

**MERCATUS CENTER**  
GEORGE MASON UNIVERSITY

March 29, 2004

**SUBMITTED VIA E-MAIL: [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)**

Ms. Jennifer J. Johnson, Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, DC 20551

*Re: Docket No. R-1173, "Alternative Forms of Privacy Notices"*

Dear Ms. Johnson:

Please find enclosed comments on the "Interagency Proposal to Consider Alternative Forms of Privacy Notices Under the Gramm-Leach-Bliley Act" (Alternative Forms of Privacy Notices) that we have prepared in response to an interagency request for comment dated December 30, 2003 (*Federal Register*, Volume 68, Number 249, p. 75164).

The Regulatory Studies Program (RSP) of the Mercatus Center at George Mason University is dedicated to advancing knowledge of regulations and their impact on society. As part of its mission, RSP produces careful and independent analyses of agency rulemaking proposals from the perspective of the public interest. This comment on the Interagency Advance Notice of Proposed Rulemaking does not represent the views of any particular affected party or special interest group, but is designed to evaluate the effect of the proposed rule on the public interest generally.

The Regulatory Studies Program appreciates the opportunity to comment on the proposed rule. We hope that consideration of these comments will enhance the quality and development of regulations and policy regarding alternative privacy notices.

Wendy L. Gramm, Chairman  
Regulatory Studies Program

Susan E. Dudley, Director  
Regulatory Studies Program

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REGULATORY STUDIES PROGRAM

**Public Interest Comment on**  
Interagency Proposal to Consider Alternative Forms of Privacy  
Notices Under the Gramm-Leach-Bliley Act<sup>1</sup>  
*(Alternative Forms of Privacy Notices)*

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The Regulatory Studies Program (RSP) of the Mercatus Center at George Mason University is dedicated to advancing knowledge of the impact of regulation on society. As part of its mission, RSP conducts careful and independent analyses employing contemporary economic scholarship to assess rulemaking proposals from the perspective of the public interest. Thus, this comment on the *Interagency Proposal to Consider Alternative Forms of Privacy Notices Under the Gramm-Leach-Bliley Act*,<sup>2</sup> does not represent the views of any particular affected party or special interest group, but is designed to evaluate the effect of the Agencies' proposals on overall consumer welfare. On this comment, Privacilla.org—a Web-based think-tank devoted to privacy as a public policy issue—joins the Mercatus Center in analyzing the proposed rule.

## I. Introduction

The Office of the Comptroller of the Currency (OCC), the Office Thrift Supervision (OTS), the Board of Governors of the Federal Reserve System (the “board”), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Federal Trade Commission (FTC), the Commodity Futures Trading Commission (CFTC), and the Securities and Exchange Commission (SEC) are jointly considering amendments to the regulations that currently implement sections 502 and 503 of the *Gramm-Leach-Bliley (GLB) Act*. (Sections 502 and 503 govern notice to consumers of the privacy policies of an affected financial institution.) The stated purpose for these changes would be “to allow or require financial institutions to provide alternative types of privacy notices, such as a short notice, that would be easier for consumers to understand.”<sup>3</sup> In this advance notice of proposed rulemaking (ANPR), the agencies listed above are seeking comment on alternative forms of proposed privacy notices, including their proposed language, format, and so on.

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<sup>1</sup> Prepared by Jay Cochran, III, Ph.D., Research Fellow, Mercatus Center at George Mason University, and James W. Harper, Editor, Privacilla.org. This comment is one in a series of Public Interest Comments from Mercatus Center's Regulatory Studies Program and does not represent an official position of George Mason University.

<sup>2</sup> Advance Notice of Proposed Rulemaking (ANPR) published in the *Federal Register* 68, (249), Tuesday, December 30, 2003: pp. 75164-75174. This proposed rulemaking is hereinafter referred to as the “proposed rule,” the “ANPR,” or as “Alternative Financial Privacy Notices under GLB.”

<sup>3</sup> Proposed rule, p. 75164.

## II. Summary of Proposed Modifications to the GLB Regulations

Because some institutions have complex business relationships and correspondingly complex privacy policies, the initial regulations (in effect since 2001) gave institutions flexibility in designing notices that met the general requirements of the *Act* by accurately describing an institution's policies and practices concerning disclosure to third parties of a consumer's non-public personal information. The agencies now suggest that this flexibility has resulted in "notices [that] have been difficult to compare, even among financial institutions with identical privacy policies."<sup>4</sup>

In response to generalized concern with privacy notices, the agencies conducted a workshop on financial privacy notices<sup>5</sup> and are now publishing the current ANPR "[i]n response to broad-based concerns expressed by representatives of financial institutions, consumers, privacy advocates, and Members of Congress...[as to] how financial institutions could provide more useful privacy notices to consumers."<sup>6</sup> The stated goal of the current ANPR is to make the financial privacy "notices more accessible, readable, and useful."<sup>7</sup>

### A. Model Privacy Notice

The agencies are considering "whether to develop a model privacy notice that would be short and simple."<sup>8</sup> Standardized notices, the agencies believe, will facilitate consumer comparisons of the privacy policies of various financial institutions—a task that consumers presumably want to do, and one that is now more difficult than the agencies believe it should be. The costs and benefits of standardization are discussed in detail below.

### B. The Four Sample Notices

To spur discussion on simplification, the agencies have designed four model privacy notices and have included these models in the ANPR. Each model varies somewhat in terms of the flexibility of format presentation and in terms of the complexity of information content. In keeping with the goal of simplification, all four model notices are quite short (2 pages at most), and each model notice contains a direct means for a consumer who is so inclined to opt out of any information sharing a financial institution might conduct with third parties.

The matrix below summarizes the model forms according to our interpretation of (a) the degree of customization or flexibility that the ANPR appears to permit in the information presentation (i.e., the model form's content appears either rigidly specified, or it allows a some flexibility in presentation by a financial institution), and (b) the complexity of information content presented, as judged using length as a proxy (i.e., longer model notices were assumed more complex, and shorter ones less complex; while model forms that

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<sup>4</sup> *ibid.*, p. 75166.

<sup>5</sup> Interagency Public Workshop, "Get Noticed: Effective Financial Privacy Notices," December 4, 2001.

<sup>6</sup> *loc. cit.*

<sup>7</sup> *loc. cit.*

<sup>8</sup> *loc. cit.*

permitted flexibility could be either simple or complex depending on the degree of discretion permitted to the affected financial institution).

### **Comparison Matrix of Model Financial Privacy Notices**

		<i>Complexity (Relative Length)</i>	
		<i>Simple</i>	<i>More Complex</i>
<i>Degree of Model Notice Flexibility</i>	<i>Rigid</i>	Model D	Models A & B
	<i>Flexible</i>	Model C	Model C

With the exception of Model Notice C, the model notices appear to be quite specific in both form and content. Model Notice A appears to be the most complex and specific of the suggested notices in that its length runs two full pages and specifies a firm’s privacy policies in binary (i.e., yes/no) form. Interestingly, Model Notice B provides essentially similar information to Model A, however, its compression to one page appears to have been achieved by employing a significantly smaller typeface. Model Notice D was judged the simplest because it provided the least amount of information but it was still rigid in that the information presentation was prescriptive.

#### **C. Mandatory or Permissible Aspects of a Short Privacy Notice**

Regardless of which of the Model Notices is selected (if any), the agencies ask whether all financial institutions “should be required to use the same form of notice and whether a short notice could be a substitute for or should be a supplement to a longer, more detailed notice.”<sup>9</sup> Consistent with the advance notice stage of the rulemaking process, the agencies ask more than 50 questions related to the goals a short notice should seek to achieve, the appropriate elements (both mandatory and permissible), language, format, as well the costs and benefits of alternative short notice approaches. We discuss this discovery process more fully below.

### **III. Economic Issues of the Proposed Rule Changes**

#### **A. Lack of Specific Evidence Cited to Support the Suggested Changes**

Privacy is an issue that has vexed policy makers for quite some time, in part because of the vague articulation given to privacy as a social concept. The term is routinely used to describe a wide variety of concerns about life in this modern, technological age. To refine debates about information policy, Privacilla.org has offered a definition of the term that can be used to assess whether policy proposals, business practices, or consumer behavior advance privacy or detract from it: *Privacy is the subjective condition individuals enjoy when they have the power to control information about themselves and when they have exercised that power consistent with their interests and values.*

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<sup>9</sup> Proposed rule, p. 75166.

Sections 502 and 503 of the *Act* are aimed at the second part of privacy, as defined: consumers' exercise of power over personal information consistent with their interests and values. A premise of the *Act* and the subsequent regulation was that consumers informed by discrete notice of the use to which their personal financial information was put would be able to make decisions that comport more closely with their interests.

In the absence of evidence, the premise of the *Act* and subsequent regulations are very difficult to validate, given the subjective nature of consumer preferences. This may explain why the ANPR is premised on "broad-based concerns" rather than any specific evidence of harm, consumer disability, or poor-quality decision-making that otherwise might justify a modified regulation.

### **1. Unconstrained Preferences vs. Constrained Optimization**

Evidence of the need for changed or added regulation must come from some negative circumstance suffered by consumers. To understand whether consumers are laboring under some kind of adversity with respect to privacy, one must understand the difference between unconstrained preferences and constrained optimization.

For years, pollsters have sought to determine consumers' preferences regarding privacy. Their chief method has been simply to ask them. A survey instrument, however, typically fails to determine the intensity of consumers' relative privacy preferences, and instead simply captures a glimpse into their unconstrained, or absolute, preferences.

Privacy, though abstract, is a good like food, shelter, education, or hundreds of other things that consumers prefer more of to less—other things being equal. However, in the real world—that is, where consumers actually must choose in the face of limited resources—other things are not always equal. Choice, in other words, consists not just of preferences, but of preferences attenuated by available resources. A consumer's available time, money, attention, and other considerations constrain his or her preferences for privacy versus other goods.

Economists refer to this process of choosing among preferences in the face of limited resources as constrained optimization. Said differently, choice necessarily entails tradeoffs. If a consumer chooses to spend time opting out of information sharing by a financial institution, for example, that time can not be devoted to other activities such as work, family, recreation, and so on.

Consumers who do *not* opt out of a firm's information sharing process, given the tradeoffs involved, may be assumed to be at least indifferent to the privacy practices of the firms with whom they do business. These consumers may, for example, be aware of the benefits that accrue to them through secondary uses of data by financial services providers and their business partners. Even where consumers are unaware of the particulars of a firm's privacy policy, they may be inclined to give their financial services providers the benefit of the doubt. This inference follows from the observation that consumers of financial services already trust their financial institution with a valued resource (their money) and they receive substantial benefits from allowing use of that money in ways they do not know. It is

reasonable to surmise that consumers would be similarly trusting with another valued resource (their personal information) and likewise benefit from its use even if they did not know the details of how their personal information was being used.

It is questionable whether one can reliably guide policy decisions based on stated consumer preferences rather than on their actual, resource-constrained choices. The more accurate, real-world approach relies instead on the actual choices consumers make when confronted with privacy choices in relation to the all the other competing avenues for their time, attention, money, and other resources.

Constrained choices suggest that focus groups and most survey instruments underlying the purported consensus surrounding short notices may suffer from substantial flaws in methodology. In particular, any study that asks representative consumers to report their preferences in the abstract is not likely to reveal their true preferences.<sup>10</sup> Such studies instead tend to reveal what consumers perceive to be the “right” answer, rather than unearthing their true preferences. This is because consumers’ true preferences are only revealed when they actually choose by trading off one good for another.

## **2. Current Status of Consumer Financial Privacy**

The ANPR provides no evidence indicating whether consumers of financial services are enjoying privacy at optimal levels. There is no study, for example, showing that consumers labor under some curable privacy deficit and, therefore, there is no strong justification for change beyond the previously cited but vague “broad-based concerns.”

To assess privacy qualitatively, a survey instrument could be devised where consumers are asked, for example, to name (unprompted) their top concerns when they do business with financial services providers. If, in such a study, “privacy” were to rank highly across a broad cross-section of consumers, this could be initially taken as at least some evidence of widespread concern or possibly dissatisfaction. Without even such rudimentary evidence, however, only a weak basis exists for changing privacy notices.

As an alternative to any measurement of consumer satisfaction or the quality of consumer decision-making, there is a temptation to adopt any number of proxies. The most attractive, but perhaps mistaken proxy is the number of opt-outs exercised in response to the *Act*’s notice requirement. While objectively verifiable data are unavailable, private conversations with financial services providers and consultants have indicated that opt-out rates under GLB are generally quite low (i.e., less than 5 percent).

One possible interpretation is that low opt-out rates evidence “bad” privacy decisions in the sense that consumers are ill-informed and would act differently if more fully informed. In the absence of supporting evidence, however, it is equally plausible that low opt-out rates are evidence of consumer satisfaction. Even without knowing about each protection explicitly, consumers may recognize that established companies value their reputation and brand, and

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<sup>10</sup> Cf., Solveig Singleton and Jim Harper, *With a Grain of Salt: What Consumer Privacy Surveys Don't Tell Us*, Competitive Enterprise Institute (June 1, 2001) <<http://www.cei.org/gencon/025,02061.cfm>>.

will, therefore, take steps to avoid harm or annoyance to their customers. Consumers are also likely to recognize that companies are bound by explicit and implicit promises to protect sensitive data; that companies are likely to bind vendors and third parties to such protections; and that all legally harmful uses of information are against the law.

Low opt-out rates are not evidence that consumers do not have enough privacy information, and they are not evidence that consumers are failing to enjoy privacy on the terms they prefer. Without evidence in support of an implicit claim that consumers, broadly speaking, are making poor or ill-informed decisions, the agencies have not laid a foundation for the currently proposed action.

### 3. The ANPR Assumes a Problem with Notice

Advocates of short notice as a substantial privacy aid may assert that GLB notices have been needlessly arcane or that they are written in legalese, and these facts explain poor consumer adoption rates, and thus imply continuing “bad” privacy choices by consumers. It is true that commercial information practices are highly developed in the United States, rendering privacy policies describing them long and sometimes difficult to read. But the question of notice and readability may be mooted by comparing the *Act’s* notice and opt-out regime with a comparable program that got very high response rates *with no individualized notice at all*.<sup>11</sup>

Since June of 2003, the Federal Trade Commission has been compiling a list of telephone numbers whose subscribers do not wish to be called by telemarketers. Under an FTC regulation,<sup>12</sup> telemarketers must compare phone numbers on their lists to the “Do-Not-Call” list and avoid calling the numbers on the FTC list. In just the first few months of the program, the list grew to nearly 50 million numbers, equating to roughly half of the residential telephone lines in the United States.<sup>13</sup> This illustrates what happens when a program strikes at a genuine consumer interest. Response rates—even in the absence of any written notice—are at least an order of magnitude greater than the *Act’s* formal written notice and opt-out regulation.<sup>14</sup>

There are of course many differences between these two programs. The “do-not-call” program is relatively easy to use because it allows telephone or Internet registration, rather than opt-outs by mail. A government authority, whose imprimatur may lend greater legitimacy than opt-outs expressed to private entities, operates the “do-not-call” program.

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<sup>11</sup> Cf., Affiliate-Sharing and Consumers: *How “Privacy” Regulation Misses the Mark, Hits Marketing*, Privacilla.org (November, 2003) <[http://www.privacilla.org/releases/Affiliate-Sharing\\_Report.html](http://www.privacilla.org/releases/Affiliate-Sharing_Report.html)>.

<sup>12</sup> Telemarketing Sales Rule, 16 C.F.R. § 310.

<sup>13</sup> Cf., “Do Not Call Registry Jumps to 48.4 Million,” Federal Trade Commission *Press Release*, September 2, 2003.

According to Federal Communications Commission data, there were approximately 111 million analog (4 KHz or equivalent) residential access lines in operation as of December 31, 2001. Cf., *Statistics of Communications Common Carriers, 2001/02*, Table 2.4, “Access Lines by Type of Customer,” p. 22, (September, 2002).

<sup>14</sup> The Do-Not-Call list involves substantial costs — to taxpayers who must pay to support it, to users of the list who give up privacy by placing their names in a government-controlled database, to telemarketing firms, to companies that sell products via telemarketing, and to consumers who will not learn of offers they may like. The Do-Not-Call list is not preferable to the market solutions that came to the problem of unwanted telemarketing too late. But it does illustrate the response rates when a regulatory program addresses a genuine consumer desire, even in the absence of notice.

Perhaps most important, the “do-not-call” program allows consumers to prevent unwanted telemarketing calls, a discrete and, in some cases, substantial annoyance. GLB opt-outs, by contrast, protect an important, but largely abstract interest. Though perhaps it should, financial privacy seems to generate little of the passion that unwanted telemarketing has.

The agencies have not articulated why written notice should be the dimension along which the GLB privacy program should be modified or improved. By contrast, there may be value for the GLB agencies in studying the “do-not-call” list, which has achieved substantial participation without any direct written notice to consumers.

## **B. No Evidence Cited to Support a Possible Market Failure**

In the ANPR, the agencies cite no concrete evidence, beyond the claim that “broad-based concerns [were] expressed by representatives of financial institutions, consumers, privacy advocates, and Members of Congress...[as to] how financial institutions could provide more useful privacy notices to consumers.”<sup>15</sup> The ANPR provided no evidence to suggest just how “broad-based” such concerns are, nor does it demonstrate a lack of utility in currently existing notices. Rather, such claims are simply asserted. The agencies have not supported their implied conjecture that the financial services market has failed to provide adequate notice on privacy policies as required under existing law.

### **1. Evidence Supplied Suggests Market is Working Properly**

Indeed, the ANPR supports precisely the opposite conclusion: that the market is working properly. The rulemaking agencies point out in the ANPR that innovation along the privacy notice dimension continues. In December 2001, for example, the agencies sponsored a workshop on financial privacy notices in which “[s]ome institutions described results of consumer testing and efforts to make their privacy notices clearer and more useful to consumers. A number of financial institutions have since sought to improve their notices. Additionally, some industry groups have been working to formulate short, consumer-friendly notices that could accompany the longer, legally-mandated notices under the rule.”<sup>16</sup>

These observations in the ANPR follow logically from a properly functioning market. To the extent firms believe they will benefit from satisfying their customers’ privacy preferences, they will articulate coherent, easy-to-understand privacy policies. In other words, if firms can gain a competitive advantage from implementing privacy policies that better comport with their customers’ preferences and willingness to pay, firms are likely to do so. Indeed, the evidence supplied by the agencies and cited above supports just such a conclusion.

### **2. Agencies Ask for Information that Competitive Firms Cannot be Expected to Provide**

Although the innovations financial institutions are pursuing in the privacy notice area may not be proceeding at the pace or along the particular dimensions that the agencies might

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<sup>15</sup> Proposed rule., p. 75166.

<sup>16</sup> *loc. cit.*

prefer, the agencies have asked for “examples of forms, model clauses, and other information, such as applicable research that has been conducted in this area.” While it might be reasonable for academics, communications experts, or consumer advocacy organizations to provide evidence from their research in these areas, it would not be reasonable to expect competitive, for-profit financial institutions to do so.

Financial institutions that are innovating along the privacy and notice dimensions have presumably done so in order to gain a competitive advantage. In so doing, these firms have incurred costs of research and creating communications strategies, among other things. Sharing this hard-won information would allow competitors to free-ride on the innovating firm’s efforts if these privately produced innovations were incorporated (even indirectly) through the rule making process.<sup>17</sup>

Moreover, the innovations produced by for-profit firms are presumably the most valuable because they have been market-tested. Those that comport most closely with consumer preferences and do so most economically will survive and those that do not will be discarded. Academics, consumer advocates and other non-market producers of privacy policies, while perhaps well-intentioned in advancing their particular ideas about suitable notices, suffer from the disadvantage of not having had their ideas subjected to the crucible of market testing.

As discussed further below, cooperation among financial services providers to assemble a “government approved” privacy notice may tend to thwart competition and innovation along this dimension. Ironically, consumers may end up with less information, or information different from what they care about, because the financial services industry and the agencies that regulate it have, in effect, colluded to thwart competition and innovation along the privacy and notice dimensions.

### **3. Details of an Ideal Notice Can Only be Discovered Through Market Process**

The merits of continuing with market-based processes are made even clearer by the agencies’ yeoman efforts in the ANPR to consider all the possible permutations and attributes of an appropriate notice. For instance, the agencies ask roughly a dozen questions alone to assess the goals an appropriate privacy policy notice should achieve. The agencies request comments on and ask questions about the appropriate elements a properly designed notice should contain (8 questions), the type of language that should be employed (4 questions), the appropriate formatting a short notice should follow (14 questions), what aspects should be permissible (if any) in a notice and which elements should be mandatory (13 questions), and what are the costs and benefits of alternative short notice approaches (6 questions).

While the agencies are to be applauded for their thoroughness, such detailed efforts suggest not only undesirable micromanagement, but, more importantly, that the agencies are seeking

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<sup>17</sup> Even though the particulars of an innovation may be protected through the confidentiality assurances of the rulemaking agencies, the general substance of any successful innovation almost surely would not remain confidential to the extent that the thrust or substance of the innovation were incorporated into the final rule. Thus, a free-riding problem remains despite confidentially pledges of the respective agencies.

answers to questions that are fundamentally unknowable in advance of actual experimentation. In other words, the answers the agencies seek are only discoverable through the trial and error process of the market.

It is imperative to recognize that, to the extent privacy is valued by a significant subset of financial services consumers (and this is not a foregone conclusion), financial institutions have ample incentive, irrespective of regulation, to satisfy those values in the most economical manner possible. To find the most economical combinations, the institutions will have to employ a trial and error process to discover them.

As discussed above, consumers may express unconstrained preferences for financial privacy in the abstract, but they will not reveal their true preferences until they are confronted with an actual tradeoff of privacy for some other good (e.g., time, attention, or money). No amount of *ex ante* probing, surveying, and notice design, no matter how well intentioned or thoroughly considered, can replace the data that will be created through an actual voluntary exchange process.

### **C. Will Standardized Presentation Benefit Consumers?**

The question that must be considered is whether short privacy notices like those proposed by the agencies will actually benefit or harm the ordinary consumer of financial services. Not all consumers, of course, unambiguously prefer strict financial privacy. Rather, when faced with tradeoffs, some consumers may prefer strong privacy protections, while others may be indifferent, and still others may be positively disposed toward financial information sharing because of the benefits they expect to gain from it. A number of observations outlined below explore whether short notices will have net benefits or net costs for consumers.

#### **1. Standardized Notices Serve Some Consumer Interests, Disserve Others**

Standardized privacy notices as presented in the ANPR may facilitate consumer comparisons among the privacy policies of various financial institutions and ease a burden on those consumers who highly value certain types of privacy. The prominent placement of opt-out procedures in the proposed notices, for example, would likely facilitate the use of opt-out, thereby serving the interests of those consumers most sensitive to financial privacy concerns.

However, for consumers who may have other privacy preferences, the notices can be positively uninformative; in that, rigidly prescribed short notices may not give consumers a complete picture of the benefits and services they may forsake by opting for an additional measure of privacy. These foregone alternatives might include better awareness of financial products and services, better customer service, more efficient and cheaper delivery of services, and so on. If the goal of short privacy notices is to facilitate more-informed consumer choice, presenting the benefits of information sharing on an equal footing with the possibility of enhanced privacy would allow ordinary consumers to make more-informed tradeoffs.

Short notice, particularly rigid short notice with prominent opt-out information, seems designed to serve the exclusive interests of those with high-value privacy preferences. It

appears to bias heavily in favor of opt out, potentially misleading consumers into thinking that this is a cost-free choice. A more balanced information presentation might lead consumers to choose differently.

## **2. Standardization Facilitates Consumer Dismissal of Multiple Notices**

Laying aside the tradeoffs between efficiency and privacy, standardized presentation of privacy policies holds potential benefit for those consumers who are indifferent to or who simply do not value financial privacy highly. A standardized presentation allows these indifferent and low-value privacy consumers to dismiss multiple privacy notices more easily under the presumption that “if you’ve seen one notice, you’ve probably seen them all.” That is, although privacy policies and information sharing practices of financial institutions likely differ in detail, a standardized presentation is likely to blur these differences in the interest of simplified presentation. Ironically, that simplified presentation can improve the efficiency with which those who carry low or indifferent privacy preferences dismiss the myriad notices they receive in the course of a year.<sup>18</sup>

In the abstract, more information is preferred to less; however, in practice more information comes at a cost of using up one of a consumer’s scarcest resources: his or her attention. It is far from clear whether a supplementary standardized notice (in addition to an institution’s current notice) will incrementally improve a consumer’s understanding or whether it will simply aggravate an information overload condition.<sup>19</sup> Given that most consumers of financial services hold multiple accounts with multiple financial institutions, the latter alternative seems far more likely, with the net result being an aggregate *reduction* in consumers’ understanding of financial privacy policies.

## **3. Standardization Lowers Cost of Compliance to Regulated Firms**

Financial institutions currently incur significant costs to develop, test, and distribute the notices mandated under the existing regulations. A standardized presentation, if that is the solution ultimately decided upon by the agencies, obviates most of the initial costs for the affected institutions—though the distribution costs remain. Specifically, standardized privacy notices relieve financial institutions of the costs associated with development, testing, and internal compliance review of institution-specific notices.

## **4. Unclear Whether Notices Actually Improve Decision-Making**

The agencies seem disposed to the idea that nutrition labels offer a successful template on which to model the short privacy notices. However, actual consumer benefits from nutrition labeling remain suspect. Though nutrition labels may provide marginal benefits to some

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<sup>18</sup> This dismissal, it is probably worth noting, does not represent a significant departure at the margin for those who attach low values to privacy already, inasmuch as such individuals are likely to dismiss more complex notices currently, and are likely to continue doing so even when presented with simpler notices. The difference becomes more important for those individuals who are indifferent at the margin, and thus might otherwise incline to read a notice if it were simple, whereas they do not do so today because of the relative complexity of those notices. Nevertheless, increased attention for those who are indifferent is likely to prove short-lived owing the “seen one, seen them all” rationale mentioned above.

<sup>19</sup> Cf., Duncan MacDonald, “Disclosure Overload: Lawyers Are Problem, Not the Solution,” *American Banker* (Jan. 23, 2004) <<http://www.americanbanker.com/article.html?id=20040122WSENHQPD&from=WashRegu>> (subscription).

segments of society, it has not been shown that nutrition labeling as such has succeeded in improving overall nutrition and health habits. Indeed, since nutrition labeling has been in effect, obesity rates have continued to climb.<sup>20</sup> Moreover, the Centers for Disease Control and Prevention recently reported that poor nutrition and physical inactivity are rivaling tobacco as leading causes of premature death.<sup>21</sup>

Nutrition labeling may, of course, have prevented the situation from becoming worse, but in the absence of more detailed research, such a conclusion would be unwarranted, and as a counterfactual claim, it cannot be taken, in any case, as evidence that labels work better than other alternatives. Clearly, health outcomes have not improved, and thus, the purported goal of more conspicuous food labeling has not been achieved. At bottom, the asserted but unsupported claim that notice improves decisions overlooks the question of whether notice is actually read and then incorporated into a consumer's decision-making processes.

### **5. Standardization Stymies Future Innovation and Discovery**

As pointed out above, the marketplace appears to be functioning properly as firms test different variations of privacy policies that best meet all consumers' preferences, and in so doing, seek a competitive advantage either through reduced costs or better consumer acceptance. We are still in the early days of an information driven-economy and it is impossible for anyone to know the dimensions on which consumers and firms will optimize given the trade offs between privacy and other considerations. Policy decisions that lock in a particular implementation of privacy can only rest on highly imperfect anticipation of the future. Consumers, financial institutions, and regulators at this point simply do not (and cannot) know which combination of privacy policies and information sharing is optimal.

Perhaps just as importantly, even if the optimal combination of privacy and information sharing were somehow known for all consumers and institutions today, it unlikely that this optimal combination would remain intact in the future as technologies, and incomes change. In short, standardized presentation of privacy information is likely to stymie future innovation and discovery as it locks in one mode of information conveyance and forecloses future avenues of discovery.

### **6. Costs of Notice are Both Monetary and “Mindshare”**

Privacy notices have substantial costs not only in terms of dollars but in “mindshare” (i.e., consumers' attention) as well. The dollar costs of privacy can be directly quantified. The millions spent on mailing annual notices can be accounted for and partially offset through higher prices for financial services charged to consumers (i.e., checking fees, interest rates, etc.). However, higher costs of bank-provided financial services makes banking per se' less attractive than other financial intermediation alternatives at the margin.

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<sup>20</sup> Cf., Centers for Disease Control and Prevention, *U.S. Obesity Trends 1985 to 2000* Web pages <<http://www.cdc.gov/nccdphp/dnpa/obesity/trend/maps/slide/001.htm>>.

<sup>21</sup> Cf., Centers for Disease Control and Prevention, Fact Sheet: *Physical Inactivity and Poor Nutrition Catching up to Tobacco as Actual Cause of Death* (March 9, 2004) <<http://www.cdc.gov/od/oc/media/pressrel/fs040309.htm>>.

Equally as important, however, privacy notices compete with other important messages for consumers' attention or "mindshare." Messages, for example, designed to educate consumers about identity theft, or about the latest Internet account number scam may be crowded out if a deluge of comparatively unimportant privacy notices has already exhausted consumers' scarce attention.

## 7. Minimum Compliance can become Maximum Disclosure

By dictating the subjects and terms of privacy notices, the agencies may discourage firms from reaching consumers on the subjects that interest them most. For example, the *Act* requires disclosure of "the policies that the institution maintains to protect the confidentiality and security of nonpublic personal information . . ." <sup>22</sup> The short notice examples in the ANPR would replace a statement of policy with a statement of compliance: "We maintain physical, electronic, and procedural safeguards that comply with federal standards to protect your personal information."

Compliance with federal standards is one appropriate "policy," so the agencies appear to be within their powers to substitute a compliance notice for a fuller policy notice. However, in doing so, the agencies' actions seem likely to discourage financial services providers from exceeding federal standards and communicating that fact to customers. In other words, with notice converged on government standards, firms face substantial disincentives to address consumer interest in other information practices. Federal standards, however, may appeal to firms that seek to avoid competition along the security and privacy dimensions.

## IV. Legal Issues of the Proposed Rule Changes

### A. Degree of Agency Latitude

The agencies have substantial latitude within the *Act* to craft a notice regime. Beyond the specific overlapping grants of authority in the statute, <sup>23</sup> the Supreme Court has given administrative agencies substantial power to interpret the statutes within their purview. <sup>24</sup> If mandated, the proposed short notices would use this latitude fully.

For example, the statute twice requires notice to include policies regarding "persons who have ceased to be customers of the financial institution." <sup>25</sup> One of the two short notice samples in the ANPR that makes specific reference to information practices offers no

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<sup>22</sup> 15 U.S.C. § 6803(b)(3).

<sup>23</sup> 15 U.S.C. § 6803(a) (requiring "disclosure...in writing or in electronic form or other form permitted by the regulations..."); 15 U.S.C. § 6804 (requiring "...such regulations as may be necessary to carry out the purposes of this subchapter...").

<sup>24</sup> *Chevron USA v. Natural Resources Defense Council*, 467 U.S. 837 (1984).

<sup>25</sup> 15 U.S.C. § 6803(a)(2) ("[A] financial institution shall provide clear and conspicuous disclosure . . . with respect to . . . disclosing nonpublic personal information of persons who have ceased to be customers of the financial institution..."); 15 U.S.C. § 6804 (b)(1)(B) ("The disclosure...shall include...the policies and practices of the institution with respect to disclosing nonpublic personal information of persons who have ceased to be customers of the financial institution.").

information about practices regarding past customers.<sup>26</sup> Given this omission, long notice would still appear to be required in order to satisfy the *Act's* requirements, inasmuch as the short notice appears to be a substantial deviation from Congressional focus on treatment of information about former customers.

### **B. Financial Information Sharing with Government Entities**

Given the substantial policy decisions involved in designing the short notices, some information sharing policies are notable for their absence. In particular, the *Act* permits information to be shared with governments without permission<sup>27</sup> or notice.<sup>28</sup> On the other hand, Congress also charged the agencies with ensuring financial institutions' "affirmative and continuing obligation to respect the privacy of its customers." If full disclosure of institution's information sharing practices is the goal of the ANPR, then logical consistency would seem to oblige financial institutions to notify consumers about potential information sharing with governments in general terms even if the firms do not do so in particular cases.

### **C. Adaptability of Notices to New Consumer Concerns**

Privacy concerns, and other concerns in information policy, are likely to continue evolving and changing over time. Recent examples include telemarketing, data retention, identity fraud, employee browsing, fairness and accuracy, *Bank Secrecy Act* reporting, and tracking methods (e.g., cookies, Web bugs), to name a few. Indeed, since the ANPR has been issued, outsourcing of data processing to foreign countries has raised "privacy" (or, more accurately, security) concerns among the public. Rigidly defined short notices would not address these concerns, even though outsourcing could be a salient issue for informed consumer decision-making.

Unless any mandated short notice allows diversity in both subject matter and format, new rulemakings will be required each time new technologies emerge that may change the trade off calculus of consumers with respect to privacy. The slow pace of the regulatory process should be a caution against rigid mandates in this fast moving area.

### **D. Threat of Liability May Chill Effective Communication**

As discussed above, successfully connecting with real consumers living busy lives requires experimentation and testing in the marketplace. Notices approved or required by regulation will undoubtedly enjoy privileged legal status, while other forms of communication will not. Properly risk-averse financial services providers will avoid different or "creative" communications because such innovations lack the imprimatur of the affirmatively authorized communications. The net result is that mandated short notices may cost consumers by depriving them of the genuine educative value that commercial communications can provide and by diluting their ability to learn information on important

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<sup>26</sup> Cf., Interagency Proposal to Consider Alternative Form of Privacy Notices Under the Gramm-Leach-Bliley Act, Appendix A, *Federal Register* 68, 75, 170-171 (2003).

<sup>27</sup> 15 U.S.C. § 6802(e)(5).

<sup>28</sup> 15 U.S.C. § 6803(b)(1)(A).

topics that may not be found in approved notices, such as specific security threats, identity theft scams, web “phishing,”<sup>29</sup> and so on. Under the proposed regime, the subject matter, content, style, and other communicative elements of notice may be dictated to the entire industry, foreclosing experimentation aimed at finding the most effective ways to reach consumers.

If government-approved short notices emerge from this rulemaking, it seems likely that they will implicitly provide *de facto* safe harbor for firms issuing privacy policies consistent with regulation. It would probably be advisable for the regulation specifically to include a *de jure* safe harbor. This would reduce the potential for litigation surrounding short privacy notice and encourage firms to communicate more information to consumers more boldly. Liability for actual violations of privacy should, of course, be maintained.

### E. Property Rights in Personal Information Remain Cloudy

In our comment to the agencies in 2000 on the original implementation of the GLB privacy requirements, we suggested the entire privacy issue could benefit from a clarification of ownership rights in personal information, including the derivative rights of use and disposal. Our analysis then remains valid now, and so, for convenience we excerpt some of that discussion<sup>30</sup> below:

Who owns and who controls nonpublic personal information? The answer to this question will profoundly affect the information economy. The increasing ease with which information can be used to the detriment of its subject has of course brought the privacy issue to the fore. However, the obverse of pervasiveness is that information also enables businesses to customize product offerings and inventories to better reflect local demand, thereby conferring substantial benefits on consumers in the form of lower costs and increased variety. Drawing the line therefore between rights of information subjects and the responsibilities of information owners will be difficult, but nevertheless essential if we are to avoid impeding progress of the new information economy.

The prevailing trend in information ownership (as well as the derivative rights of use and disposal) *appears* to be that the information’s possessors (i.e., those who collect and store it) hold title to the information as well as to the derivative rights of use and disposal.<sup>31</sup> However, such rights are qualified. Ownership rights in information may be attenuated by the subject’s right of refusal—i.e., by the subject’s ability to reject disclosure and to have that right respected—and by the legitimate needs of law enforcement as well as the need to have the information serve its subjects efficiently. (GLB allows banks to disclose nonpublic personal information to nonaffiliated third parties for the purposes of carrying out a transaction authorized by the customer without obtaining prior consent.)

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<sup>29</sup> “Phishing” occurs when a fake website is constructed to look like the true website of a financial institution. The fake website is then used to capture personal information such as account numbers, security codes, and so on.

<sup>30</sup> Cf., “Privacy of Consumer Financial Information,” Mercatus Center at George Mason University *Public Interest Comment*, Submitted March 31, 2000, p. 10, submitted in connection with “Privacy of Consumer Financial Information; Proposed Rule,” 12 CFR Part 573, *Federal Register*. 65, (35), Thursday, February 22, 2000, pp. 8770-8816.

<sup>31</sup> Jonathan P. Tomes, J.D., points out with respect to confidentiality of health care records that, “Patients often think they own their records and thus have an ownership right to them. However, many states have statutes or administrative regulations that specify that the actual physical record is the property of the [health care] provider.” [As quoted from *Healthcare Privacy & Confidentiality: The Complete Legal Guide*, (Chicago: Probus Publishing, 1994), p. 199.] We suspect that a similar state of affairs exists with respect to personal financial records. However, the crucial point is, as Tomes points out, that the treatment of the ownership question is uneven across states and thus remains uncertain.

Indeed, the entire purpose for the present regulation is to describe a line of protection for the information's subjects over which the information's possessors may not cross. A [more] constructive role for government in this instance therefore may be to remove the cloud surrounding ownership by delineating ownership rights and responsibilities, and then allowing individuals and firms to seek their own equilibria—turning to the state for adjudication when an impasse occurs.

## V. Conclusion

While it is understandable that the agencies might wish to correct some of the problems induced by past financial privacy regulations, such efforts seem likely to set in motion their own set of problems. The proposed short notices, while perhaps well-intentioned, seem likely to stymie innovation along the financial privacy dimension. The rules seem aimed at protecting those who place a high value on privacy, while offering little or no value to those who are indifferent or who positively value the gains from information sharing. In addition, excessive notice volumes (a fact unaddressed by the present ANPR) seem also likely to exhaust consumers' attention and may, ironically, result in less attention being paid to privacy rather than more.

On the benefit side, standardized, simple, government-approved short notices may benefit financial institutions by obviating the need to develop firm-specific notices that are at once informative and comply with the law. The offset is that any benefits attached to such enforced standardization are likely to come at the expense of innovation along privacy dimensions. If privacy is as important a good as its advocates and the agencies seem to suggest (i.e., a good for which its consumers and providers are freely willing to tradeoff valued resources), then standardized notices may lock in a static approach that forecloses the future ability of market participants to find preferred ways to address privacy in relation to all the other goods consumers want.

Moreover, if privacy holds a preferred status among a wide cross-section of consumers, then it should be fairly simple to produce evidence of that fact using tradeoffs that consumers have actually made—rather than the preferences consumers say they would indulge in a world without resource constraints. Without evidence of a decisive market failure, the agencies would best serve consumers and financial institutions by leaving them alone. Indeed, the evidence provided in the ANPR suggests that the market is working—perhaps not as rapidly as one might prefer, but working nonetheless. It is well to recall in this connection that financial institutions have a vested interest in serving their customers along all dimensions that are important to them and for which those consumers have demonstrated a willingness and ability to pay. The ANPR has not provided any evidence—beyond a vague and unsupported claim—that financial privacy in a resource-constrained world is being provided to consumers in a sub-optimal way. Until the agencies can convincingly do so, they should not proceed with this change in regulations.

**APPENDIX I**  
**RSP CHECKLIST**  
*Alternative Financial Privacy Notices Under Gramm-Leach-Bliley*  
*(Alternative Forms of Privacy Notices)*

<b>Element</b>	<b>Agency Approach</b>	<b>RSP Comments</b>
1. Has the agency identified a significant market failure?	No evidence cited to support change in notices, other than a vague reference to “broad-based concerns.”  <b>Grade: F</b>	Evidence cited indicated that firms and industry groups are trying to discover the best ways to optimize along a privacy dimension.
2. Has the agency identified an appropriate federal role?	GLB compels the agencies to develop regulations regarding notices of a financial institution’s policies with respect to sharing of non-public, personal information.  <b>Grade: A</b>	Regulations (though perhaps not the suggested short notices) are required by statute.
3. Has the agency examined alternative approaches?	Within the limited universe of centrally designed short notices, the agencies have considered different presentation options.  <b>Grade: C</b>	The agencies did not consider alternatives that might include market-based responses such as a financial privacy clearinghouse or Web-based service that could provide privacy policy comparisons to all interested consumers without the expense and burden of further notice mandates on all financial services providers. Only command-and-control solutions were considered despite wide latitude available to the agencies.

Element	Agency Approach	RSP Comments
4. Does the agency attempt to maximize net benefits?	<p>The agencies only attempt to facilitate comparisons among policies of different firms by employing shorter notices.</p> <p><b>Grade: D</b></p>	<p>The suggested simplifications hold potential benefit for those with high privacy preferences. The shorter notices do little and may positively harm those without such preferences. Again, no evidence was cited to facilitate these distinctions among consumers.</p>
5. Does the proposal have a strong scientific or technical basis?	<p>No evidence or analysis was cited to support the claims that privacy enjoys a privileged status for most consumers. Only vague, unsupported claims made.</p> <p><b>Grade: F</b></p>	<p>No attempt made to support an implied market failure claim. There was no indication that alternative tradeoffs were considered.</p>
6. Are distributional effects clearly understood?	<p>No.</p> <p><b>Grade: F</b></p>	<p>Agencies ignore the rule's potential effects on those who prefer to share their information, and on those who are indifferent.</p>
7. Are individual choices and property impacts understood?	<p>No.</p> <p><b>Grade: F</b></p>	<p>No consideration is given to the property rights aspect of financial information. The default setting of the rule appears to be in favor of consumer ownership and control of personal information. While this assertion may be valid in some instances, it is not universally applicable and thus may be a questionable assumption in fact and in law.</p>