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A legal update from Dechert's Financial Services Group

Federal Regulatory Agencies Propose Model Forms for Privacy Notices to Consumers Under Gramm-Leach-Bliley Act

Eight federal regulators (the "Agencies") recently issued a notice of proposed rulemaking[1] soliciting comment on a model privacy form (the "MPF") that financial institutions can use for their privacy notices to consumers, as required under the Gramm-Leach-Bliley Act (the "Act").[2] Under the Act, when a consumer becomes a customer of any financial institution, the institution must provide that consumer with a notice describing its consumer information sharing policies and practices and the consumer's rights to direct the financial institution not to share certain information. The proposed rulemaking implemented the direction under the "Financial Services Regulatory Relief Act of 2006"[3] which requires the Agencies to develop jointly an MPF that is succinct, easily readable, and comprehensible to consumers.[4] Once the MPF is finally approved, it will be a safe harbor under the Act, and thus a financial institution electing to use that MPF would satisfy the Act's privacy notice requirements.

Background

Each financial institution is required under the Act and the rules thereunder (the "privacy rules") to provide its customers who are consumers with a notice of its privacy policies and practices no later than the time when a customer relationship is formed, and annually thereafter as long as the relationship

1 Securities and Exchange Commission, Rel. No. 34-55497 (March 20, 2007). Section 248(n)(1) of SEC Regulation S-P defines "financial institution" to mean "any institution the business of which is engaging in activities that are financial in nature . . . as described in section 4(k) of the Bank Holding Company Act of 1956 ("Bank Holding Company Act"). This provision will not be changed by the proposed rulemaking. Also, Section 509 of the Gramm-Leach-Bliley Act, in effect, defines "financial institution" as "any institution the business of which is engaging in financial activities as described in section 4(k) of the Bank Holding Company Act. Section 4(k) of the Bank Holding Company Act sets forth the activities of a financial nature, or those incidental to such activities, in which bank holding companies may engage under that Act. That section sets forth a list of those activities, which include: "[p]roviding financial, investment, or economic advisory services, including advising an investment company (as defined in section 3 of the Investment Company Act of 1940)" and "[u]nderwriting, dealing in, or making a market in securities."

2 The eight federal agencies that jointly developed the proposed rulemaking and the MPF are: the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the National Credit Union Administration, the Securities and Exchange Commission, and the Federal Trade Commission. The deadline for comments on the proposed rulemaking is May 29, 2007.

3 P.L. 109-351 (Oct. 13, 2006), 120 Stat. 1966.

4 *See* Section 728 of the Financial Services Regulatory Relief Act.

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continues.[5] Generally, a financial institution's privacy notice must describe its policies and practices with respect to disclosing nonpublic personal information about a consumer to both affiliated and nonaffiliated third parties.[6] The privacy notice also must provide a consumer with an "opt-out" right—a reasonable opportunity to direct the financial institution generally not to share nonpublic personal information about the consumer with nonaffiliated third parties other than as permitted by the statute.[7] In addition, the privacy notice must provide, where applicable under the Fair Credit Reporting Act, a notice and an opportunity for a consumer to opt out of certain information sharing among affiliates.[8]

Financial institutions were first required to distribute privacy notices to their customers by July 1, 2001. However, as financial institutions, consumers, privacy advocates, and members of Congress pointed out, many privacy notices in the initial effort were long, complex, and confusing. In addition, because the current privacy rule allows institutions flexibility in designing their privacy notices, notices have been formatted in various ways and as a result have been difficult to compare, even among financial institutions with identical privacy policies.

To address these problems, the Agencies have conducted multiple discussions with financial institution representatives, consumer advocates, and privacy experts. The Agencies launched a consumer research project aimed at identifying barriers to consumer understanding of current privacy notices and developing an alternative privacy notice or elements of a notice that consumers could more easily use and understand. In March 2006, the Agencies released a report detailing the methodology and results of the research and setting forth a privacy notice prototype.

On October 13, 2006, Congress enacted the Financial Services Regulatory Relief Act, which required the Agencies, among other things, to jointly develop an MPF which a financial institution may use to provide customers with privacy policies and practices disclosures pursuant to the Act. As required under the Financial Services Regulatory Relief Act, the MPF must:

- be comprehensible to consumers, with a clear format and design;
- provide for clear and conspicuous disclosures;
- enable consumers to easily identify the sharing practices of a financial institution and to compare privacy practices among financial institutions; and
- be succinct and use an easily readable type font.

The Proposed MPF

The MPFs included in the Agencies' joint proposed rulemaking release are based on the March 2006 privacy notice prototype. As indicated above, financial institutions that choose to strictly follow the MPF's content and format requirements would satisfy the privacy disclosure requirements under the Act and be eligible for the Act's safe harbor.[9] To ensure the goals of providing consumers with easily comprehensible and comparable disclosures, both the content and format of the MPF are highly standardized, allowing little variation and almost no explanation for individual institutions' disclosure practices.

The disclosure tables on the first page of the MPF require each institution to provide customers with information on the Federal law requiring provision of a

5 15 U.S.C. 6803(a). A "customer" means a consumer who has a "customer relationship with a financial institution." *See* 17 CFR part 248.3(j). A "consumer" is "an individual who obtains, from a financial institution, financial products or services which are to be used primarily for personal, family, or household purposes, and also means the legal representative of such an individual." *See* 15 U.S.C. 6809(9).

6 *See* 15 U.S.C. 6809(4). "Nonpublic personal information" is generally defined as personally identifiable financial information provided by a consumer to a financial institution, resulting from any transaction or any service performed for the consumer, or otherwise obtained by the financial institution. *See* 17 CFR part 248.3(t) and (u).

7 *See* 15 U.S.C. 6802. Financial institutions do not need to provide consumers with an opt-out right with respect to, for example, sharing nonpublic personal information for everyday business purposes, such as processing transactions and maintaining customers' accounts, and in response to properly executed governmental requests.

8 15. U.S.C. 6803(b)(4).

9 While the MPF would provide a safe harbor, institutions could continue to use other types of notices that vary from the model form so long as these notices comply with the privacy rules under the Act.

privacy notice, the types of personal information to be collected by the financial institution, and the necessity to share customers' personal information. The tables also provide information about the financial institution's sharing practices, including disclosure of the possible types of sharing and uses of personal information and the associated opt-out choices.

The second page provides additional explanatory information that, in combination with disclosure on the first page, ensures that the institution's notice includes all elements described in the Act as implemented by the privacy rule. This includes information presented in the form of Frequently Asked Questions and definitions of technical terms, both of which seek to further clarify, and increase customers' understanding of, the nature and type of information sharing by the financial institution.

The third page provides an opt-out form, for use by those financial institutions that share nonpublic personal information in a manner that triggers consumer opt-out rights.

Use of MPF and Sample Clauses

The Agencies contemplate that the MPF, once finalized, would replace the model privacy notice currently approved by the Agencies (known as the "Sample Clauses"). The Agencies propose a one-year transition period after the final rule adopting the MPF becomes effective.

Under the current privacy rules of the Agencies, except for the Securities and Exchange Commission (the "SEC"), an institution using the Sample Clauses for its privacy notice would have the safe harbor protection. Pursuant to the transition period proposal, if the institution's privacy notice is delivered to customers or posted electronically within the transition period, the institution would continue to have the safe harbor until the next privacy notice is due one year later.[10] The Sample Clauses would be rescinded one year after the transition period ends.

However, under the SEC's current privacy rule, the Sample Clauses provide only guidance for compliance with the privacy notice requirements in ordinary circumstances, and using the Sample Clauses does not entitle an institution to any safe harbor protection. Therefore, the SEC proposes that one year after the end of the transition period, the Sample Clauses would be rescinded and would no longer provide guidance regarding the rule's application to financial institutions subject to the SEC's privacy rule.[11]

Conclusion

The adoption of the MPF would greatly simplify financial institutions' current privacy disclosure practices, but may potentially increase consumer opt-outs and therefore result in higher compliance cost. Since the Agencies are expected to conduct the second phase of consumer testing after receipt of comments in response to the proposed rule, it is unlikely that the final rule will be issued in the near future.

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[10] However, privacy notices using the Sample Clauses posted on an institution's website to meet the annual notice requirements would no longer get the safe harbor beginning one year after the final rule adopting the MPF becomes effective.

[11] *See* 17 CFR part 248.2(a). The facts and circumstances of each individual circumstance of each individual situation determine whether the use of the Sample Clauses constitute compliance with the SEC's privacy rule. *See* SEC Rel. No.34-55494, *supra* note 1 at 30.

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