to further increase costs and diminish choices for consumers. Differing state laws also will confuse a mobile consumer population trying to understand the different opt-out options that apply in different states. These are effects that Congress sought to avoid in adopting the FCRA affiliate information sharing preemption provision in 1996 and in reaffirming that preemption by making it permanent in 2003.

CONCLUSION

For these reasons and for the arguments advanced in the Plaintiffs-Appellants' brief, the judgment of the District Court should be reversed and the case remanded with instructions to enjoin the provisions of SB1 regarding affiliate information sharing.

Dated: August 9, 2004

Respectfully submitted,

L. Richard Fischer /by [illegible]

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CERTIFICATE OF COMPLIANCE

Pursuant to Federal Rule of Appellate Procedure 32(a)(7)(B) and Ninth Circuit Rule 32-1, counsel for Citizens for a Sound Economy certifies that this brief is proportionately spaced, has a typeface of 14 points or more, and contains 4,600 words.

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CERTIFICATE OF SERVICE

I hereby certify that I have caused two copies of the Brief of Amicus Curiae Citizens for a Sound Economy to be served this 9th day of August, 2004, by UPS, next business day delivery as follows:

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