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THE ROLE OF FCRA IN EMPLOYEE BACKGROUND CHECKS AND THE COLLECTION OF MEDICAL INFORMATION

HEARING

BEFORE THE

SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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THE ROLE OF FCRA IN EMPLOYEE BACKGROUND CHECKS AND THE COLLECTION OF MEDICAL INFORMATION

Tuesday, June 17, 2003

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to call, at 10:09 a.m., in Room 2128, Rayburn House Office Building, Hon. Spencer Bachus [chairman of the subcommittee] presiding.

Present: Representatives Bachus, LaTourette, Kelly, Ryun, Gillmor, Biggert, Hart, Tiberi, Hensarling, Barrett, Oxley (ex officio), Sanders, Maloney, Watt, Sherman, Moore, Velaquez, Hooley, Lucas of Kentucky, Crowley, McCarthy, and Emanuel. Representative Pete Sessions was also in attendance.

Chairman BACHUS. [Presiding.] Good morning. The Subcommittee on Financial Institutions will come to order.

Our hearing today is the fifth in a series of hearings the subcommittee is holding on FCRA. We previously held hearings covering the importance of the national uniform credit system to consumers and to the economy, and more specifically how the Fair Credit Reporting Act helps consumers obtain more affordable mortgages and credit in a timely and efficient manner.

Today, we will hear how FCRA regulates employee background checks and the collection and use of health information or medical information. This hearing consists of two panels. The first panel will focus on the application of FCRA to employee screening and other background checks. Witnesses will include various business groups, human resource managers and private investigators.

The second panel will examine how medical information is collected and used for various financial products, including a discussion on the prohibition of the use of health or medical information in the credit-granting process. Panelists will include representatives of life and health insurance companies, the banking industry, and independent experts.

While we usually think of FCRA in the context of credit information, it also applies to background checks for employees. For example, information collected for an employer by a third party about an employee's criminal record, driving record, educational record or prior employment history in some instances falls within FCRA's

coverage. The 1996 amendments to FCRA established consumer protections for employee background screening.

Some of these include consumer consent before a prospective employer may obtain a consumer report, disclosure of the report to the consumer once it is completed, and notice to the consumer of his rights before taking adverse action based on the report. Many employers conduct background checks of their employees as a safety precaution. Moreover, according to a 2002 Harris poll, a majority of Americans support their employers's conducting detailed background checks.

Congress has mandated background checks for many workers in the financial services industries, as well as for nuclear, airport and childcare businesses. The number of worker background checks has dramatically increased since 9-11 due to heightened security concerns. As a result, mandatory background checks are now required for workers at ports and for those who transport hazardous chemicals.

Because background checks are becoming commonplace, one issue we need to review today is the FTC's staff Vail opinion letter. It makes it much more difficult for employers to conduct background checks or investigations of their employees. Under the Vail letter, if an employer believes that an employee is engaged in workplace misconduct such as committing sexual harassment, racial discrimination or embezzling funds or other criminal activity, the employer cannot hire an independent third party investigator without getting the employee suspected wrongdoer's consent and telling him about the investigation and how the investigation will be conducted. That makes absolutely no sense. If you are trying to catch a criminal, why warn him in advance?

Strangely, employers can investigate alleged misconduct without following any of the Vail letter requirements if they do so internally. The Vail letter makes it unworkable to hire an outside unbiased party to do an impartial investigation. Even the FTC admits the law should be fixed.

Our second panel will discuss medical information, health information, and how the FCRA and other state and federal laws govern its use.

The FCRA prohibits consumer reporting agencies from furnishing reports containing medical information without the consumer's consent. Congress passed another law, the Health Insurance Portability and Accountability Act of 1996 which limits the sharing of health information by health care plans and providers. In addition, the States have various laws governing insurance companies in the use and sharing of health information by those companies.

The second panel will help us understand whether there are gaps in the convergence of these laws and whether financial providers are using such information, and if they are, whether they should be prevented from using an individual's medical or health information in any way or in an inappropriate way.

I want to express my gratitude to Chairman Oxley for his leadership in these FCRA hearings. I want to commend Ranking Member Frank and Mr. Sanders for working with the staff, with me, and with Chairman Oxley on FCRA reauthorization. I note that for the

second week in a row we have accommodated all of the minority witness requests.

The Chair now recognizes the ranking member of the subcommittee, Mr. Sanders, for his opening statement.

[The prepared statement of Hon. Spencer Bachus can be found on page 52 in the appendix.]

Mr. SANDERS. Thank you very much, Mr. Chairman, for holding this important hearing. I very much appreciate all of our witnesses being with us today.

This hearing will focus on the role of the Fair Credit Reporting Act in employee background checks and the collection of medical information. These are important matters that must be carefully scrutinized by this subcommittee. Before we delve into these issues, Mr. Chairman, I would like to briefly highlight the testimony of two of our witnesses from last week's hearing.

Mr. Chairman, as I recall, you raised a number of concerns about my support for consumers to receive a free copy of their credit reports at least once a year from all three of the credit bureaus. It should come as no surprise that all of the major consumer groups in this country support that view, including U.S. PIRG, the Consumer Federation of America, Consumers Union, and the National Consumer Law Center.

Yet what the chairman and some of the members of the subcommittee might not have heard clearly is that according to the testimony we received last week, that view is also shared by the America's Community Bankers and the Independent Community Bankers of America. I think that it is important that they are coming on board in order to make sure that all Americans receive a free credit report.

Let me turn for a moment to today's hearing. First, the issue of employee background checks, Mr. Chairman, under the Fair Credit Reporting Act. Companies can turn down job applicants because of the credit history contained in their credit reports, including large student loan debt, high credit card payments, a big auto loan, or a heavy mortgage bill. Even worse, job applicants who have errors in their credit reports as a result of identity theft are being denied employment. In most instances, by the time these errors are taken off the job applicant's credit report, the job they are applying for has already been filled by another person.

Mr. Chairman, this raises troubling questions for the subcommittee. One, should a young person who has accumulated $30,000 or more in student loan debt be denied a job in favor of someone who was fortunate enough to have wealthy parents to pay for their college education?

According to a May 26, 2003 article in The State newspaper in Columbia, South Carolina, "Ayana Woodson, a recent business administration and finance graduate from Howard University in Washington, DC learned this the hard way. 'These are jobs I have not gotten because of my credit,' said Woodson, now carrying a $25,000 college debt, 'I just assumed after I graduated I would have this high-paying job and would be able to pay it off,' she said. It is like a double-edged sword. I take out this loan so I can get a job, but it may be the very reason to keep me from getting a job."

Mr. Chairman, according to the U.S. Department of Education, the average student loan debt has nearly doubled over the past 8 years to close to $17,000. I think we can all agree that people who had to go into debt to get through college should not be forced to lose job opportunities because of that debt.

Secondly, should employers be allowed to deny employment opportunities to job applicants due to errors contained in their credit reports? I do not think so, but according to a March 3, 2003 article in Investment Dealers Digest, "If you want to work for Goldman Sachs, your name had better be squeaky clean. All it takes is one blemish on your credit history to prohibit employment there. At least that is what one secretarial job candidate recently found out the hard way, and she is not alone. Like many young people at age 24, Kate ran up significant debt on a Citibank credit card. She was unable to pay it off quickly, and the account was ultimately sent to collection.

"Over the next 9 years, she gradually paid down the debt, satisfying it completely by 2002. The problem was the collection agency failed to report this to the credit agencies, and the account showed up on Goldman's credit check-a-mistake for which the collection agency took full responsibility and promised to put it into writing in 30 to 60 days, but would gladly relay orally to Goldman. But according to Kate, Goldman's background checker told her the firm would not accept an oral explanation and needed it in writing."

To make a long story short, this young lady has a hard time with jobs. Mr. Chairman, I do not believe job applicants should be turned down from their jobs because of errors contained in their credit report.

Finally, we will be looking today at the Fair Credit Reporting Act in the collection of medical information. I have two concerns on this issue. First, we need to make it clear that banks and insurance companies cannot use medical information to deny consumers credit or insurance. Banks should not be allowed to use the fact that you have cancer to increase the interest rate on your credit card. Insurance companies should not be allowed to use the fact that you have diabetes to raise your premiums on your renter's insurance.

Mr. Chairman, thank you very much for calling this important hearing. I look forward to hearing from the witnesses.

Chairman BACHUS. Thank you, Mr. Sanders.

Chairman Oxley?

Mr. OXLEY. Thank you, Mr. Chairman. Let me thank you for your leadership on this important issue of FCRA as we continue the series of hearings. You have done yeoman work and we appreciate all that you have done.

I am pleased to announce that last Thursday another federal regulator came out in support of reauthorization of the national uniform standards for FCRA. Don Powell, the chairman of the FDIC, who testified before this committee, said he believes it is necessary to make permanent the preemptions in the FCRA in order to ensure no negative economic impact. Mr. Powell joins the Treasury Secretary, the chairman of the Fed, and the Conference of State Bank Supervisors in support of reauthorizing uniform FCRA standards.

I also just received a report by the independent Congressional Research Service analyzing a critical consumer benefit of the FCRA, and that is increased labor mobility. CRS found that mobility is an important barometer to judge the importance of having a national credit reporting system. No surprise, the U.S. is one of the most mobile societies, with 14.5 percent of the population moving in any given year, and lower-income individuals more likely to move than higher-income groups. It is our national uniform credit system that makes this mobility possible and gives us a further competitive edge over the rest of the world.

Throughout modern history, national economies have risen and fallen based in large part on the flexibility and mobility of labor and management. American consumers and workers enjoy unprecedented mobility in part because of our uniform national credit standards.

Today's hearing looks at two particular aspects of uniform standards under FCRA. The first panel will address the use of FCRA in employee background screening. Even before 9-11, Americans had become increasingly concerned about ensuring their safety on the job from individual predators with criminal records.

Homicide was the second leading cause of occupational fatalities in 2001, and the recent wave of corporate scandals has highlighted the need to keep out bad actors at all levels of the American workplace. Congress has been calling for expanded background checks for a number of sensitive jobs and courts have been imposing more liability on businesses that do not perform adequate background checks.

Unfortunately, an interpretation of FCRA by the Federal Trade Commission, known as the Vail letter, undermines the ability of businesses to protect their employees and consumers. The Vail letter prohibits employers from using outside third parties to investigate employee misconduct unless they first notify the wrongdoer of the precise investigation, get his consent, and ultimately give him a copy of the investigative report.

How do you investigate a CEO, for example, who is embezzling funds if you have to first get his permission and give him time to cover up his actions? How do you get victims to cooperate with a sexual or racial harassment inquiry if they know their identities will not be protected? You don't, and that is why the FTC's interpretation is at best problematic. Ironically, a company can perform an employee investigation without these requirements, but only by doing it internally without any of the protections of an outside, unbiased, and professional third party. The Vail letter is simply impractical.

Subcommittee Chairman Bachus and I wrote to the FTC last term asking the Commission to change its views, and we support efforts by the members here today to correct this problem.

On our second panel, we will receive testimony on the use of medical information in the credit-granting process and the interplay between various federal and state health privacy laws. I share the concerns of many of my colleagues that medical information may require special protections to prevent its improper use or theft, and I look forward to our witnesses's views on the appropriate balance of national consumer standards on this issue. Once

again, I would like to thank the chairman for his leadership and the continued bipartisan cooperation of our ranking subcommittee and full committee members, Mr. Sanders and Mr. Frank.

I yield back.

[The prepared statement of Hon. Michael G. Oxley can be found on page 55 in the appendix.]

Chairman BACHUS. Thank you.

The gentleman from North Carolina?

Mr. WATT. Thank you, Mr. Chairman.

I had intended not to say anything, but my chairman provoked me to say something to balance at least one thing, not necessarily to contradict what he is saying, but to thank you for having this hearing today and the series of hearings, because of the difficulty of these issues.

While the chairman is right to have the governing agency bring these employment background checks and medical information under its jurisdiction, it may be presenting some problems. The other side of that is if they are not under somebody's supervision, then they have the capacity to collect erroneous misinformation on people, and not be subject to any kind of oversight.

So we have got to figure out a way to allow them to provide the valuable service that they provide to employers, but do it in a way that makes sure they are regulated and that they answer to somebody and that they are accountable for collecting information that is not correct and viable. That is the difficulty. I am not arguing with the concern that the chairman of the full committee and the chairman of the subcommittee raised in the letter you wrote, but if they are not regulated under the Fair Credit Reporting Act, then who is going to regulate them, I guess, is the question; and how do they get regulated and how do we keep employees or prospective employees from having their employment possibilities adversely affected by information that may not even be correct?

That is the difficult balance this committee has to deal with. It is for that reason that we have witnesses here to enlighten us about how we walk that balance and get to a result that is fair, both to employers and the agencies that report information to them about people's criminal records and medical records and sexual harassment in prior venues, or what have you, yet make sure that that information is correct and defensible; and if it is not, that somebody is held accountable for it.

So I thank the chairman. I did not take the time to argue with him about this, but more to point out the difficulty of the balance and the requirement that this committee has as we go forward.

With that, I will yield back, unless the chairman wants me to give him the last word. I am always willing to give my chairman the last word.

[LAUGHTER]

I yield back.

Chairman BACHUS. Thank you.

I have a unanimous consent request, and that is that without objection the gentleman from Texas, Mr. Sessions, may be recognized for the purpose of making an opening statement and for the purpose of questioning witnesses under the five-minute rule after all members of the subcommittee and the committee have been recog-

nized. Is there objection? Hearing none, I would ask the gentleman from Texas, who is a cosponsor of H.R. 1543 which addresses the Vail letter, if he has an opening statement.

Mr. SESSIONS. I thank the chairman and appreciate you allowing me to be here today. I have got to be on the floor in a few minutes, when they are ready for the new rule.

Mr. Chairman, I would like to thank you for inviting me to join you at this hearing on the Fair Credit Reporting Act, FCRA, as it pertains to employee background checks and the collection of medical information. I am pleased to be rejoining the chairman and my esteemed former colleagues on the Financial Services Committee to discuss an issue that has long been of great interest to me.

I would also like to thank my colleague from Alabama, the Chairman, for scheduling this important hearing, for your strong leadership on the issue, and for your diligent oversight on all aspects of FCRA. Certainly, Chairman Bachus's efforts are commendable, and by holding this hearing today he will help Congress to take the first step toward making the workplace a better and safer place for all working Americans.

Mr. Chairman, in order to provide a historical context to this hearing, I would like to recount briefly the events that have brought us here today. In 1999, the staff of the Federal Trade Commission issued an opinion known as the Vail opinion, concluding that outside consultants who perform investigations of alleged employee misconduct are considered to be credit reporting agencies.

As a result, outside consultants and the employees who hire them to help ensure unbiased workplace safety are subject to a number of burdensome and unintended restrictions on their ability to perform these investigations safely, professionally, and efficiently. Accordingly, they are hampered in performing many kinds of workplace investigations, including employee complaints of sexual harassment, discrimination and threats of violence. For the last few Congresses, I have introduced legislation to fix this problem by removing the FCRA requirements for investigations of suspected misconduct related to employment and to compliance with existing laws and preexisting written policies of the employer.

This proposed legislation also respects the rights of the subject of the workplace search, while removing employers from the onerous and potentially dangerous requirement to notify their subject prior to beginning an investigation. The removal of this requirement is important because it prevents violence from employees, from giving them time to cover their tracks, or to initiate intimidation against coworkers who make or corroborate complaints, and are an integral part to ensuring the veracity of data included in these complaints.

Mr. Chairman, back in 1997 when a constituent brought the problems to me that she was having as a result of the Vail opinion, I was shocked to learn that federal law requires an employer who suspects that an employee is dealing drugs or engaged in other misconduct at the workplace to ask that employee's permission before beginning an investigation.

Furthermore, I was greatly dismayed to find that federal law would also require that the same employer to provide to a potentially violent employee with a report identifying the coworker who

made or who corroborated those allegations of wrongdoing, making those helpful employees who were only trying to make the workplace safer a target for violence or retribution, and placing themselves in harm.

This important legislation that I have introduced removes requirements of the federal Fair Credit Reporting Act solely for the purpose of having unbiased third party professional investigations of illegal or unsafe activities in the workplace. These limited activities include drug use or the sale of drugs, violence, sexual harassment, employee discrimination, job safety or health violations, and criminal activities including theft, embezzlement, sabotage, arson, patient or elderly abuse, and child abuse.

I believe that it is critical for Congress to pass this legislation in order to make our workplaces safer, to stop illegal activities such as drug dealing, and to identify dangerous employees so that they can be provided with treatment before violence occurs. This legislation offers Congress the opportunity to replace illegal and dangerous activities in the workplace with investigation and remediation. I think that this is precisely the goal for which we should all be striving.

I also would like to thank the panel that is before us, many of whom have come from all over the country to share their experiences with the Vail opinion and FCRA with us today. I look forward to hearing their testimony on the issue.

I would also like to thank the 16 members of Congress on both sides of the aisle who have cosponsored this bipartisan legislation. I want to thank you, Mr. Chairman, for your leadership, and I appreciate the time you have given me today.

[The prepared statement of Hon. Pete Sessions can be found on page 58 in the appendix.]

Chairman BACHUS. Thank you.

Are there any other members wishing to make an opening statement? If not, I would like to welcome our first panel, which deals with the role of FCRA in employee background checks. Our panelists consist of, from my left, Mr. Christopher P. Reynolds, partner in the law firm of Morgan, Lewis and Bockius, on behalf of the U.S. Chamber of Commerce. I noted that you were a U.S. Attorney for the Southern District of New York.

Mr. REYNOLDS. Mr. Chairman, I would hasten to say that I was an assistant U.S. Attorney for the Southern District.

Chairman BACHUS. Assistant U.S. attorney, and dealt with many cases involving employee and employment matters.

Mr. REYNOLDS. Yes, I did, Mr. Chairman.

Chairman BACHUS. Our second panelist is Mr. Harold Morgan, senior vice president, human resources, at Bally Total Fitness Corporation, on behalf of the Labor Policy Association, and previously with Hyatt Corporation where you were director of employee and labor relations. Our third panelist, at the request of Mr. Sanders, is Mr. Lewis Maltby, president of the National Workrights Institute. We welcome you, Mr. Maltby. Mr. Sanders also requested the testimony of Ms. Margaret Plummer, director of operations for Bashen Consulting. We welcome you as a panelist.

Our final panelist on the first panel is Mr. Eddy McClain, chairman of Krout and Schneider, on behalf of the National Council of

Investigation and Security Services. Mr. McClain, you are a former private investigator on work-related investigations?

Mr. MCCLAIN. Yes, sir.

Chairman BACHUS. So we welcome you.

At this time, Mr. Reynolds, we would recognize you for your opening statement.

STATEMENT OF CHRISTOPHER P. REYNOLDS, PARTNER, MORGAN, LEWIS AND BOCKIUS, LLP ON BEHALF OF THE U.S. CHAMBER OF COMMERCE

Mr. REYNOLDS. Thank you, Mr. Chairman, and distinguished members of the subcommittee. Good morning.

I am grateful to you for the privilege of testifying before you today. In the interests of time and with your permission, I will summarize my written testimony. My purpose today is to testify on behalf of the U.S. Chamber of Commerce regarding FCRA's affect on employee background checks and employer investigations into workplace conduct.

I do that on the basis of my experience as a partner at Morgan, Lewis and Bockius representing employers in litigation, investigations, and providing advice and guidance; as a member of the American Bar Association's Labor Section and Equal Employment Opportunity Committee; and as also a member of the Securities Industry Association's Legal Division.

Mr. Chairman, the reauthorization of FCRA's uniform standards provisions is terribly important to the members of the Chamber and to the efficient functioning of the national credit system. Without those standards, we would be faced with a complex and confusing web of conflicting state standards that could only impede the availability of credit and limit the access of small businesses to the credit that will help them grow and survive tough economic times. We urge this committee at a minimum to preserve those standards.

The two issues that also concern the Chamber beyond reauthorization would be the background check issue and the workplace investigation issue. Concerning background checks, our primary concern is not with existing law, but with the possibility that new provisions will be added, provisions that hurt an employer's ability to ensure workplace integrity and workplace safety by obtaining reliable job-related information compelled by business necessity on applicants and employees.

Now, employers use these background checks to make sure their workplaces are safe and secure. We need them. A recent study by the Avert Internet-based screening firm found that 24 percent of 1.8 million applications in the year 2000 were submitted with misleading or negative information. The Society for Human Resources Management found in a 1998 survey that 45 percent of employers found that an applicant had lied concerning their criminal record. Many states impose on employers the potential liability for negligently hiring someone who is a danger to the safety and security of the workplace. Background checks allow us to avoid that liability and fulfill our legal duty.

Against the painful backdrop of September 11, the public and this government also increasingly expect employers to use background checks. According to a Harris interactive poll in 2002, 53

percent of employees want their employers to conduct more detailed background checks of applicants and coworkers to ensure safety. In this session alone, Congress has introduced 21 different bills requiring background checks for workers. It is a clear signal that the government expects employers to use them.

The Chamber understands and appreciates that there is a necessary and welcome balance between workplace security and privacy. We believe that the existing FCRA provisions of consent, notice and disclosure provide that balance. We also believe that the nation's existing equal employment laws provide a ready remedy for any company or employer that abuses background checks for discriminatory purpose. We also note the numerous State laws that restrict or limit the ability of employers to use information in background checks improperly.

If you do make changes to FCRA on the background check issue beyond its reauthorization, we urge you to allow employers who use contract workers to have access to the contractor's background check information without converting that contractor into a consumer reporting agency. There are many safety-sensitive industries that use contract workers and the underlying employer needs that information to ensure safety.

Now, with your permission, Mr. Chairman, let me echo your previous comments on the Vail letter. The issue is simple. The FTC through the Vail letter has thrown up a roadblock to the effective use of workplace investigations of employee misconduct. We understand that the FTC will not retract that letter unless Congress acts. The Chamber urges that action.

Employers are instructed by statute in the case of Sarbanes-Oxley; instructed by the Supreme Court in the case of the Faragher-Ellerth precedent; and by regulations of the Equal Employment Opportunity Commission to conduct thorough, effective and objective investigations. Often, the only effective way to do that is through an outside firm or investigator. Under Vail, there is a requirement for notice and consent provisions that would require almost immediate notice to the object of that investigation. That fundamentally guts the investigation's effectiveness. Just a quick example. Say that I receive a request to investigate a senior executive for a sexual harassment complaint. Under the Vail letter, I am obligated to advise that senior executive before I begin my investigation that he or she might be the object of a complaint, and therefore that is going to constrict greatly the ability to find out what happened and take appropriate remedial action. There is simply no way to satisfy both Vail and the need to investigate effectively workplace conduct.

Against that backdrop of increased corporate responsibility for self-monitoring, we believe that this choice must be resolved the way Congress intended under Sarbanes-Oxley, the way the Supreme Court dictated in Faragher-Ellerth, and the way the EEOC's guidance has laid out in favor of effective investigations. The Chamber believes that H.R. 1543 is the right step to address that concern and we urge its passage.

Mr. Chairman, thank you.

[The prepared statement of Christopher P. Reynolds can be found on page 121 in the appendix.]

Chairman BACHUS. Thank you very much, Mr. Reynolds, for that testimony.

Mr. Morgan?

STATEMENT OF HAROLD MORGAN, SENIOR VICE PRESIDENT, HUMAN RESOURCES, BALLY TOTAL FITNESS CORPORATION, ON BEHALF OF THE LABOR POLICY ASSOCIATION

Mr. MORGAN. Thank you very much. Do not worry. I will not be asking the members of the committee to do exercises before we begin the testimony today.

[LAUGHTER]

This morning, I have two simple and basic messages regarding FCRA. The first is please do not make it any harder to keep our workplaces safe. And two, if possible, please help us to make it easier to keep our workplaces safe.

I am sure the original intent and the purpose for expanding FCRA to include background checks was to ensure that potential employees were guaranteed certain rights and privileges if their backgrounds were checks. I am sure the same thought applies to investigations in the workplace. However, the actual on-the-job reality of FCRA makes it increasingly difficult to maintain a safe workplace.

Many individual states have added to these restrictions on top of FCRA. The FCRA regulations, in addition to the additional State laws, really cut to the heart of workplace safety. The fact of life today is that every critical public or stakeholder that has anything to do with our operations expects me to run a safe workplace. The duty and trust and obligation of maintaining this safe workplace is even more difficult in businesses such as mine where you have large amounts of employees, a lot of employee turnover, and where you are dealing with customers on a minute-to-minute basis.

So by way of introduction, this is the overview of where we are coming from on FCRA. But what is at the heart of the problem? The problem is that to make hiring decisions with increasingly more difficult limits and restrictions on what we cannot and can look at is unrealistic and is increasingly compromising workplace safety. For instance, should I hire someone to be a childcare attendant who has several arrests, but no convictions for child molestation? Should I hire a salesperson who has information regarding credit cards and financial information about a potential customer, but who has a deferred adjudication for fraud? Should I hire a personal trainer who has been arrested for assault and battery, but has pled down to a misdemeanor, or who has a conviction that is over seven years old? The problem with FCRA and the additional State laws is that I cannot use this information in making employment decisions.

Congressmen and congresswomen, I believe that this is playing roulette with the safety of everyone involved in the workplace. Employers cannot be subject to courtroom standards in order to keep their workplaces safe. The reality of life is that I should not hire the personal trainer with several arrests, but no convictions, and I should not hire the childcare attendant who has pled down to a misdemeanor for child molestation. Nevertheless, FCRA and the

State laws suggest that I should not consider any of this information in making my employment decision.

The other issue, which Mr. Reynolds has covered, is Vail. Very simply, this makes it difficult to conduct investigations in the workplace, which all of you would agree is something that should be done and should be done in a fair and consistent manner. Vail only results in a chilling effect on people coming forward regarding workplace misconduct and problems that are going on in the workplace. Investigations should be able to be done and proceed in a way that does not limit us and that affords all people involved a great deal of confidentiality.

As I said in the beginning, please help us to make workplaces safer. In order to do that, I would suggest five key issues. First, please allow us to look at criminal backgrounds without any time limitations. Second, please allow us to consider arrests in looking at the totality of an individual's background regarding their suitability to work in a particular place. As long as we are within the EEOC guidelines, the burden of proof beyond a reasonable doubt should not be a standard that applies in the workplace.

Three, please give us access to national databases so that we do not have to go to thousands of jurisdictions to see if someone should or should not be an employee regarding what they have done in their past. Please give us a safe harbor from more restrictive State laws, provided that FCRA is adhered to from a regulation standpoint. And fifth, please allow us to conduct any and all investigations regarding workplace misconduct in a confidential manner and not subject to FCRA.

Last and certainly to highlight this issue, in 1999, as all of us are aware, several terrorists tried to come through the Canadian border to blow up the LAX airport in celebration of the millennium. The identities that these folks were using were partially stolen out of databases of my company. Now, we have since closed up that issue regarding our databases.

The employee that was involved in selling off these identities to the terrorists had a complete criminal background screen that I conducted; was drug tested; and every attempt was made to make sure that this employee, like all of my employees, were safe in the workplace. Nevertheless, those identities were sold and those identities were given to the terrorists that were fortunately caught before they were able to set up a bomb at LAX airport.

The point is this: It is difficult enough to make decisions about the unknown and about what may happen in the workplace. Please at least let us make decisions regarding what is known.

[The prepared statement of Harold Morgan can be found on page 82 in the appendix.]

Chairman BACHUS. Thank you very much.

Our next witness is Mr. Lewis Maltby. Mr. Maltby, I mentioned that you were with the National Workrights Institute. I did not mention that you were the founder of that Institute, so we very much welcome your testimony. We know you as a nationally recognized expert on employee rights in the workplace.

STATEMENT OF LEWIS MALTBY, PRESIDENT, NATIONAL WORKRIGHTS INSTITUTE

Mr. MALTBY. Thank you, Mr. Chairman, and thank you for inviting me to be here this morning.

Let me say from the very beginning, I have no problem, no objection to pre-hire investigations. I have three school-age children. Every morning, I put them on a school bus. I do not want anyone behind the wheel of that school bus with DUI convictions.

But it is not always that simple. There are many situations in which pre-hire investigations occur in ways that simply are not fair and do not help anyone. For example, at least 2.5 million people every year are required to take so-called honesty tests to get a job. There is nothing wrong with employers wanting to hire honest people, but honesty tests fail at least four honest people for every dishonest person they screen out. That is a very high price for a lot of honest people to pay for businesses to get a dubious advantage at best.

Personality tests are extremely common. They are not inherently wrong. Someone who would do very well in a laid-back Silicon Valley company might not do so well in a very straight-laced Wall Street firm. But some of the questions on these tests I would not ask my wife. There are questions about your religious belief, your sex life, even your bathroom habits on some of these common personality tests. With all due respect to Mr. Reynolds, I do not know why you have to ask an employee about their bathroom habits to tell if they are going to be a productive and safe employee.

I mentioned criminal records checks. There are many cases where that is totally appropriate, like the one with my children. On the other hand, there are many employers in America today that will not hire a person for any job at any time in their lives if they have ever been convicted of anything. You could be, and sometimes are, denied a job as a 40-year-old electrician because when you were 19 you shoplifted a CD. There is something wrong when employers go to that incredible unreasonable extreme.

The worst part of all of this is the way the information is being used. If this information were being used as something to inform the judgment of a seasoned HR professional, I would not be so concerned. But what is happening is, the machines are taking over. The test results are trumping the evaluation and the judgment of the HR professional. If the honest test says you are dishonest, I don't care if you are a nun, and this is a real case, the HR person cannot say, "Well, the test is obviously wrong." They can't and they don't. If the test says you are dishonest or you don't fit or anything else, you are simply out. That is not the way things ought to be done.

Regarding the Vail letter, let me not belabor the obvious, except to say Mr. Morgan and Mr. Reynolds are right. There is a problem here. As a civil rights lawyer, I want to see investigations of alleged sexual harassment or racial harassment or other civil rights violations conducted quickly, thoroughly and effectively, and the Vail letter as it stands is an obstacle. The real question is, how do we fix the obstacle? Mr. Sessions has certainly taken us the first step in that direction. It is clearly surreal, maybe that is too kind,

to say we have to tip off the person we are investigating and get their permission before we conduct an investigation.

But that is not the entire situation we have to deal with. What if, for example, the employee is innocent? Perhaps the investigation clears them. Shouldn't they be told after the investigation is over that they were investigated and they were cleared, and being shown a copy of the report? Is it really fair that that report should follow them for the rest of their career, or at least their career at this company, and they don't even know it happened? I do not think so.

For example, what if there never was any genuine suspicion of wrongdoing? Pretext investigations are not common, but they happen. We do not want a law that says that a company can investigate somebody whose real offense is trying to organize a union on the pretext they have stolen a pencil. The law ought to require that there be a genuine suspicion of wrongdoing before the investigation starts in the first place. And whatever minimal standards the FCRA contains about fairness and accuracy in conducting the investigation and compiling the report should not be lost either.

I know that none of those problems were intended to be created by Mr. Sessions's bill, but we need to do more than just simply crudely yank criminal investigations in the workplace out from under the FCRA. It has to be done in a more nuanced, thoughtful fashion. Mr. Sessions's bill is the first step, but it is not the only step.

From having looked at the issues, I see nothing here that people of good will and intelligence could not resolve, given discussion. We have already had some discussions on these matters and I am confident that if allowed to continue we could reach a resolution that would accomplish Congressman Sessions's objectives and the concerns of people like me in the civil rights world.

Thank you.

[The prepared statement of Lewis Maltby can be found on page 60 in the appendix.]

Chairman BACHUS. Thank you, Mr. Maltby.

We would also welcome coming together on this issue. We are also optimistic that we can do that.

Ms. Plummer, I previously recognized you. You actually manage EEOC claims, risk management services, quality assurance, and consultant supervision for Bashen. I noted that you practiced business and employment law with the firm of Randolph, Hunter in Greenville, South Carolina, so you also have litigation experience in employment matters. We welcome you.

STATEMENT OF MARGARET PLUMMER, DIRECTOR OF OPERATIONS, BASHEN CONSULTING

Ms. PLUMMER. Thank you very much, and also thank you to the members of the subcommittee for having us here today.

Bashen Consulting is a minority-owned human resources consulting firm that has conducted thousands of employment discrimination, harassment and ethics investigations for companies nationwide. I thank you for allowing us to participate in these important discussions regarding the role of the FCRA in employment-related investigations.

The Federal Trade Commission's interpretation of the FCRA as expressed in the 1999 Vail opinion letter will have a chilling effect on the efforts of employers to prevent and correct unethical discriminatory and harassing behavior in the workplace.

In 1998, the Supreme Court profoundly changed the workplace harassment landscape. It became clear that for employers to protect themselves, they must implement effective policies and complaint procedures, conduct prompt and thorough investigations of employee complaints, and take remedial action. Today, courts and government agencies charged with enforcing civil rights legislation examine not only the fundamental question of whether unlawful conduct occurred, but the quality and integrity of the employer's investigation of the alleged conduct.

Many employers naturally seek the experience and expertise of qualified third parties to thoroughly and impartially investigate employee concerns. Countless companies, especially small companies, do not have the internal resources or skills to investigate employee complaints. In many situations, companies hire third parties to ensure that maximum credibility is given to the investigation, often due to the sensitive nature of the allegations or the high-level position of the alleged wrongdoer.

I recently conducted an investigation for a large corporation in which a human resources staff member complained that he was discriminated against based on his national origin when he was denied a promotion. The company would have been placed in the untenable position of having its human resources department police itself if the investigation was conducted in-house.

The HR department recognized its potential conflict of interest, and more importantly the appearance of a conflict if the investigation failed to support the staff member's claim. The company hired Bashen Consulting to ensure the integrity of the investigation. However, according to the FTC this company would be subject to increased liabilities and requirements because they hired experts in the field instead of investigating the complaint internally.

Under the FTC's interpretation, companies striving to comply with civil rights legislation must now decide between the risk of uncapped damages under the FCRA if they request an investigation, and the limited damages available under civil rights laws if they fail to investigate at all. Companies would also be required to obtain a written authorization by the alleged wrongdoer to conduct the investigation. The notion that an accused harasser must consent to an investigation of his inappropriate behavior is contrary to common sense.

More alarming is the detrimental effect the FTC's interpretation of the FCRA poses for employees. The law would require the company to provide the alleged wrongdoer with a complete copy of the investigative report. These reports identify witnesses and the information each provided, and producing it would irreparably compromise the confidentiality of the investigation.

Absent assurances of confidentiality, the FCRA will create a chilling effect on witnesses's willing participation in the investigatory process. Many victims will be too intimidated to complain, thus undermining the expressed intent of all workplace civil rights legislation. The impact of applying the FCRA to employment inves-

tigations is monumental. It would erode the great strides companies have made toward eliminating discrimination and harassment.

H.R. 1543 will remove these roadblocks to progress by excluding workplace investigations from the FCRA's purview. We commend Representatives Sessions and Jackson Lee for their leadership on this issue and urge you to amend the FCRA accordingly.

Thank you.

[The prepared statement of Margaret Plummer can be found on page 105 in the appendix.]

Chairman BACHUS. Thank you very much.

Mr. McClain, we note that you have lectured at UCLA and other California colleges and universities, so this ought to be a piece of cake, after doing that.

STATEMENT OF EDDY MCCLAIN, CHAIRMAN, KROUT & SCHNEIDER, INC., ON BEHALF OF THE NATIONAL COUNCIL OF INVESTIGATION AND SECURITY SERVICES

Mr. MCCLAIN. Thank you, Mr. Chairman. Thank you to the committee.

I am chairman of Krout and Schneider, which is a 76-year-old firm, but I have only been a licensed investigator for 47 years. I am appearing today on behalf of the National Council of Investigation and Security Services, NCISS, which represents investigative and protective service companies and their state trade associations throughout the United States. We appreciate the opportunity to discuss the FCRA.

Besides many small-and mid-size employers, even many Fortune 100 firms hire third parties for their expertise and impartiality. The FTC says any person who regularly conducts employment investigations is a consumer reporting agency under the law. We agree that is what the law says, even before Vail, but we believe that investigators of workplace misconduct should not be designated as consumer reporting agencies and the reports should not be classified as consumer reports.

The 1996 amendments to the FCRA have substantially set back progress, as Ms. Plummer said, on sexual harassment and discrimination. The EEOC recommends prompt, thorough and impartial investigation of sexual harassment, but the Act provides no explanation or suggestion of what an employer should do if an accused person refuses to give his or her permission to be investigated.

Regarding violence, when an employee exhibits symptoms of derangement, the last thing the employer wants to do is ask the employee for permission to investigate him. My firm is often hired to assist employers to deal with potentially violent employees. It is not uncommon to have little or no background information in a personnel file.

In addition to public records and surveillance, we need to conduct covert neighborhood interviews. Neighbors are often aware of suspicious activity, proclivity toward firearms ownership, and even knowledge of explosives. Since the 1996 amendments, the report of such an investigation would be considered an investigative consumer report and it would be unlawful for the employer to order such an investigation without disclosure and permission. The ramifications of advising such an employee that he is going to be inves-

tigated, then giving him a report of what witnesses said about him are obvious.

Many business failures are the result of employee theft. When businesses fail, employees lose their jobs. These are the same employees the FCRA is supposed to protect. Investigation of embezzlement requires stealth and expertise. Embezzlers are usually in the best position to cover their tracks.

Yet before an employer can hire an outside expert to investigate embezzlement, written permission must be obtained. Illicit drugs are a scourge on our society. Seven percent of American workers use drugs on the job, but the FCRA makes it very difficult to ferret out drug dealers from the workplace.

Regarding intellectual property and trade secret theft, prior to the 1996 amendments employers were able to hire impartial experts to covertly conduct sensitive investigations that would not be possible today. For example, my firm was engaged to investigate an alleged theft of trade secrets by a Fortune 100 defense contractor. Using a combination of public record information, surveillance and undercover techniques, we were able to determine the facts.

A salesman, marketing manager and a production chief had conspired with a scientist to form a competing company that was bidding on the same government contracts. Although one conspirator left our client's employ, he was fed information by the other two who remained as moles. Not only were the scientific secrets being disclosed, but bidding information allowing the competitor to slightly undercut their pricing on closed bids. This successful prosecution would have been nearly impossible if our client had to notify the culprits in advance of the investigation.

Conversations with witnesses are considered to be interviews and our report to be an investigative consumer report. The employer must advise the accused of the nature and scope of the investigation, and before taking any adverse action against an employee, a complete unedited copy of the report must be provided to the employee no matter how felonious their behavior. Since the advent of the 1996 amendments, many of our labor lawyer clients have advised their clients not to risk investigations, even in the face of significant losses or danger to coworkers. The reason is the attorneys do not wish to provide subjects with a copy of the investigative consumer report.

We strongly support Representative Sessions's H.R. 1543. This bipartisan measure would make clear the investigations of employee misconduct are exempt from the disclosure and authorization requirements, while still providing protections for consumers and employees. H.R. 1543 does not change the permission requirement for access to credit reports. It also would require that after taking adverse action against an employee, an employer must provide a summary containing the nature and substance of the communication upon which the action is based.

At the FTC, former Chairman Pitofsky recommended Congress consider a legislative change to remedy the unintended consequences of the 1996 amendments. Last month, Howard Beales made the same recommendation to this committee. We hope action will finally be taken.

Thank you for your attention.

[The prepared statement of Eddy McClain can be found on page 63 in the appendix.]

Chairman BACHUS. I thank the gentleman.

My first question, Ms. Plummer. Prior to the FTC letter, was there any indication that Congress intended the Fair Credit Reporting Act to apply to workplace discrimination or harassment investigations?

Ms. PLUMMER. There is no indication whatsoever, either in the intent or purposes section of the statute or within the contents of the statute.

Chairman BACHUS. Thank you.

Mr. Reynolds, you testified that the Vail letter makes it virtually impossible to use third party investigators, particularly since failure to comply with FCRA can result in unlimited liability, including punitive damages. And yet in many cases, employers lack the resources, skills and fairness to do those investigations in-house. What do these employers end up doing?

Mr. REYNOLDS. Mr. Chairman, those employers are caught between a rock and a hard place in fulfilling the mandates of the regulatory schemes that I mentioned earlier and Supreme Court precedent. Often they make the choice, a tough choice, but the choice to protect their employees and to do the investigation nonetheless in a way that allows for the safety and integrity of the workplace. Employers should not be put to that choice by the Vail letter.

Chairman BACHUS. Thank you.

In your opening statement you mentioned Sarbanes-Oxley and some of the requirements of that Act. If a company finds itself in a potential Enron-WorldCom-type situation and decides that it needs to investigate some top management for financial impropriety, does the Vail letter pose a problem?

Mr. REYNOLDS. The Vail letter poses a significant problem. Under Sarbanes-Oxley, often corporate boards and management will reach out, and are in fact encouraged to reach out to third party objective investigators. Under the Vail letter, once that investigation begins, even before the investigation begins, consent has to be obtained from the subject or object of that investigation. As Mr. McClain has testified, that has the effect of completely negating the ability to gain a fair and complete picture of the facts, which is precisely what Sarbanes-Oxley went to.

Chairman BACHUS. Thank you.

Mr. Morgan, suppose you want to investigate the head manager of a fitness center, how does FTC's Vail letter make it more difficult?

Mr. MORGAN. I would have to inform them and get consent prior to that occurring. In a lot of cases, there are things going on that you don't wish them to know about or you don't wish them to know because they could cover their tracks. If someone was stealing money from the facility or if that particular manager was sexually harassing one of my employees, I would certainly want an investigation done in a way that I could get all the information before I made a fair and balanced decision.

Chairman BACHUS. Okay, thank you.

Mr. McClain, if a third party investigator uncovers significant evidence of employee wrongdoing, such as racial or sexual harassment, what stops the wrongdoer from disputing every item, particularly the testimony of the victims?

Mr. MCCLAIN. Nothing would stop him, Mr. Chairman. One of the major problems that I have with on the sexual harassment issue is when we get an assignment like that from a client, the first thing that we do is we ask our client to get permission from not only the accused, but also the accuser. The reason is we want to establish the credibility of the accuser and oftentimes, not as often as the other way, but sometimes people do conspire to give false information.

So talk about a chilling effect, when someone, take a fairly new employee who is in the probationary basis trying hard to hang onto their job and is being hit on by a supervisor, so they reluctantly go to management, to HR, because they have heard that they should report this kind of activity. So they reluctantly go forth and report this, and then management has to turn around and ask their permission to investigate them. Of course, any other witnesses that would come forth, we investigate them, too, because we need to know who all the players are and try to determine what their interests are to be impartial and fair.

So it just doesn't work. As I said before, what do we do when someone refuses to give permission to be investigated? The employer is within his rights to terminate him for failure to cooperate with an investigation, but that in itself could be unfair. Maybe the person does not want to agree just on general principles. So it creates many unintended consequences, I believe.

Chairman BACHUS. In fact, I think two or three of the panelists mentioned the EEOC, which actually asks us to protect the identity or protect the witnesses. But under this FTC letter, actually, you cannot protect their identities. In fact, you go to the wrongdoer and give him this information which could actually expose them to danger.

Mr. MCCLAIN. Some people think it is a hit list.

Chairman BACHUS. Okay, a very good point.

Mr. Maltby, you testified about the bill introduced by Representative Sessions and other members as a step in the right direction, I believe, but not a complete solution. What additional changes would you recommend, particularly since employers can avoid any FCRA requirements simply be conducting investigations in-house?

Mr. MALTBY. Mr. Chairman, if I could give you a complete and thorough set of standards for how to get the guilty without violating the rights of the innocent, I would be a much smarter man than I am. I can mention two or three critical points. One is we need to have protection against pretext investigations. They are not common, but they do occur. It is not clear that Congressman Sessions's bill addresses that issue.

We need to have people be able to see the results of the investigation, possibly with certain information redacted, at whatever time is appropriate. You obviously cannot show someone, especially if they are guilty, the results of the investigation in mid-stream, but at some point the investigation is over. There is nothing left to compromise and the employee, guilty or innocent, ought to be

able to see the report, again possibly with certain information redacted.

There are provisions, I believe, in the Fair Credit Reporting Act, not terribly strong, to be sure, but I believe they exist, that set some sort of minimal standards for the fairness of the process and the accuracy of information. Those would be lost if we took employee investigations completely out from under the jurisdiction of the FCRA. I do not think anyone wants to do that.

I would be happy to submit additional suggestions to the Chair in a very short time, if I might have permission to do that.

Chairman BACHUS. Thank you, and we would welcome that.

At this time, the gentleman from North Carolina, Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman.

I would welcome a copy of Mr. Maltby's follow-up also. Mr. Maltby, you seem to be a little outnumbered on this panel.

Mr. MALTBY. I am not, Congressman.

Mr. WATT. Not necessarily. I am trying to find common ground here, rather than trying to score points about who is right and who is wrong, because there is some right, as you acknowledged, on both sides of this issue.

So that I can explore that common ground, let me talk to Mr. Reynolds and Mr. Morgan for a little bit here, about their reactions to the things that Mr. Maltby has proposed. He, as I was jotting down what he said, agrees that the prior consent requirement of Vail is probably not a good thing. I think most people would probably agree with that. I take it you all agree with that.

Mr. REYNOLDS. Yes, Congressman.

Mr. WATT. Check one for common ground there.

On pretext investigations, he thinks there ought to be some explicit protection that says you cannot use criminal or other background information as a pretext to try to eliminate somebody. What do you think about that?

Mr. REYNOLDS. Congressman, there are already provisions in existing law to cover that.

Mr. WATT. What law?

Mr. REYNOLDS. For example, under Title VII, if an employer were to use a criminal background check as a pretext where the real purpose, for example, was to discriminate, that would clearly violate Title VII.

Mr. WATT. So what you are saying is we just need to reconcile EEOC Title VII and the Fair Credit Reporting. Is that an explicit provision or is that case law?

Mr. REYNOLDS. That is case law, and it is commonly held case law that has been in place since the 1970s.

Mr. WATT. And you agree with that, so if we could figure out some way to get those things consistent, you would be happy with that?

Mr. REYNOLDS. Congressman, I believe they are already consistent. Title VII is in existence. The case law is quite explicit.

Mr. WATT. Okay, but if we made it explicit under Fair Credit Reporting that you cannot do pretext, would that be something you and Mr. Morgan would object to?

Mr. REYNOLDS. At least from my standpoint, Congressman, I believe the pretext issue is covered completely by both Title VII and

the courts and I do not see a need to add to the provisions of FCRA in order to address that issue.

Mr. WATT. Okay, well, I think you are missing my point. You have one law that doesn't say anything about it, and another law that says something explicit about it, at least in case law, and you all are testifying that there is a conflict here. Couldn't we reconcile that by simply making it explicit? That is the question I am asking. I am looking for common ground here. Am I missing something here?

Ms. Plummer, would I be chasing the wrong dog if I tried to just make explicit what Mr. Reynolds says is already over there somewhere in another area, but if we just put it in Fair Credit Reporting, would that be okay with you?

Ms. PLUMMER. No, it would not be okay.

Mr. WATT. Okay, then why wouldn't it be okay?

Ms. PLUMMER. The effect of doing that would be to muddy the waters because Title VII and the case law that follows it do completely cover the issue of pretext based on protected class status. If you then add that to the FCRA, you are simply adding yet another burden, yet another interpretation that has to be made of that law.

Mr. WATT. But Mr. Reynolds just told me that I am not adding anything because FCRA is already subject to Title VII. So why would I care about making that explicit?

Ms. PLUMMER. You would not be adding anything to the rights of the employees or to the citizens, but you would be adding yet another layer of judicial interpretation of the statute that employers would have to combat. As we can see here, the language in the existing statute has brought us all here today. So my concern if we attempt or Congress attempts to clarify pretext in the FCRA, it will lead to confusion.

Mr. WATT. Mr. Maltby, what do you say to this? I am trying to be an honest broker here and walk down the middle.

Mr. MALTBY. Congressman, I would not say you are chasing the wrong dog, but I would say you are missing a lot of the pack.

Mr. WATT. Okay. Go ahead.

Mr. MALTBY. I actually think Mr. Reynolds is correct.

Mr. WATT. All right.

Mr. MALTBY. If the investigation is a pretext for getting the black employee out of the workplace because of some sort of racial bias, I think he may be right; that that is already adequately addressed by Title VII. But that is one of 100 possible reasons for pretext.

What if the real reason for launching the investigation is because the person is organizing a union, or they are a woman who does not like the way women are being treated in the company and they are starting to make some noise about it, or because you just don't like the guy, or because he is gay in a jurisdiction where that is not protected by law? There are 100 reasons to launch a pretext investigation. One of them may be covered, but the other 99 are not protected.

Mr. WATT. What about this copy of the report in some redacted form at some appropriate time? Mr. Reynolds, do you think if somebody is investigating me and I am found to not have any problem; I am investigated and you have found nothing. Do you think it is

okay if I get the report at some point, that maybe then I can take it to another employer and say, look, this one turned me down after they found that I was not guilty; maybe you will consider me positively.

Mr. REYNOLDS. Congressman, let me at the outset just caution the use of the words "innocence" and "guilt." In the context of workplace investigations, the employer is not the government. They do not make findings of whether someone has violated a statute. This is important for this reason. What Mr. Maltby may suggest in his comments, the provision of the report et cetera, those are certainly potentially due process protections, but they are due process protections that are better suited to the context of governmental action in a criminal prosecution.

In this context, you have an employer whose obligation is to make the best possible judgment based on the best possible investigation they can do. They are not held to the standards of reasonable doubt, nor should a question of innocence or guilt be at issue. The real question is whether or not the employer can do an effective investigation to determine whether or not the company's policies have been violated, and sometimes those policies are broader and more expansive at the employer's option than law.

So under those circumstances, to get to your question, Congressman, my answer would be that there are many circumstances where it would not be appropriate to mandate that the employer provide a copy of the report. One quick example, there are many instances in which the investigation is about a current employee's actions vis-a-vis another current employee. It is the employer's obligation to make sure that the complaining employee is not retaliated against. We would not want to be in a position of creating the atmosphere, the conditions for retaliation.

Mr. WATT. I think that is what Mr. Maltby was trying to redact, I assume. I do not think we would have any problem with that.

Okay, I think what you all have succeeded in doing is showing us how difficult this area is. Mr. McClain is going to clarify it for us.

Mr. MCCLAIN. Thank you, Mr. Watt. I would just like to comment on some of these issues.

With regard to providing a copy of the report, Section 609 of the FCRA does provide for discovery. So even if Representative Sessions's bill were enacted, anybody that wanted to dispute their termination still has the ability to get a complete copy of that report usually under a confidentiality agreement supervised by the court. That is the way they do it, so they can get a copy.

Mr. WATT. I have to be in litigation before I can get a copy of it?

Mr. MCCLAIN. Well, there are reasons for that. The court can protect the witnesses, for instance. If there is some indication that the names of those witnesses should not be just handed over, so then they use the attorneys for insulation. The other thing, regarding Mr. Maltby's statement, talk about unfairness, some employers, and I do not have any hard and proof evidence of this, but I do believe that sometimes because employers are unable to do a thorough investigation without telling everyone, because of the Fair Credit Reporting Act, I think they sometimes think that the easier

way, and it is certainly cheaper than hiring me, the easier way is to just get rid of the suspect; find another reason to get rid of him. Now, that is unfairness and that is an indirect result of a law that is supposed to be protecting these same employees.

Mr. WATT. I think Mr. Morgan wants to say something. I have run out of time myself, but maybe the Chair will let you respond.

Mr. MORGAN. Congressman, in a lot of workplaces, the reality is that there are sometimes small groups of employees. My stores, which would not be untypical, usually employ 50 employees. With a 50-employee work group, even providing a redacted document, it will be obvious who did this and that would create additional workplace problems that I would really be concerned with.

Also, regarding Mr. Maltby's comments, if someone was organizing, I cannot fire someone as a pretext under the National Labor Relations Act. And also, if there were a history of discrimination that was going on, I would be subject to a patterns and practice suit under EEOC for that. So there really are a lot of protections out there already.

Chairman BACHUS. At this time, I am going to ask Mr. Tiberi to take the chair, and I am going to recognize Mr. Crowley, the gentleman from New York, for questions.

Mr. CROWLEY. I thank the Chairman.

My staff is telling me the second round of panelists is going to have more difficult issues, and it is interesting to hear about the Vail letter and the FTC, that this seems to be an issue that needs to be worked on a great deal more. So I appreciate the testimony of all of you here today.

I thank Mr. Watt for his line of questioning as well. I think it amply demonstrated that there is a need to really clarify what the intent is.

I just want to move to another area, and that is concerning the seven criteria. Mr. McClain, if I can direct the question to you, and then if the other members of the panel could respond in some way, I would appreciate it. The consumer credit report certainly includes information about a consumer's credit worthiness, credit standing, and credit capacity, and then four other categories: character, general reputation, personal characteristics, and mode of living.

I understand that for the most part, the financial services industry generally looks at the issue of credit worthiness, credit standing and credit capacity for granting or denial of credit. The terms "character, general reputation, personal characteristics and mode of living" are used more in investigatory reports that are governed by the FCRA.

As these four criteria are not defined at all under 15 U.S. Code, I was wondering if you would both define these terms as you believe they are used, as well as let the committee know if these are important criteria. And if so, should they be defined in statute to prevent such a broad swath of information from being used in investigatory and/or credit reports under FCRA?

Mr. MCCLAIN. I think further definition would always be helpful. I am not sure to what extent you can do that. The FTC has taken the position, and I don't think wrongfully, that pretty much in any report it is very difficult to have a report that does not encompass one or more of those definitions.

So I do not know if a further definition might help, but I think the big issue is whether or not these types of reports should be consumer reports. I believe rather than trying to define all of these things further, if we just made it clear in the law that these types of investigative reports are not covered by the FCRA, I think that would be appropriate.

Many of the investigations that we do, we do not necessarily run credit reports. Credit reports contain information that would be very helpful on embezzlement investigations, particularly when you are looking for someone who is living beyond their means. It is a flag that indicates you might be on the right track. But in every instance, the Sessions bill would not change that. You would still have to have the consumer's written permission before you could run a credit report. So we would be able to do other types of investigations, but we would not be able to run credit reports. I hope I was responsive to your question.

Mr. CROWLEY. Would you be in favor of the status quo, then, leaving the seven criteria and those four particularly that I mentioned at the end, intact?

Mr. MCCLAIN. We have learned to live with and understand what they mean, provided that this general category of misconduct investigation is excluded, and it clearly indicates that it is not a consumer report, then those definitions would not affect misconduct investigations, but they would still affect all of the other investigations.

I do not have any problem with preemployment. We have learned to live with that. I think most of the employers have learned to get applicants's permission before they investigate them. That is not a problem. It is when you have an existing employee who is malfeasant in some respect that you have to investigate. Therein lies the problem.

Mr. CROWLEY. In all four of these, character, general reputation, personal characteristics, mode of living, are these all opinions that you derive from information that is given to you? For instance, personal characteristics and general reputation, how would you define that?

Mr. MCCLAIN. Well, the FTC can say that just about anything we do, I mean, if I go down and check Superior Court records on someone and they say that that record check is going to possibly indicate the mode of living or the characteristics, so I do not know how else to get around that.

Mr. TIBERI. [Presiding.] The gentleman's time has expired.

The gentlelady from New York is recognized for five minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman, and thank you to all the members of the panel for the information that will help us embarking on this comprehensive reauthorization of the legislation that is before us.

Mr. Maltby, employers obviously collect an abundance of data regarding their employees. Some of the data, such as salary, is furnished to credit reporting agencies and plays an integral part in the credit-granting process. Outside of salary and tenure data, what sort of data to employers do employers systematically collect on their employees?

Mr. MALTBY. It obviously varies a great deal from employer to employer. But if I think back to the days when I was a corporate general counsel and had responsibility for the HR function, I cannot think of a great deal that I could not find out about one of our employees if I were to take a very careful look through the personnel file. There is almost nothing that I could imagine that would not be in there.

Ms. VELAZQUEZ. How do employers use this information? Do they furnish this data to credit reporting agencies?

Mr. MALTBY. Ma'am, I really do not know that for sure. My assumption would be that if the employee had applied for the loan and the employer knew the employee had applied for the loan, the employer would provide any information that appeared to be relevant, but that is strictly an impression on my part. I really do not have any hard data to back that up.

Ms. VELAZQUEZ. Mr. Morgan, given your HR experience, could you please comment on this as well?

Mr. MORGAN. Yes. We would only give out information to an agency if I had written permission from the employee to do that. Under normal circumstances, I am not gathering data up and giving it out to anyone. As a matter of fact, I see it as one of my great responsibilities to the employees to not do that.

So generally speaking, I would only give out any information as long as I had a release from the employee. That also would go for reference checks. The reality of life today is that reference checks do not exist because no employers are giving out any information.

Ms. VELAZQUEZ. Thank you.

I would like to ask this question of Ms. Plummer and Mr. Maltby. I understand the restrictions that the Vail letter imposes on employers. Employers must provide an employee with notice that they are being investigated, and also must secure their consent before an investigator can begin their investigation.

I also understand that these restrictions can prevent outside consultants from conducting an effective investigation. What risks to the employee do external private investigators pose to employees? In your experience, is there a need for enhanced protections when a third party conducts these employee investigations?

Mr. MALTBY. Ma'am, I would not go so far as to say that there are no concerns for having an outside third party investigator, but in general it is probably better off if there is a third party investigator. There are just too many possibilities for bias or intimidation in an internal investigation, particularly if the person being accused is fairly far up the corporate food chain.

Again, I would not want to make that as a blanket recommendation, but my blood does not run cold when I hear that a firm has brought in an outside investigator, assuming they are a competent professional firm. It might be better to bring in someone from the outside who does not have all the potential for bias that an inside party might have.

Ms. VELAZQUEZ. Ms. Plummer?

Ms. PLUMMER. There are no enhanced concerns for the employee when a third party is brought in to investigate. In fact, it improves, as Mr. Maltby just expressed, the possibility of an impartial and fair investigation. In fact, it is to the employee's benefit to have

somebody from outside the company come in to investigate for just that purpose.

Ms. VELAZQUEZ. Thank you.

Thank you, Mr. Chairman.

Mr. TIBERI. Thank you.

I would like to thank the panelists from our first panel for testifying today, and ask the second panel to be seated for their testimony. Thank you very much.

Thank you all for coming today. I will introduce the second panel, starting from my left, working to my right: Mr. Chris Petersen, attorney with Morris, Manning and Martin, LLP, on behalf of the Health Insurance Association of America; Mrs. Roberta Meyer, Senior Counsel, American Council of Life Insurers; Mr. Marc Rotenberg, Executive Director, Electronic Piracy Information Center; Ms. Joy Pritts, Assistant Research Professor, Health Policy Institute, Georgetown University; and last but not least, Mr. Edward L. Yingling, Executive Vice President, American Bankers Association.

Thank you all for being here today. I would like to remind all of you that you have 5 minutes to give us your testimony, and it will be followed by questions from those who remain here today. I would like to start with Mr. Petersen. Thank you for being here.

STATEMENT OF L. CHRIS PETERSEN, ATTORNEY, MORRIS, MANNING & MARTIN, LLP, ON BEHALF OF THE HEALTH INSURANCE ASSOCIATION OF AMERICA

Mr. PETERSEN. Thank you very much, Mr. Chairman, members of the subcommittee.

My name is Chris Petersen. I am a partner with the law firm of Morris, Manning and Martin. Today I am testifying on behalf of the Health Insurance Association of America. The HIAA is the nation's most prominent trade association representing the private health insurance system. Its nearly 300 members provide the full array of health insurance products, including medical expense, long-term care, dental, disability and supplemental coverage to over 100 million Americans.

My written statement focuses on the continuum of federal and state privacy laws and the interplay among those various laws. In my oral testimony, I will examine these additional privacy laws, in conjunction with the Fair Credit Reporting Act, limiting health insurers' ability to disclose information. As the committee is aware, important provisions of the FCRA are up for reauthorization. The HIAA supports the reauthorization of the Fair Credit Reporting Act.

The HIPAA privacy rule is the first of these many privacy laws that health insurers must comply with. The rule provides that those insurers that meet the definition of a health plan may not use or disclose protected health information except as permitted or required by the privacy rule. In addition, the privacy rule provides for six instances under which a health plan is permitted to use or disclose information. Most relevant for today's discussion are the permitted uses and disclosures for treatment, payment and health care operations, and those uses and disclosures made pursuant to an authorization.

Health care operations encompass uses and disclosures necessary to administer a health plan's business and provide benefits to covered individuals. Many of the health plan's routine uses would fall under this provision. However, disclosing to a financial institution for that institution's operations would not fall under the health care operations exception. As a result, the HIPAA privacy rule would not allow a health plan to disclose health information to another financial institution without that individual's signed authorization for purposes of that financial institution to make credit decisions regarding the individual that is the subject of the information.

The HIPAA privacy rule also provides the privacy standards requirements under the rule. State laws are preempted if they are contrary to the HIPAA privacy rule. Therefore, we have to also look at state privacy laws to determine how they interact and regulate the ability of a health insurer to disclose financial information or health information.

In 1999, Congress enacted the Gramm-Leach-Bliley Act establishing a statutory framework for all financial institutions to use in disclosing information. The National Association of Insurance Commissioners adopted a model law regulating Gramm-Leach-Bliley disclosures by health insurers at the State level to provide guidance for State insurance departments in regulating this important area.

That model regulation governs financial disclosures, but the State insurance departments went further than the federal law as they also regulate disclosures regarding health insurance information. Insurance entities may not rely on the opt-out rule of the Gramm-Leach-Bliley Act to disclose nonpublic personal health information. Instead, insurance entities must either have the individual's written authorization to disclose the information, or the disclosure must be allowed under the regulation's permitted exceptions.

Generally, the regulation allows an insurance entity to disclose information in order to service a transaction that a consumer requests, or to conduct insurance functions, or to make disclosures that are in the public good. This regulation was drafted with industry, regulatory and consumer input, and I believe those exceptions, once again, would not allow an insurance entity to disclose health information to another financial institution for the purpose of that financial institution making credit decisions.

In 1982, the NAIC adopted a comprehensive privacy model. This also regulates insurance institutions and requires that an insurer must have an authorization in order to disclose financial or medical information or personal characteristics information, as we discussed earlier. Once again, you can disclose for insurance functions, but you cannot disclose for purposes to another institution for that institution's credit-making decisions without an authorization.

Finally, there are a whole array of State privacy laws that govern sensitive health information, for lack of a better term. These laws are additional protections for specific types of information. As you look at the HIPAA privacy rule, insurers have to once again make a decision: Do these laws provide greater privacy protections,

and limit the scope and uses and disclosures of health information? If so, health plans must comply with these laws as well.

In conclusion, a whole array of laws would prevent health plans and health insurers from disclosing medical information for credit purposes.

Thank you.

[The prepared statement of L. Chris Petersen can be found on page 96 in the appendix.]

Mr. TIBERI. Thank you.

Ms. Meyer?

STATEMENT OF ROBERTA MEYER, SENIOR COUNSEL, AMERICAN COUNCIL OF LIFE INSURERS

Mrs. MEYER. Thank you, Mr. Chairman, and members of the subcommittee. I am very pleased to be here to testify before you today on behalf of the American Council of Life Insurers, the principal trade association for life insurance companies. Our members sell life insurance, disability income insurance, long-term care insurance, and also provide annuities.

Life insurers have a very long history of trading highly sensitive information, including our policyholders's medical information, in a highly professional and appropriate manner. Life insurers collect and use this information in order to serve their existing customers. At the same time, life insurers support very strict protections relating to the confidentiality of the medical records. Accordingly, we strongly support prohibiting the sharing of medical information in connection with the extension of credit.

Today, I am going to very briefly explain why life insurers collect medical information and why it is so important to the life insurance process. I will very briefly provide an overview of ACLI's policy on medical records confidentiality, and then again touch on the key elements of the numerous federal and state privacy laws that do in fact provide very comprehensive protection to life insurers's policyholder medical records. In today's world, life insurance protection is more important than ever. In order to continue to make insurance products and services widely available at the lowest possible cost, life insurers must have access to medical information. The risk classification process, which is based in large part on medical information, provides the fundamental framework for the current private system of insurance. In fact, it is largely this process which has made it possible for insurers to make their products widely available to American consumers today.

ACLI's privacy policy, as I said before, provides for very, very strict limits on insurers's ability to both obtain and disclose consumer medical information. The principles also support a prohibition on the sharing of policyholders's medical information with a financial institution for purposes of determining eligibility for credit, even if in fact that financial institution is an affiliate of the insurer.

I would now like to speak very quickly to the various federal and State laws. Mr. Petersen has spoken to some of them already, so I will just touch very briefly on the key elements of those provisions. First, under the Fair Credit Reporting Act, medical information may be a consumer report because it does in fact bear on the

consumer's personal characteristics and is used as a factor in determining an individual's eligibility for insurance. However, medical information is afforded special status under the FCRA.

Medical information can be disclosed by a consumer reporting agency to an insurer only in connection with an insurance transaction and only with the consumer's consent. Insurers believe that the FCRA is critical to their business. It in fact facilitates widespread availability and affordability of insurance today.

ACLI member companies also strongly support the privacy provisions of the Gramm-Leach-Bliley Act. As Mr. Petersen has already indicated, medical information under that Act is treated as nonpublic personal information, and may only be disclosed by a financial institution provided the individual is given notice of the sharing and given the opportunity to opt out of the sharing.

The only circumstances under which notice and opt-out do not need to be provided is when the information is shared for operational insurance business functional purposes or in connection with joint marketing agreement. In fact, state privacy laws generally go further than this and require insurers to obtain an opt-in for the sharing of medical information.

In fact, when the National Association of Insurance Commissioners and the States were first developing and then adopting the State laws to enforce and implement the Gramm-Leach-Bliley Act, the ACLI member companies strongly expressed the view that medical information should be afforded increased protection, given its highly sensitive nature.

Both with the NAIC and throughout the country, as the States have considered adoption of the NAIC model, Gramm-Leach-Bliley confidentiality regulation, the ACLI has firmly expressed its support for the privacy provisions, medical records provisions of that regulation, which provide that in fact before a policyholder's medical information may be disclosed, there has to be obtained by the insurer the authorization or the opt-in of the individual.

Similarly, the old NAIC model privacy act, as it is called, which was enacted before Gramm-Leach-Bliley, would require the opt-in of an individual before his or her medical information could be shared with a non-affiliated third party, unless in fact the information was again being shared for operational insurance business functions.

Mr. TIBERI. If you could wrap up, Ms. Meyer.

Mrs. MEYER. I can. Thank you very much.

The HIPAA rule, similarly, even though the HIPAA rule does not directly impact on life and disability income insurers, it would in fact require that a health care provider obtain the consent of the individual before an individual's medical records may be disclosed to a life or disability income insurer.

Finally, Mr. Chairman, we appreciate the opportunity to testify today. We strongly support strict medical records privacy protections, and would strongly support a prohibition on the sharing of medical information for purposes of determination of eligibility for credit.

Thank you.

[The prepared statement of Roberta B. Meyer can be found on page 72 in the appendix.]

Mr. TIBERI. Thank you.
Mr. Rotenberg?

STATEMENT OF MARC ROTENBERG, EXECUTIVE DIRECTOR, ELECTRONIC PRIVACY INFORMATION CENTER

Mr. ROTENBERG. Thank you very much, Mr. Chairman, members of the committee.

My name is Mark Rotenberg. I am Executive Director of the Electronic Privacy Information Center. I have taught information privacy law for many years at Georgetown. I also chair the American Bar Association's Committee on Privacy and Information Security, although I am testifying today on behalf of myself and not on behalf of the ABA. Also with me this morning are Chris Hoofnagle, Deputy Counsel at EPIC, and Anna Slomovic, our Senior Fellow.

I am very grateful to you and the members of the committee for looking at the issue of medical record privacy. This is clearly one of the top privacy concerns for consumers in the United States. I think the particular challenge that you face this morning is trying to understand the relationship between three different regulatory regimes, and whether or not they adequately safeguard the privacy of medical records, particularly when they may be made available to employers.

Now, the HIPAA privacy rules, which have been discussed earlier, do a good job of providing privacy protection for covered entities, which are typically the health care plans. But the HHS understood that HIPAA could not be generally extended to employers, and that protection for that type of use of personal information would have to be found elsewhere.

The Fair Credit Reporting Act, while it recognizes certain protections for medical information, does not in fact go as far as the HIPAA rules, which set out a separate category of protected health information. The Gramm-Leach-Bliley rules do not speak directly to the protection of medical record information. Other means were needed to try to safeguard the protection of medical information after passage of Gramm-Leach-Bliley.

Where does that leave us today? I would like you to consider the following scenario. Imagine a prospective employee who is seeking a job and the employer asks this person to provide consent for access to the credit report, which is done increasingly today, both through standard employment practices and also through obligations imposed by federal statute. The employee, believing she has a fine credit report and that there is nothing there that would produce an adverse determination, signs the consent.

Now, it turns out that the credit report may in fact provide information from which the employer could infer medical care or medical services that she has received because, for example, she has obtained credit from a neonatal clinic for fertility drugs, an expensive procedure and something where people might quite likely obtain credit and establish what would be considered on the credit report a trade line. From this, the employer may be able to infer some information about her intent to have children.

As a general matter in employment law, it would be improper to use that information in the employment determination, but it is an example of how information could be made available through a

credit report to an employer that the HIPAA rule would otherwise try to protect, but could not protect in this instance because the employer is not in fact a covered entity under the HIPAA rules.

Now, I think there are legislative approaches to try to solve this problem. But I want to suggest to you more generally, particularly in the context of the Fair Credit Reporting Act and the many issues that you are considering in this session, that it is particularly important to understand the role that the States play in safeguarding the right of privacy. I think we have been a little bit too quick over the last few years to look for national uniform solutions that effectively restrict the ability of State regulators to safeguard the interests of consumers when these types of issues arise.

Returning again, for example, to the example of medical privacy under Gramm-Leach-Bliley, this was a problem that was dealt with by the National Association of Insurance Commissioners. It was in fact the NAIC model guidelines promulgated after Gramm-Leach-Bliley that provided a framework for good state regulations intended to safeguard the privacy of medical information that GLB did not otherwise cover.

But more generally, if you look at the development of privacy law in the United States over the last 30 years, invariably what you see is that Congress passes a baseline standard to provide a basic level of protection to protect privacy interests for consumers across the country, and allows the States to regulate upwards, to provide more protection when they identify new problems that perhaps Washington cannot get to as quickly.

Sometimes the State efforts succeed, in which case they will be followed by other States. Sometimes the State efforts fail, in which case they will be disregarded. I think this is precisely what is meant by the concept of the States being the laboratories of democracy.

So I would urge you today as you consider medical privacy issues in the context of financial services, and more broadly the importance of the Fair Credit Reporting Act, that you safeguard the ability of the States to protect the interests of consumers. I think it would be a mistake to allow the preemption loophole to be extended beyond this Congress.

Thank you very much.

[The prepared statement of Marc Rotenberg can be found on page 146 in the appendix.]

Mr. TIBERI. Thank you, sir.

Ms. Pritts?

STATEMENT OF JOY PRITTS, ASSISTANT RESEARCH PROFESSOR, HEALTH POLICY INSTITUTE, GEORGETOWN UNIVERSITY

Ms. PRITTS. Good morning, Mr. Chairman and members of the Subcommittee on Financial Institutions. I would like to thank you for this opportunity to testify today on medical information and how it is protected in the financial services area.

I would like to incorporate everything that Mr. Rotenberg just said into my testimony, because I think he said it so well. But I would also like to emphasize that this is an area that consumers are very concerned about. They do not want their medical informa-

tion shared in the financial service area without their advance permission.

In particular, there is a Gallup survey which was done in the year 2000 which showed that fully 95 percent of Americans said they did not want their banks to have access to medical record information without their advance permission. This is a consistent trend, too. It is not something that has just happened. It is consistent. It is persistent. People are concerned.

There is no question that those in the financial service industry collect and use medical information for legitimate uses in a variety of different contexts. From the written testimony that was submitted, many of those in the financial services industry say that they believe, and as we have heard earlier from Ms. Meyer, that they believe that it is improper to use in particular health information for credit purposes.

These are important policies that the financial services trade associations have in place and many do subscribe to them, but policies are not enough. The consumer cannot enforce the policy. You cannot take it to court. More important, I think, is also the fact that policies can change. Fifteen years ago, you would have never seen an insurer using a credit score for underwriting purposes. There are many instances in which health information can lead people to financial distress, so what is to prevent in the future from people using health information for credit purposes? What we really need are adequate legal protections. The time to put them into place is now, before the sharing of this type of information is used consistently as a business practice for determining credit purposes and for other purposes that medical information really was not intended.

One of the things that we really saw when the HIPAA privacy regulations were being drafted was a very persistent problem that people had been using health information for a long time in manners that health care consumers really did not understand and know about. Yet because it had become an established business practice, it was in many ways difficult to control it. The horse was out of the barn and there was no getting it back.

The problem I see is that the laws that we have today are inadequate. There are a lot of them, but there still are a number of loopholes. For one thing, they do not cover everyone who holds and uses health information in a commercial-type context. They set different standards and they are often inadequate for using and sharing health information. And where they overlap, there is confusion as to which law prevails. It is that last point, which I think is fairly confusing to a lot of people, but which I also find to be fairly disturbing.

I think that the FCRA and GLBA, the Gramm-Leach-Bliley Act, are particularly problematic from a health consumer's point of view. They govern the sharing of financial information which can, by implication, and often does include medical information in the financial services industry.

The Gramm-Leach-Bliley Act allows the sharing of financial information, including medical information, among affiliates without the permission of the consumer. It does provide for notice, but as

anybody who has received the scores of privacy notices from financial institutions knows, those notices are often incomprehensible.

This type of sharing of health information is precisely the activity that consumers have repeatedly and strongly said they do not want. They do not want insurers and banks looking at it and then asking them after the fact whether this is something that they really would permit.

The states have stepped up to the plate. They have filled a lot of these gaps, particularly in the health insurance area. They have been very, very much advanced as to protections that they offer. But the concern is that these laws are subject to attack.

In particular, the problem here lies, and this is a very kind of wonky discussion I am going to launch into, but the problem lies with the fact that GLBA has essentially two preemption provisions. It allows states to have stronger laws, but then it also incorporates all the provisions of the Fair Credit Reporting Act. The Fair Credit Reporting Act has a provision that prohibits states from enacting laws with respect to the exchange of information sharing among affiliates.

There have been a number of articles in some trade association magazines and law reviews that say what this effectively does is prevent States from requiring, for instance, an opt-in for the sharing of affiliate information. We think that this really needs to be clarified and the time to clarify it is now. There is no need to wait for a court to make that sort of decision.

In summation, I would say that health care consumers prefer and demand that they have an opt-in for sharing of medical information, including information among affiliates; that the Fair Credit Reporting Act preemption provision should be allowed to expire, it is merely causing confusion; and that the Congress needs to clarify when you have these three different statutes, HIPAA, Gramm-Leach-Bliley and the Fair Credit Reporting Act, where they overlap, and there is some confusion as to which one is going to prevail, because that is not in the Congressional Record whatsoever.

Thank you.

[The prepared statement of Joy Pitts can be found on page 113 in the appendix.]

Mr. TIBERI. Thank you.

Mr. Yingling?

STATEMENT OF EDWARD YINGLING, EXECUTIVE VICE PRESIDENT, AMERICAN BANKERS ASSOCIATION

Mr. YINGLING. Thank you, Mr. Chairman.

The ABA appreciates the subcommittee's holding hearings on the Fair Credit Reporting Act and the issue of protecting consumer information, including medical information. Before I address medical privacy specifically, I would like to briefly outline the philosophy of the banking industry regarding the use of information and the importance of preserving FCRA for our economy.

First, the cornerstone of banking is preserving the trust of our customers. That only can be accomplished by protection and responsible use of information. Not only is protecting privacy the right thing to do, the highly competitive financial market demands

it. No bank can be successful without having a strong reputation for protecting the confidentiality of consumer information.

Second, we do believe preserving a national credit reporting system is critical to the U.S. economy. The strength and resiliency of the U.S. economy is linked to the efficiency of consumer credit markets. U.S. consumers have access to more credit, from more sources, and at lower cost than consumers anywhere else in the world.

What makes this possible is a nationwide, seamless, and reliable system of credit reporting. Such a system would be impossible without the Fair Credit Reporting Act. For consumers, it means they can walk into an auto dealership and drive off with a new car within an hour. They can move across the country and open a banking account without hassle. They can quickly refinance their mortgage loan from lenders across the country to take advantage of falling interest rates.

As is pointed out in a study cited in my testimony, one of the more remarkable achievements of the FCRA is the increased access to credit for lower-income households. By enabling complete and accurate credit histories, FCRA has helped extend credit to millions of Americans who otherwise might not have been able to get it. Simply put, the U.S. credit system works and is the envy of the world. The reauthorization of FCRA, and in particular the preemption of State laws which assures a national, consistent and complete system, is very important.

Turning to medical information, it is obvious that such information is at the top of the list of personal information that consumers worry about. Three years ago, we convened a select group of bankers to work on privacy issues. Regarding medical privacy, the task force believed it important to reassure the public that, to the extent banks possess medical information on a customer, it will be held sacred.

Concern has been expressed that lenders might use medical information obtained elsewhere in making a credit decision. ABA's position is that such use of medical information in a credit decision, obtained without the knowledge and consent of the borrower, is just plain wrong.

There are, of course, a limited number of instances where medical information is directly relevant, for example in loans to sole proprietorships or small businesses where the franchise value of the firm hinges on one or two key individuals. In such cases, insurance on the key individuals might be required.

In those instances, the prospective borrower will know what information is required and can expressly consent to it being obtained and used. Otherwise, the lender should not need such medical information. Finally, any such information obtained should be kept strictly confidential by the lender.

Mr. Chairman, we appreciate the opportunity to testify today, and I would be happy to answer any questions.

[The prepared statement of Edward L. Yingling can be found on page 162 in the appendix.]

Mr. TIBERI. I don't think I have ever seen that before. You have 1 minute and 20 seconds to spare.

Mr. YINGLING. I am the last guy before lunch.

[LAUGHTER]

Mr. TIBERI. Thank you, Mr. Yingling.

Thank you, panel, for your testimony today.

I am going to defer my 5 minutes for questioning. I am going to call on the gentlelady from New York for 5 minutes.

Mrs. KELLY. Thank you.

We have been talking today about the use of information that is collected with regard to people. I would like to just ask anyone on the panel, who is collecting this? Where do you go to get this information? There was at one time a situation I recall, for instance with medical information, there was only one company that carried it. It was all in one massive computer, so everybody went there to get that information. Where do you go to get this information about people?

Mr. PETERSEN. Health insurers typically get most of their information first, from an application and/or a claim. So that would be the starting base. Some of the insurance industry would use a clearinghouse that you are referring to. A lot of the health insurance industry does not use that clearinghouse because of the cost-benefit analysis.

So for health insurers, it would be primarily the application process. Then they would get an authorization, and they have to get an authorization both under State law and federal law, to collect information from other sources. Those sources would be identified in the authorization. It would be primarily providers, other insurers, and maybe in some limited circumstances this clearinghouse that you are referring to.

Claim information, if it is a claim, that information generally would come first from the claim submitted by the individual, but most generally from the providers themselves.

Mrs. KELLY. In that clearinghouse that you are talking about, where they hold the information, does a consumer have the opportunity to change medical information?

Mr. PETERSEN. Once again, I am speaking from the perspective of health insurers, both under the National Association of Insurance Commissioners's 1982 NAIC Act, people have a right to access and amend their information. The clearinghouse would be one of the covered entities under that Act.

Now, that Act is only in 16 states. It was the first comprehensive privacy attempt at the State level. A lot of very significant population states have it, but it is only 16 states. The HIPAA privacy rule would allow you to get access and amend your information, so you would have access to the information that the health insurer had, and if the health insurer disclosed it, you would have to correct the information down the disclosure chain.

Mrs. KELLY. How complicated is that? How easy is it to find out who has your information?

Mr. PETERSEN. Once again, from the health insurance perspective, you have to make an accounting of disclosures, both under HIPAA and under the 1981 Act. So if you made disclosures to those kinds of entities, you would have to tell them they had it, and if you made a correction, you would have to tell them you made a correction. If you wanted a correction and me, the insurance company, disagreed, you would have to allow that individual to put some-

thing in the record stating that you disagreed with the failure to make the correction.

This is all fairly recent, though, so it is not well-tested as to how well it works, to be quite honest, under the HIPAA rule because April was the effective date, so we do not know how well it works, but they have a process, I think, to address concerns of the past in that area.

Mrs. KELLY. Thank you.

Ms. Pritts, do you want to speak to that?

Ms. PRITTS. Yes. I think that your original inquiry was directed towards the Medical Information Bureau. Is that correct? The Medical Information Bureau is essentially like a credit reporting agency for health information. It is a national bureau that I believe other insurers, other than health insurers, can rely on for obtaining more or less the status of health information for individuals.

MIB reached an agreement with the Federal Trade Commission a number of years ago that its reports would be considered to be consumer reports. So individuals have the right now to obtain a copy of their report from MIB, much as they would a credit report from a credit reporting agency, for a fee of I think it is $8.50 now. They can review that information and they can request that that information be corrected if it is inaccurate. They can try to supplement that record if it is incomplete.

As a matter of practice, people who have actually attempted to use this process have met with mixed degrees of satisfaction with it.

Mrs. KELLY. What I am really driving at is if you are in the process of questioning your medical record that someone else is holding, and a financial institution is also getting some of that information, is that then flagged to the financial institution so that the financial institution knows that there is a question about something on your record? There are some things on people's records that they simply do not want others to know, and yet you must sign, in certain situations, you feel you must sign a disclosure form.

So my question is, if you are in the process of questioning the great computers in the sky that hold all of this information about your credit and your medical records, then how is that transmitted to you as institutions for your use so that you know that these are issues that are at question?

Ms. PRITTS. Under HIPAA, what happens is, as Mr. Petersen was explaining, the individual has the right, first of all, to look at their own health information, and we would urge health consumers to do that so you have an idea before you sign one of those authorization forms what exactly your financial institution would be receiving. If you see something in there that you think is erroneous, under HIPAA you can ask your doctor to correct that information.

Now, there are a number of circumstances under which they do not have to do that. What they do is, the patient can also submit a statement saying, "I still think that this information is wrong." At that point, the health care provider is supposed to forward that, either they correct it or they deny it, and we are going to assume that the patient has supplemented and said, "I still disagree with you." At that point, they are supposed to forward that information on to places like perhaps a financial institution.

If a patient has said, "Look, I am worried; I think this information might be getting into my credit report," they would have to identify them as somebody that this information should be forwarded to.

Mrs. KELLY. I am out of time, but I hope you will give me my own time to further pursue this a bit.

Thank you.

Mr. TIBERI. Mr. Lucas?

Mr. LUCAS OF KENTUCKY. Thank you, Mr. Chairman.

I have found this testimony very enlightening. In my prior life for some 32 years, I was involved in insurance underwriting and also banking, so I am a little conflicted here about some of the things that I hear.

I can see, Mr. Yingling, from the bankers's standpoint, particularly the analysis used of a small business owner, this medical information is very relevant in making a credit decision. I also can appreciate from the fact of people wanting privacy that there is some information that may get out there that they do not want people to know, that is not relevant to the decision.

I guess from a public policy standpoint, I think that we need to reauthorize the preemption. But I would be interested in what kinds of things we could do to tweak this so we could hopefully make everybody reasonably comfortable, because as it is now, we have some problems. So does anybody want to take a shot at that?

Mr. YINGLING. Congressman, I would just say that the only time in the credit-granting process that we believe medical information ought to be used is where two criteria are met. One is that it is relevant; and two, that you get the express consent of the potential borrower.

Now, this is really tight. It is not just a tight criteria. It is not opt-in. It means that for this specific transaction only, you are going to get the permission of the borrower to get specific information, so that the borrower would have the ability to say, for example in Ms. Kelly's question, "You are not going to some third party that has all this information in a computer. You can go to my insurance company and make sure I have an insurance policy. I will show you the insurance policy that protects you in case I die and I am the franchise."

Or in rare instances, where there is a specific health question, you can go to my doctor and get specific information. But it seems to me that you have a real governor here in that the borrower has the ability to say, "Yes, I will give you the information and I will only give you that specific information, and here is where we are going to agree to go get it."

Mr. LUCAS OF KENTUCKY. What if you had a situation of a small business owner and he found out that he was terminally ill. So he thought, "Well, I will go to my bank and get this line of credit set up that will help my wayward son who is not that good a businessman; I will get this set up for him." And you know about the information, you find out about it, but he has withheld it. What do you do in a situation like that, where you know, you have gotten that information, but he has not given you that information? How do you deal with that?

Mr. YINGLING. Well, I think that would depend on how you get it. I do not think the lender has the right to go out and ask for the information without the permission of the borrower. I guess you could conceive of a small town where everybody knows it and so it is common knowledge that there is a health problem or some other problem. I guess from my point of view, it is hard to say the banker could not act on that general knowledge. But the lender should not be in a position of going out and fishing without the permission of the borrower.

Mr. LUCAS OF KENTUCKY. Okay. Any other thoughts?

Mr. ROTENBERG. Well, Congressman, I think you put it very well. It is a public policy issue. Certainly, one of the things that privacy laws try to do is to allow people to participate in the marketplace, to obtain credit, to pursue employment, without being required to disclose a great deal of personal information, because many people would rightly feel that if they were forced to say everything about themselves, they might choose not to go for the loan or they might choose not to try to get the job.

I have always believed the privacy laws are actually good for the economy because they give people the safety and assurance that they can pursue economic opportunity without having to disclose a lot of personal information. Now, I think in the years ahead, this problem is going to become quite a bit more serious. Diagnostics are becoming more precise, more advanced. There has been more commercialization of this information. It is easier for employers to get access to. Our health care system is being radically transformed by new technology.

I think it is very much appropriate for the Congress at this point to draw some lines and to say the information that might be appropriate in the diagnostic setting in the delivery of medical care for an individual is not necessarily information that we should make available to employers, even though they may be interested.

Let us be honest on this point as well. Employers would probably like to know a great deal about their employees. But I think it is very appropriate for Congress in those situations to say, that person is your employee; they are not your patients, and there is only certain information that you are going to learn about that person.

Mr. LUCAS OF KENTUCKY. Okay. Anybody else?

Mrs. MEYER. I might say on behalf of the life insurers that we believe that extension of the FCRA affiliate-sharing provisions is absolutely critical. Just as the FCRA has made it possible for credit to be widely available in the United States, it has also very much facilitated the availability and the affordability of life insurance products across the country.

It is essential, as I stated in my testimony, that insurers be able to obtain and use medical information in order to assess risk, in order to make life insurance products widely available and affordable. At the same time, we recognize and very much appreciate consumers's particular concerns about medical information. For that reason, we do in fact support laws and regulations that would actually impose strict requirements and limits on our ability to in fact obtain and disclose this information. We very much support a prohibition on the sharing of medical information to determine credit.

Mr. LUCAS OF KENTUCKY. Thank you.

Mrs. MEYER. Thank you.

Mr. TIBERI. Thank you. The gentleman's time has expired.

I am going to recognize the gentleman from Ohio for 5 minutes.

Mr. LATOURETTE. Thank you, Mr. Chairman.

Mr. Petersen, I apologize. I was not in the room for your testimony, but I have read it and I have a question that has nothing to do with fair credit reporting, and just wonder, as a representative of the health insurance industry, if you have an observation.

When I talk to the small business folks in my district about the implementation of HIPAA and the law of unintended consequences, they are describing a situation that because, not that they want to root around in their employees's medical information, but because when they approach a health insurer they can only share or know so much information. They are finding that their insurance premiums are dramatically increasing because the insurance company is not aware of the risk that they are being asked to insure. Is that a reasonable observation by these people?

Mr. PETERSEN. It is difficult. First off, for your small employers, I feel for them because I represent large insurers who have the absolutely same responsibilities as very small employers, and individual doctors. They all have to comply with this very large rule, and not all of them can afford to hire attorneys. So it is a very difficult problem.

There is one problem about how you share information as an employer. The rule sets up group health plans, plan sponsors and employer requirements, all for the separate sharing of information. Unless you provide notices and put in policies and procedures, you may have restrictions on your ability to obtain and/or disclose information.

I have heard of situations where small employers are finding it difficult to sometimes have one health plan disclose to the other health plan, or just to get the information generally and to disclose. From a health insurance perspective, if you do not have the information, a conservative underwriting approach is to, unfortunately, consider that it is probably bad.

There has been some state activity. A few states are now enacting laws requiring one health plan to give it directly to the other health plan, so that the employer is not in the middle. They can just tell the one insurance company, give my information to the other insurance company. I think those types of laws will help address it, but it is a 50-state problem.

Mr. LATOURETTE. Thank you.

Mr. Rotenberg, I was in the room for your testimony and I heard you talk about a credit report of a prospective employer that might have some billing or a credit application for fertility. I think you said that the employer could not make an inference, which would be improper in the employment setting anyway.

But couldn't the same inference be drawn, since we are talking about inferences, by an employer who was interviewing a woman who was 22 years old who just got married, from the fact that on her credit report there was testing for fertility, that she may want to in the foreseeable future start a family?

In both of those inferences, if you reach the conclusion that she was desiring to get pregnant, that would not, under the laws already on the books, be a disqualifier. It would be an impermissible reason to disqualify someone for employment. Is there a better example or a greater danger that you see than the one that you cited to us in your testimony?

Mr. ROTENBERG. Congressman, I actually think the example is a fairly good one because it is a medical service that is increasingly likely to appear on credit payments. In fact, when the Federal Reserve took a look at credit reports, they were very interested in their study of February 2003 this year to find a very large number of credit payments related to medical services.

So we could go into a bit more detail. We could imagine certain types of clinics that provide help for people with stigmatizing conditions. But I think the critical point is that there is information made available today through the credit report that would otherwise be covered under HIPAA, but for the fact that the employer is not a covered entity under HIPAA. That is the statutory problem.

Mr. LATOURETTE. And Ms. Pritts, as I read your testimony, there was a reference that I did not hear you talk about, but there was apparently a banking executive that served on his county health board, is that right?, and you cite that as an example of bankers using medical information for making credit decisions.

My question is, based upon your study of HIPAA, wouldn't the conduct of, I assume it is a fellow, but this banker prior to 1993 be a violation of HIPAA today? And if not, why not?

Ms. PRITTS. He is not a health care provider, and it is not clear where he was getting his health information from. He was serving on a board, I believe. It is not clear whether that registry would be a covered entity under HIPAA, because of the definition of health care provider.

Mr. LATOURETTE. Okay. But you would agree with me if in fact the information was being supplied by a health care provider, that it would be covered, and your answer is that it would?

Ms. PRITTS. Well, if it is supplied by the health care provider to a registry, it then becomes uncovered by HIPAA, so then it is not protected.

Mr. LATOURETTE. Thank you very much.

Thank you, Mr. Chairman.

Mr. TIBERI. Thank you.

Mr. Crowley is recognized for 5 minutes.

Mr. CROWLEY. Thank you, Mr. Chairman.

Let me just take Mr. Rotenberg's example to another level. I would ask Mr. Petersen and Ms. Meyer or Ms. Pritts to chime in.

If an individual were to obtain the TB test or an AIDS test or even a mammogram and pay for that using a credit card, would it be possible for that information then to be shared with affiliates? If so, is that possibly exposing what we determine as risky behavior in one's personal behavior that could be used against them to deny them insurance, both health and PC? Or even taking it to a further extent, is it possible that information could be used to deny them employment?

Mr. PETERSEN. I will take the first shot at the question. The mere fact that they charged the information from a health insurance perspective, if they then submitted that charge to the health insurer for reimbursement, that would become protected health information and would be subject to all the protections I described.

The 1982 Act, you asked earlier about avocation, lifestyle, reputation, the 1982 Act of the NAIC provides special protections for that information as well. They essentially treat it for health purposes like marketing. So if you inferred something from that, you also could not share that for marketing with a third party.

Mr. CROWLEY. What if you are an affiliate with the company?

Mr. PETERSEN. You have limitations under HIPAA about how you can share protected health information from marketing. You can share it to do upgrades to existing products, for instance, but very limited ability to use that. So if you just had that claim information, I think you would be restricted on how you could use it within the internal, even within affiliates, or internal uses. So you would have limitations on how you could do it.

Under HIPAA, if it was not a part of the hybrid entity, for instance if you had an affiliate that was a life company, you could not disclose at all to the life affiliate. It would have to be health to health, and for limited ways to share it for marketing.

Now, on the other hand, of course, if it was something that came up in the application process, so you paid for it with your credit card, but it came up in the application process, then the health insurance company could use that information.

Mr. CROWLEY. They could use it. Well, then, Ms. Meyer, would you like to respond?

Mrs. MEYER. Yes, thank you.

If in fact you are talking about the bank sharing information with an insurance affiliate. Under the Fair Credit Reporting Act in fact that probably would be an experience in transaction information, so that the bank could share it with the life insurance affiliate. Although, I have got to tell you, I am hard-pressed to think of an actual situation where a bank would be sharing information of that nature, of a charge with a life insurance company.

But say in fact the life insurance company did get the information, then once the life insurance company gets the information, then it would first, I cannot even think of the real-world where it would get it, so that it would even be an issue, because I cannot imagine they get that information in connection with underwriting.

But if in fact an insurer ever did get the information, then the whole ambit of all the body of laws dealing with insurer's ability to disclose information would come into play, notably the NAIC model regulation, which requires an opt-in for the sharing of medical information, unless it is for an insurance business function, or the old NAIC model Act, which again requires an opt-in. Then you would possibly get into the Fair Credit Reporting Act, which would probably require an opt-out for the sharing.

But in fact, insurers that do business all over the country adhere to the NAIC model Act and regulation, essentially in all States in which they do business. So that essentially ends up being the law of the land. But again, getting to the very beginning, I am hard-

pressed to think of a situation where a life insurer would actually be getting that type of information from a bank.

Mr. CROWLEY. You may be hard-pressed, but it not inconceivable that something like that could happen in the future.

Mrs. MEYER. I just don't know how.

Mr. CROWLEY. We don't know where this is going, actually. Things are evolving in terms of information and the need for more information to make decisions based on one's personal life, especially risky business.

Mrs. MEYER. I guess conceivably, but that flow of information is something that I have not seen.

Mr. CROWLEY. Difficult. Okay, Mr. Chairman, just one more question, if I could, for Mr. Yingling.

I missed your opening statement, but it was pointed out to me by my staff that it says, "With respect to the banks, medical information should only be used for the express purpose for which it is provided and should not be shared without the express consent of the consumer." Are you advocating a system of opt-in for health information, as opposed to opt-out?

Mr. YINGLING. As I mentioned in a previous answer, I don't think it really is opt-in. I think it is stricter than opt-in. An opt-in regime could be a general approval to seek information or to use information, and it could be prospective and cover additional transactions.

When we say with the approval and consent of the potential borrower, what we mean is a specific approval of the information that is needed for the application in front of you, so to speak. So it actually I think is stricter than opt-in.

Mr. CROWLEY. Thank you.

I thank the chairman.

Mr. TIBERI. Thank you. The gentleman's time has expired.

Without objection, the gentleman from Illinois, Mr. Emanuel, may be recognized for the purpose of questioning witnesses under the 5-minute rule. Do I hear an objection? Not hearing an objection, Mr. Emanuel? Mr. Emanuel is recognized for 5 minutes.

Mr. EMANUEL. Mr. Chairman, thank you. As a member of the full committee, I ask unanimous consent to ask questions. Thank you.

First of all, thank you for holding this hearing and putting this panel together. To follow up on this set of questions and your answer, I think we are at a critical point in finding a balance here that allows commerce and information to flow freely, but also give consumers a certain level of protection in this storm that they have a safe harbor. As you said, it is more strict than opt-in or opt-out. I actually am working on a bill creating a blackout as it relates to medical information.

We have to create, I think, for consumers, because it touches on what Ms. Pritts said earlier as it relates to information, what consumers most care about is their medical privacy. If you look at it as a set of issues, you go down the ladder of what they care about, at least in the data and the research I have seen, and obviously I am dealing with five experts here who may show counter-data, but medical information is what they care most about in the sense that they feel vulnerable and they feel that their privacy has been

violated, and then forces greater than they can control and have access to things about them that are not relevant.

With that, and again the world we live in is changing by the time we deal with this, and we are trying to set up some set of rules going forward that do not allow the different legislation that we have passed in the past, at least to set a clear mark of what the rules of the road are going forward.

Let me ask a question, and this is for anybody, so have at it. I have a set of questions. What are some of the scenarios that could occur if the existing loopholes are not closed as we try to explore different scenarios? And is there a chance for widespread abuse here? I have some follow-up questions after that, so does anybody want to just take at it?

Mr. ROTENBERG. Congressman, I return to the original purposes of the Fair Credit Reporting Act. It was an extraordinary law at the time it was passed in 1970. Senator Proxmire and others came together. People became aware that a lot of derogatory information about individuals was being gathered up and being used in an adverse way. The information was inaccurate. We would call it today probably defamatory. It kept people out of jobs. It kept people from getting loans.

The Fair Credit Reporting Act was passed to create stable transparent markets that consumers could participate in by ensuring accuracy and fairness and privacy. I think what happens, as you describe, as the technology gets ahead of us and some of the new business practices get ahead of us, we get back in some ways to where we were back in the 1960s, where there is the risk that inaccurate information, defamatory information will produce bad consequences.

I think Congress was very wise in 1970 to deal with the problem then. I think you are going to have to deal with it today with new technology and with new business practices.

Mr. PETERSEN. I think from the health insurance perspective, it is very difficult to think of any loopholes that actually exist as the HIPAA rule interacts with the State laws. Our firm conducted an analysis of how the HIPAA privacy rule interplays with all 50 State insurance codes. That analysis is over 600 pages, and I am assuming a non-lawyer could do it in 400 pages or however many extra words we might add to it. It is still a very lengthy analysis. State law, from a health insurance perspective, adds a lot of additional layers of privacy protections.

Now, it is very difficult as a national carrier to interact with all those, so sometimes preemption might be good. But you look at, as I said in my testimony, you have two NAIC models; you have the HIPAA rule; and then you have sort of sensitive information, reproductive rights, genetic testing, mental health, substance abuse, a variety of information that states have deemed to be extra-sensitive, and they have passed additional laws on the uses and disclosures. So I think from a health insurance perspective, almost all bases have been covered.

Mr. EMANUEL. Okay.

Mrs. MEYER. I think from the perspective of life insurers, which are in a slightly different position than health insurers because they are not directly subject to the HIPAA rule, life insurers's and

disability income insurers's ability to obtain medical information is very much determined by the HIPAA rule, which would not permit health care providers to give information to life insurers and disability income insurers without their providing the authorization of the individual.

So you take all of the others, the Fair Credit Reporting Act, Gramm-Leach-Bliley, the HIPAA rule and all of the State privacy rules, and again the combination, the fitting of all these rules together in effect operates in the same way, because both life insurers's ability to get the information and then to disclose the information is covered by the combination of all of these rules.

Mr. EMANUEL. Did you want to say something?

Ms. PRITTS. Yes. I think HIPAA protects health privacy fairly well in the context of health insurance, but HIPAA is not comprehensive. It only covers health care providers and only if they do certain kinds of transactions, a health care clearinghouse, and health plans. So it does not cover everybody.

The other point I want to make is that we have heard repeatedly today how important the State laws have been in filling in the gaps at the federal level. They are particularly important with insurance, because that is traditionally governed at the State level. To the extent there is this ambiguity in GLBA and FCRA about whether the States can go as far as they want to go, I really think that needs to be clarified.

Mr. EMANUEL. One question is, and if you have the life of a member as I do, with office hours in grocery stores, meeting people, doing constituent work, making it easier for people. My day is, and it is a pathetic life, maybe; I do it on Saturday. You meet people. You try to make office hours easier. And I don't think consumers have any idea that on a credit background, health information is accessible. Maybe from the insurance side, but I will tell you from the general public, I would be interested if, from your own background and your own research, your own knowledge of the public, whether you think they know that health information is accessible on a credit background check.

Mr. TIBERI. The gentleman's time has expired, but please answer the question.

Mr. EMANUEL. Thank you, Mr. Chairman.

Mr. YINGLING. If I could comment, I am sure I am oversimplifying here, but the expansion that we are talking about here is due to the Fair Credit Reporting Act covering a whole bunch of different types of reporting agencies.

If you are talking about the basic credit reporting system, when a bank looks at an application and goes and gets a credit report, they do not have medical information in that report. When people are doing employment checks, they go to a different type of reporting agency where they get that kind of information. I think it is important to make that distinction.

I am a little concerned if we start trying to deal with issues that just go through basically the payment system or the traditional credit card system where all you have is something that says a payment was made to the Yingling Clinic, and that is all that is in there, or a late payment was made to the Yingling Clinic. Then to ask the reporting system somehow or other to make a distinction

between whether the Yingling Clinic is a health clinic or a doctor clinic or a golf clinic, and people who have seen me play golf know that it is not, when you are dealing with millions and millions of transactions with one little piece of information. I do not think you want to require those kinds of reports, or in the situation of those kinds of reports, to have people sit there manually and try and figure out what the Yingling Clinic is.

Mr. EMANUEL. Thank you, Mr. Chairman.

Mr. TIBERI. Thank you.

The gentlelady from New York is recognized for 5 minutes.

Mrs. MALONEY. Thank you very much.

I would like to follow up on the questioning of my colleague, Mr. Emanuel. I agree that certainly health information and privacy information and medical information is one of the most sensitive areas this committee deals with. I would like to go back to some of the testimony by Mr. Rotenberg, in which he talked about the availability of medical information in credit reports and the ability to infer a person's medical history based on this information. He cited studies by the Consumer Federation and the Federal Reserve on this point.

I would like to ask the panel, beginning with Mr. Rotenberg, do you know of any companies that are using this information to make conclusions about people's medical history and base credit decisions on such information, not just late payment, but medical history? You could say payments to a clinic; you could infer they have cancer or whatever. So starting with you, Mr. Rotenberg, and if anyone else would like to comment.

Mr. ROTENBERG. Congresswoman, the quick answer to your question is no, we have not been able to identify organizations that have used this information in an adverse way. I want to say two things, though, on this point. First of all, that the problem has recently come to light. The Consumer Federation of America report is from December of last year; the Federal Reserve Board report is February of this year.

Secondly, I think it will take further investigation to actually find those instances where these kinds of determinations are made. But having looked at the report from the Federal Reserve Board, it seems apparent, it was at least apparent to them that medical record information can now be obtained from a credit report.

Mrs. MALONEY. Has anyone else on the panel, do any of you know of any business that has used this information in an adverse way? Any other members of the panel?

I would like to follow up and ask, do you, Mr. Rotenberg, or anyone else on the panel, believe that employers are using this information to base employment decisions on people's health? People look at credit reports for employment decisions also.

Mr. ROTENBERG. Well, I suspect that an employer with access to this information would consider it. Now, as I also indicated in my earlier statement, certain types of determinations, for example a prospective pregnancy, would not be a permissible factor in an employment determination. Nonetheless, under the HIPAA guidelines, which would prevent people from getting access to this information, without those safeguards applying to employers who get access in effect to the same information through the credit report, they can

now make judgments about AIDS trials and TB and so forth. I think it is a problem that the committee will need to look at more closely.

Mrs. MALONEY. Yes.

Mr. PETERSEN. I was going to say from a HIPAA perspective, employers that provide group health plans, their group health plan is treated just like a health insurer under HIPAA. So if in the context of providing benefits to their employees, if they receive protected health information that identifies the individual, they are subject to all of the same rules as a health insurer. So they could not use the information received in that context to make employment decisions. I think Mr. Rotenberg was talking about information where you could infer health status.

Mr. ROTENBERG. Just to clarify if I might, Mr. Petersen is describing the information obtained by virtue of the health plan, which is correctly covered under HIPAA. I am talking about the information that is obtained from the credit report that the employer might access as part of an employment determination, which would not be covered under HIPAA.

Mr. PETERSEN. That is correct, yes.

Mr. YINGLING. I just want to add again that when we use the term "credit report," we may think that we are talking about the credit report a bank gets. It is technically a credit report because it is all covered by the Fair Credit Reporting Act, but when a lender gets a credit report, they do not get that information. All they get is the payments and the late payments and your credit history. They do not get the medical information. When you are an employer, you are going to a different type of entity, and that is where you may be getting some of this medical information.

Mrs. MALONEY. But as I understand it from Mr. Rotenberg's testimony, just getting the payment history can infer medical conditions. Is that what you were saying?

Mr. ROTENBERG. To be precise, it is the trade line information that would indicate, for example, an outstanding debt to a clinic. That information would be made available to the employer through a credit report, and that is the type of information that is being made more widely accessible today.

Mrs. MALONEY. And you were implying that you could gain information just from the credit report on a person's health.

Mr. ROTENBERG. Yes, exactly.

Mrs. MALONEY. And a health condition, if you are making a payment to a cancer clinic, obviously you probably have cancer, that type of thing. What specifically did the Federal Reserve say about this? Could you elaborate?

Mr. ROTENBERG. Well, I have the Federal Reserve report in front of me, and I would be happy to provide it to the committee, perhaps as an attachment to my testimony. But I will just read one sentence, and this is under a heading "collection agency accounts." I am reading from the report of the Federal Reserve, February of this year: "Information on noncredit-related bills and collections such as those for unpaid medical services is reported to credit reporting companies by collection agencies. In addition, collection on some credit-related accounts also are reported directly by collection agencies."

So the Federal Reserve, this is a very good study, it is a non-political study. They were simply trying to understand how the credit report is generated, where does the information come from. They seem to be interested in the fact that a significant amount of information, in fact on page 69 of the report, they indicate that approximately 52 percent of transactions relate to medical payment. So this is I think very interesting.

Mrs. MALONEY. Yes. My time is up. I thank all the panelists.

Mr. TIBERI. The gentlelady's time has expired.

We will go for a second round of questioning between the three of us, if both of you would like to stay.

Mr. Yingling, just following up on this line of questioning from the last two questioners, let's say a customer of one of your banks has a checking account and is writing a check to the Ohio State cancer clinic, or is a credit cardholder with one of your banks and goes to a grocery store pharmacy and purchases medication that is for mental illness or something. Typically, how is that information protected for a consumer?

Mr. YINGLING. Typically, all the payment system information is protected. There is no distinction, I don't think, made with medical versus any other type of information. It is protected through normal security measures. If you look at Gramm-Leach-Bliley, there are specific provisions in there that require that banking institutions have security that protects all this type of private information.

Quite frankly, it is moving through the computers so fast that I don't think any human looks at it unless it is an exception item. I believe that our task force was pretty clear in the Statement that it made in its report that is quoted at the end of my testimony. It said that none of that type of information should be gathered or should be used for any purpose other than making sure that the checks are paid and the accounts are reconciled.

Mr. TIBERI. In terms of the wording, "should be" or "cannot be" used? Can you comment on that?

Mr. YINGLING. Well, I don't make law, so I can't say "cannot." But I recommend "cannot" should be used. If you chose to make it "cannot," you could make it "cannot." However you would have to have an exception to cover all those instances, and we have been talking about one example, which is the key-man insurance on a small business. You would have to have many exceptions, but even in those exceptions it would only be with the express consent of the potential borrower.

So I think the better way to phrase it so you do not have to get into the business of trying to foresee every exception, which is impossible, would be to say it can only be used with the express consent of the customer.

Mr. TIBERI. But to your knowledge, your membership does not abuse that customer relationship now, to your knowledge?

Mr. YINGLING. No, not to my knowledge. It is hard to foresee instances where it would be worth the candle to try to do it, quite frankly. There are lots of instances where you do get medical information. Another one, for example, is we do a lot of trust work, and quite often when you are setting up a trust, if you have a child that has medical problems or mental problems, you would want that

banker working with you to set up the trust, to understand that. You want the person running the trust to have the authority to make decisions about when additional medical care is needed or not needed. But those are the exceptions, and again it is for that express purpose and that purpose only.

Mr. TIBERI. In your testimony earlier, you mentioned the State preemption of the FCRA is important for us to re-extend or extend. Can you explain or delve into why that is important and, in your mind, what would happen if it is not extended?

Mr. YINGLING. Well, part of that is to go into all the benefits of the Fair Credit Reporting Act, which I won't do, but there are just huge benefits, one of which is the way it helps low-and moderate-income individuals obtain loans. There is a remarkable chart in this study that shows the incredible growth in the availability of credit to low-income people since the passage of the Fair Credit Reporting Act.

I was interested in Chairman Oxley's comment, which is another aspect of this, about the incredible mobility we have for people to move and to get jobs, which is so important to our economy, and that is in part due to the Fair Credit Reporting Act.

Specifically in answer to your question, I think the best way to frame it is to give you an example that came to my attention recently when I was talking to the CEO of a small bank down in the southern part of Virginia. She was saying, because we all know California is very active in this area, "You mean to say that if I have a son or daughter of one of my long-term customers who goes to California as a student, that I am going to be subject to California law?"

Well, you carry that out. Suppose it was a graduate student that moved to California. The first thing this community bank would have to do is apparently track all their customers to figure out if they had moved. Then they would have to figure out, well, this is a graduate student. Are they a resident of California or a resident of Virginia? Are they subject to California law now or not? And then if they are subject to California law, they would have to have somebody explain to them all the nuances of what they could collect and what they could report on the credit card loan and the auto loan to that son or daughter.

Now, there is almost no way for them to do that other than to have a lawyer on hand in every state that can tell that community bank how you cover that person. The end result is, they will not report on that person. They cannot afford to report on that person.

That means if that person has problems and does not make payments, that is not going to be reported. On the other hand, maybe with this graduate student, the only loans he or she has ever had were the credit card and the automobile loan, and now that is not reported, so the student has no credit history.

So you can see how the whole system can start to break down if you do not have one national law that this Virginia banker can plug into.

Mr. TIBERI. Thank you.

Unfortunately, my time has expired. I will recognize Mr. Crowley for 5 minutes.

Mr. CROWLEY. Mr. Yingling, I understand that while health information is not allowed on credit reports, affiliate sharing is often exempt from FCRA privacy rules. So as banks and insurance companies, and this goes back somewhat to my original question, become more affiliated, could this information flow between affiliates, particularly these new brands of banks that are buying and marketing health insurance plans, could that information flow between?

And who would govern the privacy of this health information, HIPAA, FCRA or no entity? And where is this distinction codified in the law, as I don't think anyone wants to see this end up in the courts for many years of litigation to sort out these issues, especially as it pertains to such important issues as the issue of one's personal privacy?

Mr. YINGLING. I think the simple answer is if you had a bank that chose to violate all the principles of trust of their customers and to take medical information and give it to an affiliate, it could do it. There is nothing illegal about it.

Mr. CROWLEY. So you think the pressure of the market would come to bear, advertisement by other competitors?

Mr. YINGLING. I think that would be a major factor. We believe it is wrong to do it, but if you are asking me, is there a law that prevents it at this moment in time, the answer is no, sir, there is not.

Mr. CROWLEY. Would anyone else like to comment on it?

Mr. PETERSEN. There are rules against the flow in the opposite direction. So in that situation you described, if a bank were to purchase a health insurance health plan, the bank evidently can flow information to the health plan. The health plan could not flow information to the bank under the HIPAA privacy rule of 1982 and the NAIC Act article five.

So you would have restrictions of the information flowing the other way, and you would have to have an authorization for the health plan to release that information to the bank. Most of this sensitive information will be within the health plan.

Mr. CROWLEY. Ms. Meyer?

Mrs. MEYER. I was just going to say, to the extent there ever would be that flow from the bank in another direction, it would seem to me that both the Fair Credit Reporting Act and GLB itself would govern those disclosures and require at least an opt-out in that situation. Although again, it seems a stretch.

Mr. CROWLEY. I keep coming back to those difficult stretches for you, don't I, Ms. Meyer?

[LAUGHTER]

Just to show you how I think. I thank you.

Would you like to respond, Ms. Pritts?

Ms. PRITTS. Yes, I would like to just go back to the one point that I think we continually miss, which is that Congress in enacting HIPAA and in enacting Gramm-Leach-Bliley subsequently, never really indicates who is on first.

The Fair Credit Reporting Act was passed I think in 1990. The amendments to the Fair Credit Reporting Act were in 1996. HIPAA was in 1996. HIPAA does not say anything about the Fair Credit

Reporting Act. HIPAA hardly says anything about how you protect health information, in all honesty, the statute.

Subsequently, you have the Gramm-Leach-Bliley Act, which was enacted after HIPAA, and very detailed. It does not mention HIPAA. Subsequent to that, then, you have the actual promulgation of the HIPAA privacy regulations, which are very detailed. But if you actually go through an implied repeal analysis, first of all you should not have to do that. We should have some indication from Congress as to what law governs if there is an overlap. It is an easy thing to fix, and it is something that we should not be relying on the court for.

Mr. CROWLEY. Thank you.

I thank the chairman. I have other questions, but I will submit them in writing for an answer.

Mr. TIBERI. Ms. Meyer, you were going to comment, it looked like?

Mrs. MEYER. Actually, I was going to say that in fact insurance companies for a number of years have been dealing with the meshing of all of these rules together. It is because of the fact that there is this meshing, we see that it is going to be so critical to reauthorize the preemption provisions of the Fair Credit Reporting Act, so in fact there will be certainty as to what the rules are.

Mr. TIBERI. The gentleman from New York's time has expired.

I would like to thank all the witnesses for being here today. The record will be open for 30 days for members to submit any additional testimony or comments or questions.

The hearing is now adjourned.

[Whereupon, at 1:03 p.m., the subcommittee was adjourned.]

A P P E N D I X

June 17, 2003

STATEMENT OF CHAIRMAN SPENCER BACHUS
SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
"THE ROLE OF FCRA IN EMPLOYEE BACKGROUND CHECKS AND THE COLLECTION OF MEDICAL INFORMATION"

Good morning. The Subcommittee will come to order. Our hearing today is the fifth in the series of hearings this Subcommittee is holding on FCRA. We have previously held hearings covering the importance of a national uniform credit system to consumers and the economy and more specifically on how FCRA helps consumers obtain more affordable mortgages and credit in a timely and efficient manner. Today we will learn about how FCRA regulates employee background checks and the collection of health information.

This hearing consists of two panels. The first panel will focus on the application of FCRA to employee screening and other background checks. Witnesses will include various business groups, human resource managers, and private investigators. The second panel will examine how medical information is collected and used for various financial products, including a discussion of the prohibition on the use of health information in the credit-granting process. Panelists will include representatives of the life and health insurance industry, banking industry, and independent experts.

While we usually think of FCRA in the context of credit information, it also applies to background checks for employees. For example, information collected for an employer by a third party about an employee's criminal record, driving record, educational record, or prior employment history in some instances falls within the FCRA's coverage. The 1996 amendments to FCRA established consumer protections for employee background screening. Some of these

include: consumer consent before a prospective employer may obtain a consumer report; disclosure of the report to the consumer once it is completed; and notice to the consumer of his rights before taking an adverse action based on the report.

Many employers conduct background checks of their employees as a safety precaution. Moreover, according to a 2002 Harris poll, a majority of Americans support their employers conducting detailed background checks. Congress has mandated background checks for many workers in the financial services industry, as well as for nuclear, airport, and childcare businesses. As a result, mandatory background checks are now required for workers at ports and for those who transport hazardous chemicals. The number of worker background checks has dramatically increased since 9/11 due to heightened security concerns.

In light of the fact that background checks are becoming commonplace, one issue that we need to look at is the FTC's staff Vail opinion letter. It makes it more difficult for employers to conduct investigations. Under the Vail letter, if an employer believes that an employee is engaging in workplace misconduct – such as committing sexual harassment, racial discrimination or embezzling funds -- the employer can't hire an independent third party investigator without getting the wrongdoer's consent and telling him how he will be investigated. This makes absolutely no sense. If you're trying to catch a criminal, why warn him in advance? Strangely, employers can investigate alleged misconduct without following any of the Vail letter requirements if they do so internally. The Vail letter makes it unworkable to hire an outside, unbiased party to do an impartial investigation. Even the FTC admits that the law should be fixed.

Our second panel will turn to a different but equally important subject, the collection of medical information and how the FCRA and other Federal and State laws govern its use. The FCRA prohibits consumer reporting agencies from furnishing reports containing medical information without the consumer's consent. Congress passed another law, the Health Insurance Portability and Accountability Act of 1996, which limits the sharing of health information by health care plans and providers. In addition, the States have various laws governing how insurance companies use and share information. This panel of experts will help us to understand whether there are gaps in the convergence of these laws, and whether financial providers are using or should be prevented from using individuals' medical information in an inappropriate way.

I want to again express my gratitude to Chairman Oxley, Ranking Member Frank and Mr. Sanders for working with me on FCRA reauthorization, and note that for the second week in a row we accommodated all of the Minority's witness requests.

The chair now recognizes the Ranking Member of the Subcommittee, Mr. Sanders, for any opening statement he would like to make.

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit
"The Role of FCRA in Employee Background Checks and the Collection of Medical Information"

Tuesday, June 17, 2003

I am pleased to announce that last Thursday another Federal regulator came out in support of a reauthorization of the national uniform standards of FCRA. Don Powell, Chairman of the FDIC, said he believes it's necessary to make permanent the preemptions in the FCRA to ensure no negative economic impact.

Mr. Powell joins the Treasury Secretary, the Chairman of the Federal Reserve Board, and the Conference of State Bank Supervisors, in support of reauthorizing uniform FCRA standards.

I also just received a report by the independent Congressional Research Service analyzing a critical consumer benefit of the FCRA – increased labor mobility. CRS found that mobility is an important barometer to judge the importance of having a national credit reporting system. No surprise, the U.S. has one of the most mobile societies, with 14.5 percent of the population moving in any given year, and lower income individuals more likely to move than higher income groups. It is our national uniform credit system that makes this mobility possible, and gives us a further competitive edge over the rest of the world.

Throughout modern history, national economies have risen and fallen based in large part on the flexibility and mobility of labor and management. American consumers and workers enjoy unprecedented mobility in part because of our uniform national credit standards.

Today's hearing looks at two particular aspects of uniform standards under FCRA. The first panel will address the use of FCRA in employee background screening. Even before 9-11, Americans had become increasingly concerned about ensuring their safety on the job from individual predators with criminal records. Homicide was the second leading cause of occupational fatalities in 2001, and the recent wave of corporate scandals has highlighted the need to keep out bad actors at all levels of the American workplace. Congress has been calling for expanded background checks for a

number of sensitive jobs, and courts have been imposing more liability on businesses that don't perform adequate background checks.

Unfortunately, an interpretation of FCRA by the Federal Trade Commission known as the "Vail letter" undermines the ability of businesses to protect their employees and consumers. The Vail letter prohibits employers from using outside third parties to investigate employee misconduct unless they first notify the wrongdoer of the precise investigation, get his consent, and ultimately give him a copy of the investigative report. How do you investigate a CEO who's embezzling funds if you have to first get his permission and give him time to cover up his actions? How do you get victims to cooperate with a sexual or racial harassment inquiry if they know their identities won't be protected? You don't, and that's why the FTC's interpretation is problematic.

Ironically, a company can perform an employee investigation without these requirements, but only by doing it internally, without any of the protections of an outside, unbiased and professional third party. The Vail letter is impractical. Subcommittee Chairman Spencer Bachus and I wrote to the FTC last term asking the Commission to change its views, and we support efforts by the Members here today to correct this problem.

On our second panel, we will receive testimony on the use of medical information in the credit granting process, and the interplay between various Federal and State health privacy laws. I share the concerns of many of my colleagues that medical information may require special protections to prevent its improper use or theft and look forward to our witnesses' views on the appropriate balance of national consumer standards on this issue.

I would like again to thank Subcommittee Chairman Mr. Bachus for his leadership on FCRA reauthorization, and the continued bipartisan cooperation of our ranking Subcommittee and full Committee Members Mr. Sanders and Mr. Frank.

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June 17, 2003

Opening Statement by Congressman Paul E. Gillmor
House Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit Hearing entitled, "The Role of FCRA in employee background checks and the collection of medical information"

Thank you, Mr. Chairman, for holding this important hearing on the Fair Credit Reporting Act (FCRA) and its role in employee background checks and the collection of medical information. I continue to believe that ensuring a uniform national standard for consumer protections governing credit transactions is one of the most important tasks this committee will face in the 108th Congress.

As we are all now aware, on January 1, 2004 these standards as established in the FCRA will expire and states will again have the ability to enact differing regulations. Congress enacted the FCRA in 1970, to bring the consumer credit reporting industry under Federal regulation and to create a uniform system of rights governing credit reporting transaction. This mandate has been incredibly successful and allowed for the creation of the sophisticated system we have today. It has greatly expanded consumer access to credit and allowing individual states to enact their own standards would undoubtedly risk its collapse.

The 1996 amendments to the FCRA established a national consumer protection standard for employee background checks detailing the following requirements:

1. a consumer consent before a prospective employer may obtain a consumer report;
2. an employer provide a copy of such report to the consumer;
3. a description of a consumer's rights be provided to the consumer before taking an adverse action based on such report.

The FCRA also prohibits consumer reporting agencies from producing reports containing medical information without the consumer's consent.

Today, I look forward to a thorough discussion of the issues that remain concerning the FCRA's application in these areas. Thank you again, Mr. Chairman, for continuing our dialogue on this issue and I look forward to swift committee action.

Opening Statement
Congressman Pete Sessions (R-TX 32)
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit
June 17, 2003

"The Role of FCRA in Employee Background Checks and the Collection of Medical Information"

Mr. Chairman, I would like to thank you for inviting me to join you today at this hearing on the Fair Credit Reporting Act (FCRA) as it pertains to employee background checks and the collection of medical information. I am pleased to be rejoining the Chairman and my esteemed former colleagues on the Financial Services Committee to discuss an issue that has long been of great interest to me. I would also like to thank my colleague from Alabama for scheduling this important hearing, for his strong leadership on this issue, and for his diligent oversight of all aspects of the FCRA. His efforts are commendable, and by holding this hearing today, he will have helped Congress to take the first step toward making the workplace a better and safer place for all working Americans.

Mr. Chairman, in order to provide historical context to this hearing, I would like to recount briefly the events that have brought us here today. In 1999, the staff of the Federal Trade Commission (FTC) issued an opinion – known as the "Vail Opinion" – concluding that outside consultants who perform investigations of alleged employee misconduct are considered to be "Credit Reporting Agencies." As a result, outside consultants and the employers who hire them to help ensure unbiased workplace safety are subject to a number of burdensome and unintended restrictions on their ability to perform these investigations safely, professionally and efficiently. Accordingly, they are hampered in performing many different kinds of helpful workplace investigations, including employee complaints of sexual harassment, discrimination and threats of violence.

For the last few Congresses, I have introduced legislation to fix this problem by removing the FCRA requirements for: 1) investigations of suspected misconduct related to employment and 2) compliance with existing laws and pre-existing written policies of the employer. This proposed legislation also respects the rights of the subject of a workplace search (by providing him/her with a summary of the findings), while removing employers from the onerous and potentially dangerous requirement to notify their subject prior to beginning an investigation. The removal of this requirement is important because it prevents violent employees from having time to "cover their tracks" or to intimidate coworkers who can make or corroborate complaints and are integral to ensuring the veracity of data included in these complaints.

Mr. Chairman, back in 1997, when a constituent brought the problems that she was having as a result of the Vail Opinion to my attention, I was shocked. Shocked to learn that federal law requires an employer who suspects that an employee is dealing drugs at their workplace to ask that employee's permission before beginning an investigation. Furthermore, I was greatly

dismayed to find that federal law would also require that same employer to provide a potentially violent employee a with report identifying the co-workers who made or corroborated those allegations of wrongdoing, making those helpful employees who were only trying to make their workplace safer a target for violence or retribution themselves.

This important legislation that I have introduced removes requirements of the Fair Credit Reporting Act solely for the purpose of having unbiased, third-party professional investigations of illegal or unsafe activities in the workplace. These limited activities include drug use or sale of drugs, violence, sexual harassment, employee discrimination, job safety or health violations and criminal activities including theft, embezzlement, sabotage, arson, patient or elderly abuse, and child abuse.

Mr. Chairman, I believe that it is critical that Congress pass this legislation in order to make workplaces safer, to stop illegal activities such as drug dealing and to identify dangerous employees so that they can be provided with treatment before violence occurs. This legislation offers Congress the opportunity to replace illegal and dangerous activities in the workplace with investigation and remediation – and I think that is precisely the goal for which we should all be striving.

I would like to thank our entire panel, many of who have come from all over the country just to share their experiences with the Vail Opinion and the FCRA with us today, and I look forward to hearing their testimony on this issue. I would like to thank the 16 Members of Congress on both sides of the aisle who have cosponsored this bipartisan legislation. And I would like to thank the Chairman for the leadership and initiative he has shown by addressing this issue – I greatly appreciate the time provided to me today.

TESTIMONY OF LEWIS L. MALTBY
PRESIDENT- NATIONAL WORKRIGHTS INSTITUTE
REGARDING EMPLOYEE INVESTIGATIONS
BEFORE THE HOUSE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
JUNE 16, 2003

Introduction

My name is Lewis Maltby. I am president of the National Workrights Institute. The Institute is a not-for-profit research and education organization dedicated to advancing human rights in the American workplace.

Testimony

Pre-Hiring Investigations

The Institute is very concerned about the growth of employment investigations in America. There is nothing wrong with employment investigation. For employers to select the strongest applicant, they must screen out the other applicants. An employer who hired everyone who applied would quickly be bankrupt.

But there is much that is wrong with the way employment investigation is practiced today. Many employment screens are highly intrusive and invade people's privacy. Others are highly arbitrary and deny work to honest hard working people.

For example, many employers require all applicants to take a so-called honesty test. At least 2.5 million people are required to take such tests every year. There is nothing wrong with employers wanting to hire honest people. But honesty tests are notoriously unreliable. For every dishonest person they identify, at least four honest people are denied a job. Worse yet, honest people who fail one honesty test generally fail them all. In an industry where honesty tests are standard practice, many honest people are virtually unemployable.

Other employers require prospective employees to take personality tests. This also is not inherently wrong. Organizations, like people, have personalities. A person who would fit it well with an informal Silicon Valley company might have difficulties in a highly structured Wall Street firm. Companies that choose employees based on personality as well as ability can save both parties from the consequences of a bad decision.

But many personality tests are shockingly intrusive. The Minnesota Multiphasic Personality Inventory (MMPI) asks detailed questions about applicants' sex lives, religious beliefs, and bathroom habits. No one should have to reveal such intimate aspects of their personal lives just to get a job. The harm is all the worse because such information is irrelevant to job performance.

Relatively recently, employers have begun investigating employees' private lives. Approximately 6% of American employers inquire whether their employees smoke, drink, or engage in risky hobbies in their private lives. Twenty-nine states have enacted legislation that restricts this type of discrimination, often with the help of the Workrights Institute. But in the remaining 21 states, employers can and do deny people employment because they smoke or drink in their own homes on their own time.

In the wake of 9/11 the number of employers conducting criminal record checks has exploded. Companies supplying such reports report than their business has at least doubled in less than two years. Under certain circumstances, this is entirely proper, or even necessary. I have three children who ride the school bus every day. The youngest is 5 years old. I would be angry if my school district did not conduct record checks and screen out prospective drivers with DWI convictions.

But some employers use criminal records in irrational and unfair ways. Eli Lilly, for example, will not hire anyone who has ever been convicted for anything for any job, no matter what the circumstances, and no matter how long ago the offense. Kimberly Kelley lost her job as a pipe insulator at a Lilly contractor because, before starting this job, she had been convicted in absentia of passing a bad check for $60.

Such "zero judgment" laws violate federal anti-discrimination law because of their disparate impact on minority groups. Eight states require that there be a nexus between the nature of the offense and the nature of the job. But many employers do not comply with these laws.

The worst aspect of such employee investigations is that they have taken over the hiring process. Instead of the result of the investigation being used as input to a human being who will consider it, along with all the other relevant information, the investigation results determine the outcome. Human judgment is eliminated. In most companies today, if you fail the honesty test, you are automatically dropped from the applicant pool. Even if the HR professional thinks the test is wrong, it makes no difference. If you smoke or drink (in certain companies) you are out, no matter how strong your job performance. If you have a criminal record, you are not hired, no matter what the circumstances.

It is unfair to employees and damaging to productivity and our standard of living for hiring decisions to be made in this manor. While it is impossible to legislate good judgment, there are steps that Congress could take that would improve the situation.

Fair Credit Reporting Act

Ironically, the area in which employee investigations are most needed is the one area where there are substantial legal restrictions. Under the Fair Credit Reporting Act (FCRA), when an employer commissions a third party to conduct a "consumer report" or "investigative consumer report", the employer must notify the affected employee in advance and obtain their permission.

In general, this is a good rule. Such reports can be extremely revealing and people should not be forced into investigations against their will.

But the rule makes no sense in the context of employer investigation of employee misconduct. Telling the employee suspected of misconduct that an investigation is about to begin gives them the opportunity to alter their behavior, destroy evidence, and take other action to hide the truth. Even worse, the suspected employee can prevent the investigation by refusing to consent. This is so irrational as to border on the surreal. What kind of law enforcement system allows people who have broken the law to escape justice by refusing to let the authorities investigate their conduct?

As a human rights organization, the Institute is most concerned about the impact this law has on civil rights. Consider the situation in which a female employee complains to her boss that another employee has sexually harassed her. Assume that she identifies eyewitnesses to the harassment. The employer obviously needs to conduct an investigation. But it can't, because speaking to the witnesses falls under the definition of "investigative consumer report" in FCRA. The accused harasser can protect himself by refusing to consent to the investigation. This is obviously an intolerable result.

Legislation has been proposed that addresses this issue. Representative Sessions and other Members have introduced legislation, the Civil Rights and Employee Investigation Act (H.R. 1543), that would remove from the FRCA "investigation of suspected misconduct related to employment". This is a step in the right direction, but not a complete solution. For example, not everyone suspected of sexual harassment or other workplace misconduct is guilty. The FCRA contains rights that help protect innocent people suspected of misconduct. H.R. 1543, standing alone, would eliminate these protections.

What is needed is for all concerned groups to work together to find a way to amend the FCRA that eliminates the impediments to legitimate workplace investigations without eliminating other important employee protection. The beginning of this dialogue has already taken place. The National Workrights Institute would be happy to help continue these discussions.

The Institute would also like to submit supplemental materials after the conclusion of the hearings.

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Testimony

of

Eddy McClain

Chairman, Krout & Schneider, Inc.

on behalf of the

National Council of Investigation and Security Services (NCISS)

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

U.S. House of Representatives

June 17, 2003

My name is Eddy McClain, Chairman of Krout and Schneider, Inc., a 76-year-old private investigative firm in California. I've been a licensed private investigator for 47 years. I am appearing today on behalf of the National Council of Investigation and Security Services (NCISS) representing both investigative and protective service companies and their State associations throughout the United States. I previously served as Chairman and President of NCISS and am currently a member of the Board of Directors.

We appreciate the opportunity afforded us today to discuss how the Fair Credit Reporting Act impedes the ability of employers to provide a safe and secure workplace. We regret that we did not participate the last time Congress considered the FCRA. The 1996 amendments to the Act, as interpreted by the Federal Trade Commission, restrict employers from obtaining independent investigations of employee misconduct.

We believe the FCRA was intended to provide consumers a remedy when their credit records contained errors that affected their ability to obtain credit. And, to the extent that credit reports might be used as a yardstick in the hiring process, to allow the applicant an opportunity to correct those errors. We do not believe Congress intended to hamper investigations of lawbreaking in the workplace.

As outlined in detail by others on the panel, employers face restrictions on the conduct of preemployment criminal background checks. They are also limited in obtaining frank appraisals in job references because of former employers' fear of liability. Unfortunately, they will sometimes have to confront the possibility of employee misconduct.

The FCRA thwarts investigations of misconduct by third parties in many ways. The most egregious require:

1. Notice to employees, including possible suspects, before any investigator or consultant initiates an investigation.

2. Written authorization from the accused or suspect employee before an investigation is undertaken.

3. Providing a complete, unedited copy of an investigative report prior to taking any adverse action against an employee.

The FCRA stymies the ability of all employers to engage outside experts to investigate employee misconduct and provide a safe workplace. Even many Fortune 100 firms prefer to hire third parties to conduct employee misconduct investigations to avail themselves of the expertise of specialists and to maintain the integrity and objectivity of an impartial review. Indeed, they are encouraged to do so by government agencies. Then Assistant Attorney General James Robinson testified before this Subcommittee previously that

"The Department is very concerned about the possible implications for law enforcement investigations and on corporate compliance and self-reporting programs that the Department and other agencies encourage, and in some cases, even require that arise from applying the FCRA to investigations by outside counsel of specific allegations of wrongdoing in the workplace by an employee."

The FCRA will continue to frustrate Boards of Directors from retaining independent experts to ferret out corporate malfeasance. When a Board needs to investigate the CEO, President and CFO, who will be able to provide an independent investigation under the FCRA? Can the Board obtain these officers' consent for such an investigation which could lead eventually to criminal prosecution?

The FTC interprets the FCRA as meaning that any investigator, who regularly conducts employment investigations that report on the character or reputation of an employee, is a Consumer Reporting Agency and subject to the FCRA rules. But most of the requirements of the FCRA do not make sense except in the context of credit reports. They should not apply to investigations that have nothing to do with credit and should not be imposed on employers attempting to maintain safe workplaces. We believe that investigators of workplace misconduct should not be designated as Consumer Reporting Agencies and their reports should not be classified as Consumer Reports.

Section 611 is an example of a provision that was designed to correct credit report errors. It requires a re-investigation at any time that a consumer disputes anything in a consumer's file at a Consumer Reporting Agency and requests a re-investigation. That may make sense for a disputed invoice in a credit file, but employee misconduct investigations often involve hundreds of hours of investigation and interviews of witnesses who may become less cooperative when they learn their statements were released to the suspect. This section would require an investigator to go over the same ground and conduct new interviews at no charge within 30 days from the time of the request.

The FTC has said that no portion of a completed Consumer Report may be redacted. Therefore, information that is not relevant to the accused, but is relevant to the safety and privacy of others, would also have to be revealed. While Section 609 of the Act says it is not necessary to divulge sources of information acquired solely to prepare an Investigative Consumer Report, it is in conflict with Section 604 (b)(3)(A) that says the employee must receive a copy of the report.

Moreover, even absent the name of a witness, the content and circumstances described in a statement frequently will reveal the identity of a witness.

Harassment and Discrimination

The 1996 amendments to the FCRA have set back progress on sexual harassment and discrimination substantially. The Act provides no explanation or suggestion of what an employer should do if an accused person refuses to give his/her permission to be investigated . Investigation of harassment and civil rights cases call for the most tactful and professional investigative techniques. Tempers are often at a fever pitch. The EEOC has recognized that they are best done by experienced third parties—yet the FCRA discourages employers from retaining them.

Violence

These requirements exacerbate investigations of employee violence even more. When an employee appears to exhibit the symptoms of a deranged individual and is suspected of having the wherewithal to carry out threats to fellow workers or supervisors, the last thing the employer wants to do is ask the employee for permission to investigate her or him. Even in cases where permission was obtained at the time of hire, handing the employee a report containing the details of evidence against him before terminating or suspending his employment is like lighting a fuse. Employers are damned if they do and damned if they don't comply with the FCRA.

My firm is often hired to assist employers in dealing with potentially violent employees. It is not uncommon for employees exhibiting violent propensities not to have been thoroughly

backgrounded at the time of hire. In addition to surveillance, these investigations usually involve conducting inquiries to include covert neighborhood interviews. Neighbors are often aware of suspicious activity, proclivity towards firearm ownership or even knowledge of explosives. Since the 1996 FCRA amendments, the report of such an investigation would be considered an Investigative Consumer Report and it would be unlawful for the employer to order such an investigation without disclosure and permission. The ramifications of advising such an employee that he is going to be investigated, are obvious.

Theft

Statistics indicate that about one-third of business failures each year in this country are the result of employee theft. When businesses fail, consumer employees lose their jobs. Of all crimes by employees, perhaps investigation of embezzlement requires the most stealth and expertise. Embezzlers are often in the best position to cover their tracks. Yet, before an employer can hire an outside expert to investigate embezzlement, written permission must be obtained. As the Chairman of a House Committee recently remarked, "That defies common sense."

Drug Use

Illicit drugs continue to be a scourge on American society. Ostensibly, we've been fighting a war on drugs for years yet recent statistics reveal that about seven percent of employees still use drugs in the workplace. This endangers fellow employees and customers, as well as themselves, particularly if they operate forklifts or other hazardous machinery. But the FCRA makes it virtually impossible to ferret out users or drug dealers from the workplace. The FCRA now requires us to obtain certification from the employer that they have received

permission from employees to initiate an investigation. Yet in many instances, we have no idea who the suspects are when we commence an investigation. Since most employers have not obtained the requisite permission in advance, should we wait until we know which ones are dealing drugs to ask for permission to investigate them?

Intellectual Property

Prior to the 1996 amendments, employers were able to hire impartial experts to covertly conduct sensitive investigations that would not be possible today. For example, my firm was engaged to investigate an alleged theft of trade secrets for a Fortune 100 defense contractor. Using a combination of public record information, surveillance and undercover techniques, we were able to determine the facts. A sales/marketing manager and a production chief had conspired with a scientist to form a competing company that was bidding on the same government contracts. Although one conspirator left our client's employ, he was fed information by the other two who remained as moles. Not only were the scientific secrets being disclosed, but bidding information allowed the competitor to slightly undercut their pricing on closed bids. This successful prosecution would have been nearly impossible if our client had to notify the culprits in advance of the investigation.

The need for confidentiality should be obvious in any investigation of misconduct. In fact, Congress determined this to be the case in other statutes of recent vintage. I understand that the Bank Secrecy Act makes it a violation of law to tell a customer if a bank will file a suspicious transaction report. The Act provides at 31USC 5318(g)(2)

"A financial institution, and a director, officer, employee or agent of any financial institution, who voluntarily reports a suspicious transaction pursuant to this section or any other

authority, may not notify any person involved in the transaction that the transaction has been reported."

If we conduct any interviews -- and even reported conversations with witnesses are considered to be interviews -- then our report is considered to be an Investigative Consumer Report and the employer must advise the accused of the nature and scope of the investigation. And, before taking adverse action against an employee, a complete unedited copy of the report must be provided to the employee no matter how felonious their behavior.

We often conduct undercover investigations by placing an operative in a client's workplace to interact with suspects. These types of investigations are some of the most cost effective ways to obtain conclusive proof of employee criminality. Since the advent of the 1996 amendments, many of our labor lawyer clients have advised their clients not to risk such an investigation even in the face of significant losses or danger to co-workers. The reason is the attorneys do not wish to provide suspects with a copy of the Investigative Consumer Report. Not only does this risk jeopardizing safety, but it could lead some employers to terminate suspect employees for other reasons, which could result in an employee being wrongfully terminated. It is fairer to all parties to know the facts.

Holding employee violators to answer for their misdeeds by imposing discipline is often traumatic and unpleasant for employers. But their other employees have a right and expectation of a safe work environment. Many employees are naturally reluctant to come forward and cooperate with an investigation. And, when they learn that the requirements of the FCRA mandate disclosure of their cooperation, the chances of getting to the truth are greatly minimized.

Many times in my experience, at the conclusion of such an investigation, honest employees have come forward to say, "Thank goodness you did something about this."

HR 1543

NCISS strongly supports HR 1543, The "Civil Rights and Employee Investigation Clarification Act." The bipartisan measure would make clear that investigations of employee misconduct are not covered by the FCRA. But it would provide protections for consumers and employees. The bill makes clear that it does not permit access to credit reports. It also would require that after taking adverse action against an employee, an employer must provide a summary containing the nature and substance of the communication upon which the action is based.

But time is of the essence. If Congress does not act quickly to amend the FCRA, invasions of privacy and violations of safety will continue. Witnesses will be coerced and possibly killed or injured and violations of law will go unchallenged because employers without an employee's authorization are not permitted to hire a discreet, confidential investigation by an impartial expert or use that investigative report properly. Congress must not let stand regulations that further jeopardize the safety and well being of honest employees.

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Statement of

the American Council of Life Insurers

Before the

House Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

On

The Role of FCRA in Employee Background Checks and the

Collection of Medical Information

Tuesday, June 17, 2003

Presented by

Roberta Meyer, Esq.

Senior Counsel, Risk Classification

Chairman Bachus, and Members of the Subcommittee. I am Roberta Meyer, Senior Counsel at the American Council of Life Insurers ("ACLI"). I am pleased to appear before the Subcommittee today on behalf of the ACLI to discuss the topic of the Fair Credit Reporting Act ("FCRA") and the collection of medical information by life insurers. The ACLI is the principal trade association of life insurance companies. Its 383 member companies account for 73 percent of the assets of legal reserve life insurance companies, 70 percent of life insurance premiums and 77 percent of annuity considerations in the United States. ACLI members are also major participants in the pension, long-term care insurance, disability income insurance and reinsurance markets.

Life insurers have a long history of dealing with highly sensitive information, including consumers' medical information, in a professional and appropriate manner. Life insurers must collect and use medical information in order to serve their existing and prospective customers. At the same time, life insurers support strict protections for medical records confidentiality, including support for prohibiting the sharing of medical information in connection with an extension of credit .

Why Life Insurers Collect Medical Information

In today's world, it is more important than ever for consumers to have ready access to as much insurance as possible to protect their future financial security as well as the financial security of their families. In order to continue to make insurance products and services widely available at the lowest possible cost, life insurers need access to information that establishes a consumer's eligibility and the appropriate premium for insurance products for which the consumer has applied. An applicant's medical

condition is an important factor in making that determination. Accordingly, insurers collect personal medical information from consumers in connection with providing life, disability income and long term care insurance.

Medical information is used to group applicants into pools that accurately reflect the financial risk presented by the applicants. This system of classifying proposed insureds by level of risk is called risk classification. It enables insurers to group together people with similar characteristics and to calculate a premium based on that group's level of risk. Those with similar risks pay the same premiums. The process of risk classification provides the fundamental framework for the current private insurance system in the United States. It is essential to insurers' ability to determine premiums which are fair relative to the risk posed by the applicant. It is the process of risk classification based in large part on medical information, which has made life, disability income and long term care insurance widely available and affordable in our country. Preserving our risk classification process is critical to preserving our ability to continue to pay future claims to consumers.

Life insurers may collect medical information directly from the consumer. With the consumer's consent, medical information may also be collected from the consumer's medical provider. Medical information used for underwriting purposes is collected from third parties only with the consumer's consent. Insurers may also request medical information in connection with processing a policyholder's claim. For additional information regarding the operational aspects of the underwriting process, I refer you to

my previous testimony before the Subcommittee in June 1999 and before the full Committee in June, 2000.[1]

The ACLI's Medical Information Confidentiality Policy

ACLI members are keenly aware of the importance of maintaining the confidentiality of medical information of policyholders. They are committed to the principle that they must handle medical information appropriately and ensure that its confidentiality is preserved. To underscore that commitment, our members strongly support ACLI's policy, entitled Confidentiality of Medical Information: Principles of Support, which is intended to be used in connection with legislative and regulatory privacy proposals. I have attached a copy of our Principles of Support to my testimony.

The ACLI's Principles of Support provide for strict limits on the ability of insurers to obtain and disclose medical information about their policyholders. The Principles also support a prohibition against an insurance company sharing a consumer's medical information with a financial institution, such as a bank, for the purpose of determining the person's eligibility for a loan or other credit. This policy applies even if the financial institution is affiliated with the insurer. Our members are strongly committed to this principle.

Medical Information and the FCRA

Under the FCRA, medical information may be a "consumer report" because it bears on the consumer's personal characteristics and is used as a factor in establishing a consumer's eligibility for insurance. However, medical information is accorded special

[1] Testimony of the American Council of Life Insurance Before the House Committee on Banking and Financial Services, Subcommittee on Financial Institutions and Consumer Credit On Emerging Privacy Issues, June 21, 1999; Testimony of the American Council of Life Insurers Before the House Committee on Banking and Financial Services On The Medical Financial Privacy Protection Act, June 14, 2000.

status under the FCRA. Medical information can be disclosed by a consumer reporting agency to an insurer only in connection with an insurance transaction and only with the consumer's consent.

The FCRA is important to insurers because it establishes a framework under which insurers may obtain and share consumer information which facilitates the widespread availability and affordability of life insurance products and services uniformly through out the country. For example, the Act establishes that insurers may obtain a consumer report in connection with underwriting insurance. The Act enables insurers to obtain and share information that is critical to the determination of the consumer's eligibility for insurance and the appropriate premium. At the same time, the FCRA provides safeguards to ensure that the confidentiality of highly sensitive medical information will be preserved. Insurers believe that the FCRA is critical to their business. The act acknowledges that it is important for insurers to obtain medical information in connection with underwriting insurance and processing claims. At the same time, the FCRA recognizes the highly sensitive nature of medical information and establishes safeguards for consumers.

The Gramm-Leach-Bliley Act and State Law

Insurers also strongly support the privacy protections of Title V of the Gramm-Leach-Bliley Act (the "GLB Act"). Under the GLB Act, medical information is regarded as nonpublic personal information and is subject to the protections established by that act. Medical information may not be shared with an unaffiliated third party unless the consumer has been given a notice that the information may be shared and is provided with the opportunity to opt-out of such sharing. Medical information is permitted to be

shared without an opt-out only for operational reasons or in connection with a joint marketing agreement between two or more financial institutions. However, as noted below, state privacy laws and regulations generally require an opt-in for the sharing of medical information.

The GLB Act provides that state insurance authorities are to adopt rules to implement and enforce the GLB Act under state insurance law. When the National Association of Insurance Commissioners ("NAIC") and the states were in the process of developing and promulgating their rules, the ACLI expressed the view that medical information should be accorded additional protections in view of its highly sensitive nature. Accordingly, the ACLI firmly supported the heightened protections contained in the NAIC Privacy of Consumer Financial and Health Information Model Regulation. Under the Model Regulation, an insurer may not disclose health information about a consumer unless an authorization is obtained from the consumer. In effect, the NAIC's Model Regulation requires an opt-in before medical information may be shared by insurers. It should be noted, of course, that like the GLB Act, the Model Regulation permits the disclosure of medical information in connection with operational requirements in order to complete the insurance transaction, as well as for other operational needs.

The NAIC's Insurance Information and Privacy Protection Model Act

Before Congress enacted the GLB Act, the NAIC developed its Insurance Information and Privacy Protection Model Act (the "NAIC Model Act"). The NAIC Model Act requires the written authorization of the consumer before an insurer may share consumer medical information with another person. Information, of course, can be

shared in order to enable the insurer to perform business functions needed to process an application and to complete the insurance transaction. Under the NAIC Model Act, an insurer must obtain a consumer's authorization (i.e., opt-in) before it may disclose medical information to a nonaffiliated party for marketing. The Model Act provides an added degree of protection to consumers and underscores the importance insurers attach to preserving the confidentiality of consumer medical information. Also, in addition to these NAIC model laws, many states have other laws and regulations that require insurers to obtain consumers' consent before disclosing medical information relating to particular medical conditions.

HIPAA

Health insurers and long term care insurers are subject to regulations adopted by the Secretary of Health and Human Services under the Health Insurance Portability and Accountability Act of 1996 ("HIPAA"). The ability of other insurers, including life and disability income insurers, to obtain medical information is also subject to the HIPAA rules. The HIPAA rules establish a broad regulatory framework governing the use and disclosure of consumer health information by health care providers, such as doctors, hospitals, pharmacies and health plans, which include long term care insurers. Unless they are engaged in treatment, payment or health care operations, health care providers may not disclose medical information about a consumer to others, including life and disability insurers, as well as long term care insurers, unless they first obtain the authorization (i.e., opt-in) of the consumer. Similarly, unless they are engaged in treatment, payment, or health care operations, health insurers and long term care insurers may only disclose medical information about a consumer with the consumer's

authorization (i.e., opt-in). The HIPAA rules, therefore, provide another significant level of protection to assure that consumer medical information is handled properly.

Conclusion

The ACLI and its members are committed to protecting the privacy of consumer medical information. We believe that our exemplary record in preserving the confidentiality of such information demonstrates our commitment to protecting the privacy of our policyholders. We reiterate our strong support for strict protections for medical records confidentiality, including support for prohibiting the sharing of medical information in connection with an extension of credit . We appreciate the opportunity to testify today, and I would be pleased to address any questions the Subcommittee may have.

Confidentiality of Medical Information

Principles of Support

Life, disability income, and long-term care insurers have a long history of dealing with highly sensitive personal information, including medical information, in a professional and appropriate manner. The life insurance industry is proud of its record of protecting the confidentiality of this information. The industry believes that individuals have a legitimate interest in the proper collection and use of individually identifiable medical information about them and that insurers must continue to handle such medical information in a confidential manner. The industry supports the following principles:

1. Medical information to be collected from third parties for underwriting life, disability income and long-term care insurance coverages should be collected only with the authorization of the individual.

2. In general, any redisclosure of medical information to third parties should only be made with the authorization of the individual.

3. Any redisclosure of medical information made without the individual's authorization should only be made in limited circumstances, such as when required by law.

4. Medical information will not be shared for marketing purposes.

5. Under no circumstances will an insurance company share an individual's medical information with a financial company, such as a bank, in determining eligibility for a loan or other credit - even if the insurance company and the financial company are commonly owned.

6. Upon request, individuals should be entitled to learn of any redisclosures of medical information pertaining to them which may have been made to third parties.

7. All permissible redisclosures should contain only such medical information as was authorized by the individual to be disclosed or which was otherwise permitted or required by law to be disclosed. Similarly, the recipient of the medical information should generally be prohibited from making further redisclosures without the authorization of the individual.

8. Upon request, individuals should be entitled to have access and correction rights regarding medical information collected about them from third parties in connection with any application they make for life, disability income or long-term care insurance coverage.

9. Individuals should be entitled to receive, upon request, a notice which describes the insurer's medical information confidentiality practices.

10. Insurance companies providing life, disability income and long-term care coverages should document their medical information confidentiality policies and adopt internal operating procedures to restrict access to medical information to only those who are aware of these internal policies and who have a legitimate business reason to have access to such information.

11. If an insurer improperly discloses medical information about an individual, it could be subject to a civil action for actual damages in a court of law.

12. State legislation seeking to implement these principles should be uniform. Any federal legislation to implement the foregoing principles should preempt all other state requirements.

TESTIMONY OF

HAROLD MORGAN
SENIOR VICE PRESIDENT, HUMAN RESOURCES
BALLY TOTAL FITNESS CORPORATION

ON BEHALF OF

LPA, THE HR POLICY ASSOCIATION

BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT
OF THE
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

CONCERNING
THE ROLE OF FCRA IN EMPLOYEE BACKGROUND CHECKS

WASHINGTON, DC
JUNE 17, 2003
(03-77)

The HR Policy Association

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Mr. Chairman and Distinguished Members of the Subcommittee:

My name is Harold Morgan. I am Senior Vice President, Human Resources for Bally Total Fitness Corporation. I am pleased to appear before you today on behalf of LPA, the HR Policy Association, to discuss the critical role played by employment background screening in today's workplace and other important issues concerning the Fair Credit Reporting Act.

Bally Total Fitness Corporation is the largest and only nationwide, commercial operator of fitness centers, with approximately four million members and nearly 430 facilities located in 29 states, Canada, Asia and the Caribbean. We have approximately 23,000 employees, of whom over 5,000 are personal trainers and 1,000 are employed in our child care centers.

LPA, the HR Policy Association, is a public policy advocacy organization representing senior human resource executives of more than 200 leading employers doing business in the United States. LPA provides in-depth information, analysis, and opinion regarding current situations and emerging trends in employment policy among its member companies, policy makers, and the general public. Collectively, LPA members employ over 19 million people worldwide and over 12 percent of the U.S. private sector workforce.

I appreciate the opportunity to appear before you today to discuss the application of the Fair Credit Reporting Act to employment background checks and investigations of sexual harassment and other serious workplace misconduct. The Fair Credit Reporting Act applies to most employment background checks by large employers such as my company, because a consumer reporting agency is typically used to perform the screening. Yet, employment screening is an aspect of FCRA that is often overlooked, as most of the focus of the policy debate centers on credit records and other consumer financial information.

While credit records can be an important component of an employment background check, depending on whether the position involves some financial responsibilities, the reality is that the vast majority of employment background checks are more focused upon information of far greater relevance to most positions—employment history, educational background, professional credentials, and, most importantly, criminal history. It is important for Congress to be aware that all of these aspects of background screening are regulated by a statute originally intended and designed to regulate the sharing of personal financial information.

These regulations can have an enormous impact, especially in the service sector. Businesses in the service sector generally have greater turnover and, as a result hire many employees. By way of example, last year my company hired over 10,000 new employees.

Generally speaking, we urge your Subcommittee to recognize the enormous pressures and expectations imposed on today's employer with regard to seeking to ensure that individuals in their workplace do not pose a threat to their co-workers, customers, and the public at large. If any changes to FCRA are to occur, they should facilitate the ability of employers to address these needs rather than hindering it with new restrictions.

The Importance of Background Checks

Since 1996, when significant new employer obligations were added to FCRA, the priority attached to employment background checks by employers, employees and the public generally has changed dramatically. While the horrific events of September 11 have clearly played a part in this, that is not the entire story. A decade of disturbing headlines involving workplace violence, coupled with a commitment by companies to stamp out sexual and racial harassment in the workplace, had already prompted employers to exercise greater care. Meanwhile, soon after September 11, a wave of corporate scandals, where the misdeeds of a few key employees brought corporate giants to their knees, demonstrated the need to exercise this caution at all levels of the corporate domain.

In my own company, we have several employee groups where caution must be "exercised" (so to speak) from a screening and hiring perspective. In the nature of their work, our personal trainers have a certain amount of physical contact with their clients as well as having access to our locker rooms. We certainly need to avoid hiring anyone that may have a tendency toward violence, sex offenses or other actions that would pose a serious threat to their co-workers or our customers. In addition, our supervisors have considerable access to personal client information that must be accorded the utmost confidentiality. Finally, the sensitivities regarding our child care attendants go without saying. Clearly, all of these employees need to be thoroughly screened.

Employers conduct background checks on potential and current employees in order to screen out candidates who pose a greater-than-average threat to the safety and security of the workplace. Examples of why background checks are necessary, unfortunately, are not hard to find. Indeed, the newspapers are full of stories detailing workplace violence, fraud, sexual and racial harassment, or other problems that may have been avoided with a background investigation. In the last few years, several episodes of workplace violence have highlighted this issue. Meanwhile, the Occupational Safety and Health Administration (OSHA) reports that homicide was the second leading cause of occupational fatalities in 2001.[1]

Examples of why screening can be a critical part of maintaining a safe work environment, unfortunately, are not hard to come by. In one recent case, a maintenance employee in an apartment building, strangled a 20-year-old mother. As part of his work, the maintenance employee had access to the keys for all the apartments and he used those keys to unlawfully enter the victim's residence. Had the apartment complex run a background check, it would have discovered he had previously been convicted of rape, armed robbery, burglary, robbery by force, and credit card fraud and that there was an outstanding warrant for his arrest.[2]

Another area where background checks can be a useful tool is in the prevention of identity theft, which has been a major focus of the FCRA hearings this year. An example of how a background check can help curb identity theft is provided by an incident involving First Interstate Bank prior to its acquisition. In 1994, First Interstate permitted an individual to work for three months in its Visa credit-card-collections division before terminating him after a background check revealed he had been convicted of grand theft in California in 1981.[3] During those three months, however, the employee used a

customer's confidential information to obtain credit cards and take out high-interest-rate loans, accumulating a total of $50,000 in debt.[4] The customer in turn, sued the First Interstate for $150,000.[5]

A similar identity theft case shows the importance of a *thorough* background check. An individual who was convicted in 1996 of two felony counts related to identity theft in Ohio reused the identity he had stolen in that case to apply for the position to oversee pension funds with the state Public Employee Retirement Fund.[6] The state had run a limited background check that did not reveal the false identity or convictions.[7] After a tip, however, a newspaper engaged in a more thorough background investigation and discovered his real identity and criminal past.[8] Not surprisingly, after the incident, the Governor called for a review of the state's background check procedures.[9]

Thus, it is not surprising that the public not only supports—but also in many cases *expects*—employers to conduct criminal background checks. Indeed, according to a 2002 Harris poll conducted for Privacy & American Business, the vast majority of employees found investigations into a job candidate's work history (92 percent) and/or criminal convictions (91 percent) acceptable, and a majority believe that employers should be able to examine arrest records without convictions.[10] The poll also found that 53 percent of employees *want* their employers to conduct more detailed background checks.[11]

Meanwhile, in response to this heightened public concern, the government increasingly requires that certain employers conduct background checks. For example, in sensitive industries—day care, transportation, ports, security, financial services and nuclear power—the government either has instituted or is seriously considering mandated background checks. Most recently, under proposed rules currently pending before EPA, contractors performing work for EPA on federally-owned, leased or occupied facilities would be required to conduct background checks and make suitability determinations regarding employees working at those facilities.[12] In addition, in an action required by the USA PATRIOT ACT, the Transportation Security Administration and DOT have issued interim regulations, effective immediately, requiring background checks for holders of commercial drivers licenses with a hazardous materials endorsement.[13]

This list is likely to grow as several Members of Congress on both sides of the aisle have introduced numerous bills that would require employers in specific industries to perform background checks for certain occupations. A partial listing includes: H.R. 18, by Rep. Judy Biggert (R-IL), requiring background checks for employees of certain Medicare providers; H.R. 439, by Rep. Rob Andrews (D-NJ), requiring that businesses "that send employees into people's homes" perform background checks on those employees; H.R, 364, by Rep. Darlene Hooley (D-OR), requiring background checks on drivers providing Medicaid medical assistance transportation services; and S. 350, by Sen. Hillary Clinton (D-NY), requiring background checks on employees who handle radioactive materials.

In some instances, the government does not explicitly require background checks, but encourages them by permitting "negligent hiring" suits against employers that fail to conduct adequate checks. Under a negligent hiring claim, a plaintiff may recover against an employer for injuries caused by an employee whom the employer would not have hired had it conducted an adequate background check.

LPA Background Check Protocol

As the importance of employment background screening has grown, we also recognize the need for employers to maintain the confidentiality and ensure the accuracy of the highly sensitive and private information about prospective and current employees gained through background checks and employee investigations. Employers are responsive to this need and take the utmost care in developing and implementing practices that maintain confidentiality and accuracy of information gathered from background checks and investigations.

A description of how LPA member companies approach this sensitive area is provided by the *LPA Background Check Protocol*. The Protocol was authored by the LPA Workplace Security Advisory Board, which is composed of the top security officials of LPA member companies. The Protocol articulates the best practices of companies that have had considerable experience with background checks and illustrates the complexity of the issues in this area. Those issues—which involve matching the unique characteristics of the applicant or employee with the distinctive components of the job in question—do not lend themselves to black letter prescriptions. Thus, the Protocol, like voluntary guidelines, acts as an effective guidepost for employers without imposing rigid, inflexible and ineffective restrictions.

Application of FCRA to Employment Background Checks

Employment background checks are regulated by the Fair Credit Reporting Act whenever the employer uses a consumer reporting agency (CRA) to collect the information. Because few large employers have the resources to conduct their own background checks, it is quite common to use CRAs to ensure a thorough and accurate search. Regulation by FCRA has two implications for an employer: 1) procedural requirements pertaining to the initiation of the background check and use of the information gathered; and 2) limits on the reporting of information by the CRA to the employer.

Procedural Requirements. In terms of procedural requirements, the employer must:

- notify and obtain consent from the employee or applicant before initiating a covered background check;[14]
- before receiving the background check, certify to the CRA that it has provided notice and received consent and will provide a copy of the background check and description of FCRA rights before taking adverse action;[15]
- before taking an adverse employment action (*i.e.,* termination, demotion, etc.) based on the background check, provide the applicant or employee with a copy of the background check and a summary of his or her rights under FCRA (this will be provided by the CRA);[16] and
- after taking an adverse action, provide the individual with an "adverse action notice." The notice may be provided orally, in writing, or electronically, but must include:

- the name, address, and phone number of the CRA (including any toll-free telephone number established by a national CRA) that supplied the background check;
- a statement that the CRA did not make the decision to take the adverse action and cannot give specific reasons for it; and
- a notice of the individual's right to dispute the accuracy or completeness of any information the CRA furnished, and his or her right to an additional free consumer report from the agency upon request within 60 days;[17]

- if the individual disputes the accuracy or completeness of the information in his or her file, the CRA shall reinvestigate the matter free of charge and record the status of the disputed information within 30 days.[18]

As far as background checks are concerned—as opposed to workplace misconduct investigations which we will discuss later—we are not aware of any problems LPA member companies have had in complying with these procedural requirements. Because of the critical nature of employment background checks described at the outset, we would strongly caution against imposing any further restrictions that would only impede the process of obtaining essential information in a timely manner.

Limits on Information. The second major limitation of FCRA on employment background checks pertains to the information that may be provided to the employer. FCRA provides that covered background check reports for employees or applicants expected to earn less than $75,000 a year may not contain information regarding arrest records, civil suits or judgments, or other adverse information that predates the report by more than seven years or the applicable statute of limitations—whichever is longer.[19] Conviction records are excluded from this prohibition.

The seven-year time frame is a product of the statute's primary focus upon personal financial information, where seven years is a very long period of time. We would ask whether it makes sense to apply the same time frame to criminal records. Most employers are going to discount an arrest without a conviction that is more than seven years old anyway, but this may not always be the case. If a position involves contact with children and the applicant was arrested more than seven years previously for child molestation, even if it was beyond the statute of limitations, shouldn't the employer at least have that information to make an informed decision? In these instances, the employer could allow the applicant to demonstrate that he or she was exonerated on the basis of the facts and not some procedural technicality.

If your Subcommittee wishes to support the ability of employers to conduct background checks in order to enhance workplace security, we believe the seven-year limit on all non-financial information—or at the very least criminal histories—should be removed or at least extended.

Proliferation of State Laws Inhibiting Access to Criminal Records

While the seven-year limit on adverse information in FCRA poses some obstacles to a thorough background check, this is not nearly as serious as a recent trend among states laws posing even greater restrictions. Several states completely prohibit or severely limit an employer's access to arrest and conviction information. Most of these prohibitions are contained in state discrimination laws, although some are part of state credit reporting laws (*i.e.*, state versions of FCRA).

State Discrimination Laws. The prohibitions pursuant to state discrimination laws are a derivative of several federal courts rulings that using arrest or conviction records as an *absolute* bar to employment may, in certain circumstances, have a disproportionate or "disparate" impact on select minorities and therefore violate Title VII of the Civil Rights Act of 1964 (Title VII) unless the employer can show that such action is "job related."[20]

Unfortunately, many states are using the logic behind these decisions to prohibit employers from ever *inquiring* about a candidate's arrest record—even where there is no evidence that the employer's inquiry will lead to unlawful employment discrimination.[21] Some states take it a step further by limiting an employer's ability to inquire into *convictions*—again, even where there is no evidence that the inquiry will lead to unlawful discrimination.

Yet, even the Equal Employment Opportunity Commission (EEOC) has acknowledged that arrest records may provide information important to the employee selection process.[22] In a guidance document, the Commission provided examples where information gained from an arrest record would justify refusing to hire a candidate.[23] In one of the examples, the Commission said a company would be justified for refusing to hire someone as a bus driver if the person had been arrested two years ago for driving while intoxicated, but was acquitted on procedural grounds.[24] Similarly, the Commission found it acceptable for a school to refuse to hire as a teacher a candidate who was arrested for statutory rape of a student while working at another school, even though charges were dropped because it was discovered the student had just turned 18.[25]

A recent case involving a high school here in Washington, D.C. illustrates the potential danger of ignoring an arrest record for a sensitive position. A former Ballou High School counselor has been charged with forcing a Ballou student to have sex with him more than 10 times over a two-year period. A police affidavit alleges that the counselor told the student he would change her grades or fail her if she refused to have sex with him. According to court records, the same individual was charged in 1996 with raping a 15-year-old girl in August 1992. The case was tried in D.C. Superior Court in March 1997 and ended in a hung jury with no retrial.

School officials point out that, because there was no conviction, D.C. regulations prohibited them from taking the earlier criminal case into account when the individual applied to be a school attendance counselor in 1999. It is worth noting that the same individual received probation in 1988 for two charges of attempted drug possession. School officials indicate, even for a school counselor, that information also could not have been used to bar him from employment with D.C. schools because drug convictions more than 10 years old or that involve only marijuana do not preclude employment.[26]

These examples show that arrest records can reveal important information. Indeed, just because a prosecutor could not prove *beyond a reasonable doubt* that the alleged violation occurred does not definitely resolve whether some misconduct did not occur, particularly in light of limitations on evidence in criminal trials. In fact, even in the context of arrest records, the EEOC has specifically rejected the notion that federal discrimination law requires an employer to apply the *beyond a reasonable doubt* standard in order to base an employment decision on an candidate's arrest record. In guidance, it has noted that the employer may use an arrest record as a basis of an employment decision without conducting "an informal 'trial' or extensive investigation to determine an applicant's or employee's guilt or innocence."[27]

Nevertheless, many state equal employment opportunity laws prohibit employers from seeking information on arrest records. Indeed, at least 11 states have statutes explicitly prohibiting arrest records inquiries,[28] and as many as 12 states have issued administrative guidance declaring the inquiries unlawful.[29] Other states only permit arrest inquiries if the employer shows business necessity.[30]

Some states even limit inquiries into conviction records, such as Alaska, the District of Columbia (as noted), and Ohio, which prohibit inquiries into certain convictions more than 10 years old. [31] Other states impose different limitations. For example, Hawaii only permits inquiries into convictions for candidates who have been extended a conditional offer of employment.[32] California prohibits requests into marijuana convictions over two years old.[33] Similarly, Massachusetts prohibits inquiries into certain first-time convictions—including misdemeanor drunkenness, simple assault, and speeding.[34] Some states only allow inquiring into convictions when the employer proves it is job related.[35]

State Credit Reporting Laws and Other Laws. Several states impose limitations on consideration of criminal records through their own credit reporting laws. The state laws, unfortunately, often impose different obligations than FCRA, thus creating a patchwork of requirements employers must navigate to conduct a nationwide background check.[36]

For example, in California, Montana, Nevada, and New Mexico, a reporting agency may not report arrests or *convictions* more than seven years old.[37] California, New Mexico, and New York prohibit a reporting agency from reporting any arrest that does not result in a conviction.[38] Other states, such as Kansas, Maryland, Massachusetts, and New Hampshire,[39] prohibit consumer reporting agencies from reporting on arrests or *convictions* more than seven years old if the employee or applicant is expected to earn less than $20,000 a year. New York and Texas have similar laws but set the salary level at $25,000 and $75,000, respectively.[40]

If your Subcommittee wishes to support the ability of employers to conduct background checks in order to enhance workplace safety, we believe you should consider a safe harbor against prosecution under state law limitations on criminal information for employers who have complied with the terms of FCRA.

Inadequacy of Existing Databases

Even where an employer to is allowed to consider criminal data, there is the problem of access to such data. While FCRA itself cannot correct this problem, any discussion of the impact of FCRA on background checks would not be complete without at least noting

the problem. While workers in certain industries, such as those employed at nuclear plants or in U.S. ports, are subject to national and international background checks run through the Justice Department—employers in most industries do not have access to federal databases and must run nationwide background checks by accessing each state database either through their own resources or through a consumer reporting agency.[41]

The federal government maintains various databases with criminal history information, the most comprehensive of which is the National Crime Information Center (NCIC), which is maintained by the FBI. Yet, access to these databases is limited to law enforcement and certain other governmental personnel, even though to a large extent the data in the databases is a matter of public record. Congress has enacted laws permitting some employer access to criminal history records through the FBI or state agencies but this access is narrowly limited to certain occupations.

Thus, for the vast majority of positions, employers and the consumer reporting agencies they use are left with a jurisdiction-by-jurisdiction search, which is not always sufficient. For example, in a recent case in Virginia, a former employee of the Williams School, was convicted of videotaping nude boys from the school.[42] The school only ran a background check in Virginia which, of course, failed to turn up a previous conviction for child molestation in North Carolina.

While we recognize that any changes in access to federal criminal databases is outside the jurisdiction of your committee, we would encourage Congress to look into this problem. Since FCRA encompasses information about criminal records, it would certainly be relevant as part of any new legislation amending FCRA to authorize a study of the effects of the current prohibition against employers accessing these records for employment purposes.

Application of FCRA to Sexual Harassment and Other Workplace Misconduct Investigations

Your Subcommittee's consideration of the reauthorization of FCRA provides an opportunity to address a serious misinterpretation of the statute by the Federal Trade Commission with regard to certain workplace misconduct investigations. In 1999, the FTC issued an opinion letter, known as the Vail letter, which states that if an employer uses experienced outside investigators, such as private investigators, consultants, or law firms, to investigate workplace misconduct, the investigators are considered "consumer reporting agencies" (CRAs) under FCRA and, therefore must comply with that Act's notice, disclosures and other requirements.[43]

Unfortunately, an investigator cannot possibly conduct an effective investigation into many forms of serious workplace misconduct while also complying with these requirements. For example, as is illustrated in a case we describe below, a board of directors cannot effectively investigate its CEO and other high-level executives for "cooking the books" if it must first inform and obtain consent from the subjects of the investigation. Nor could an employer conduct an effective investigation into sexual or racial harassment if witnesses knew that the employer would have to readily reveal to the accused a report in which he or she could easily identify those witnesses.[44]

Thus, the FTC interpretation effectively deters employers from using *outside* organizations to conduct investigations. Yet state and federal laws strongly encourage employers to use experienced and objective third parties to investigate suspected workplace misconduct, such as workplace violence, fraud, employment discrimination and harassment, securities violations, and theft. Moreover, in many cases an employer may need to use an outside investigator because the technical nature of the alleged misconduct requires an expert investigator or the investigation is of a high-level official and outside objectivity is needed. In other cases, the employer may simply lack the resources to conduct an in-house investigation.

Even the FTC has acknowledged the problem caused by the Vail letter.[45] Nevertheless, the Commission has refused to rescind the Vail letter, claiming again in its testimony earlier this month that it is a correct interpretation of the statute and that Congress must amend FCRA in order to fix the problem. Indeed, the Commission has maintained this position despite change in leadership and in the face of overwhelming criticism of the legal reasoning behind the Vail letter, particularly with respect to Congressional intent and legislative history.[46]

The few courts that have addressed the issue have neither embraced nor squarely rejected the Vail letter. While most have expressed doubt over the validity of the Vail letter interpretation, they have nonetheless disposed of the case on technical issues not directly related the to FTC's interpretation.

In one noteworthy case where this issue has yet to be resolved, *Rugg v. Hanac*,[47] the company hired a consulting firm to investigate possible problems with its finances after the city of New York expressed concern following an audit. Soon thereafter, the board of directors discharged the company's executive director. Relying on the Vail letter, the executive director sued the company for failing to follow FCRA's notice and disclosure requirements. Although the court expressed reservations about the validity of the Vail letter interpretation, it nonetheless denied the employer's motion to dismiss and ordered more discovery on the issue of whether the consulting firm regularly conducted such investigations, and therefore is a CRA within the meaning of the statute.[48]

Bipartisan legislation has been introduced —H.R. 1543, the Civil Rights and Employee Investigation Clarification Act, by Reps. Pete Sessions (R-TX) and Sheila Jackson-Lee (D-TX)—which would exempt workplace misconduct investigations from FCRA as long as certain conditions are met. H.R. 1543 would amend FCRA to exclude from the definition of a "consumer report investigation" an investigation concerning: (1) suspected misconduct relating to employment, or (2) compliance with the law, the rules of a self-regulatory organization, or any pre-existing written policies of the employer. The exemption would not include investigations of an employee's credit, and the results of the investigation could only be given to the employer or its agent, a government official, a self-regulatory organization, or as otherwise required by law. For the exemption to apply, after taking any adverse action based on information in the investigative report, the employer would be required to provide to the employee a summary of the report containing the nature and substance of the investigation, but not the sources of the information. The effect of this exclusion is that employers would not need to get consent from an employee *before* conducting an investigation or disclose the

details of the investigation, the two major impediments FCRA imposes on workplace misconduct investigations.

While we would prefer legislation that would exclude altogether from FCRA workplace misconduct investigations that do not involve a CRA background check, H.R. 1543 represents a workable solution and we commend Reps. Sessions and Jackson-Lee for their leadership on this issue. We urge you to include this measure as part of any FCRA amendments enacted in this Congress, if not as a separate bill.

Conclusion

In sum, the reauthorization of FCRA occurs at a time when employers are under considerable pressure from their stakeholders to provide a secure workplace. We urge that any action you take, if anything, help employers address those critical needs. We have made several suggestions in this testimony for improvements to FCRA and we look forward to working with you. Thank you for the opportunity to present our views.

Endnotes

[1] 2001 Census of Fatal Occupational Injuries Data, retrieved from http://www.bls.gov/iif/oshcfoi1.htm#2001.
[2] Janet L. Conley, *$13.4 Million Damages Awarded in Gwinnett Apartment Slaying,* Fulton County Daily Report, Vol. 113, No. 157 (Aug. 14, 2002).
[3] Rob Eure, *Bank Is Sued Over Theft Of Private Data,* Wall Street Journal (Sept. 8, 1999).
[4] *Id.*
[5] *Id.*
[6] *Ex-Indiana pension chief hid conviction; Benefit officer served time for identity theft,* The Courier-Journal, (Aug. 16 2002).
[7] *Id.*
[88] *Id.*
[9] *Id.*
[10] Harris Interactive, *Privacy and Security: The Mind and Mood of U.S. Employees and Managers* 34, 81 (May 14, 2002); *see also* Alan Westin, *Biometrics and Privacy in the Private Sector: An In-Depth Report,* Privacy & American Business, Vol. 9, No. 8 at 7, 8 (Dec. 2002) (76 percent of those polled found it acceptable for employers to check biometrics of a job applicant against a government database of convicted felons and 90 percent found it acceptable for the government to check applicants for licenses as teachers, private guards, or nursing home workers against a biometric database of criminal offenders).
[11] Harris Interactive at 36 & 83.
[12] Acquisition Regulation: Background Checks for Environmental Protection Agency Contractors Performing Services On-Site, 68 Fed. Reg. 2988 (2003).
[13] Security Threat Assessment for Individuals Applying for a Hazardous Materials Endorsement for a Commercial Drivers License, 68 Fed. Reg. 23852 (2003) (codified at 49 C.F.R. Parts 1570 and 1572).
[14] 15 U.S.C. § 1681b(b)(2).
[15] *Id.* § 1681b(b)(1).
[16] *Id.* § 1681b(b)(3).
[17] *Id.* § 1681m(a).
[18] *Id.* § 1681i.
[19] *Id.*. § 1681c(a) & (b).
[20] 42 U.S.C. § 2000e *et seq.; see Equal Employment Opportunity Commission Policy Guidance on the Consideration of Arrest Records in Employment Decisions Under Title VII* (1990) (citing several cases supporting this proposition).
[21] Strangely enough, guidance issued by the Equal Employment Opportunity Commission appears to condone a state ban on inquiries, even though it readily admits arrest information can be pertinent to the job selection process. *See Equal Employment Opportunity Commission Policy Guidance on the Consideration of Arrest Records in Employment Decisions Under Title VII* 5-6 & 9 (1990); *see also Equal Employment Opportunity Commission, Theories of Discrimination Appendix 604-A* at 3 (stating that an absolute bar to employment on the basis of conviction records is only unlawful "where there is evidence of adverse impact").
[22] *Id.*
[23] *See generally id.*
[24] *Id.*
[25] *Id.*
[26] *Counselor Faces Sex Charge*, Wash. Post, June 5, 2003, at B-2.
[27] *Id.* at 9.
[28] Those states are: Alaska (Alaska Stat. § 12.62.160(b)(8); Arkansas (Ark. Code Ann. § 12-12-1009(c)); California (Cal. Lab. Code § 432.7(a)); Illinois (Ill. Comp. Stat. 5/2-103(A)); Massachusetts (Mass. Gen. Laws ch. 151B § 4(9)(ii)); Michigan—but for misdemeanor offenses only (Mich Camp. Laws § 37.2205a(1)); Mississippi (Miss. Code Ann. § 45-27-12(a)(b)); Nebraska—if the arrest is more than a year old (Neb. Rev. Stat. § 29-3523(1)); New York (N.Y. Exec. Law § 296(16)); North Dakota (N.D. Cent. Code § 12-60-16.6)); and Rhode Island (R.I. Gen. Laws § 28-5-7(7)).
[29] Those states are: Arizona (Arizona Civil Rights Division's Pre-Employment Guide); Colorado (Colorado Civil Rights Commission guidelines on pre-employment inquiries); Kansas (Kansas Human Rights

Commission's Guidance on Equal Employment Practices); Michigan (Michigan Civil Rights Commission Pre-Employment Inquiry Guide); Nevada (Nevada Pre-Employment Inquiry Guide); New Hampshire (New Hampshire Commission for Human Rights guidelines); New Jersey (New Jersey Guide to Pre-employment Inquiries); Ohio (Ohio Civil Rights Commission's "A Guide for Application Forms and Interviews"); Rhode Island (Rhode Island Commission for Human Rights guidelines); South Dakota (South Dakota Division of Human Rights Pre-employment Inquiry Guide); Utah (Utah Industrial Commission, Anti-Discrimination Division Pre-employment Inquiry Guide); and West Virginia (West Virginia Bureau of Employment Programs Guidelines for Pre-Employment Inquiries").

[30] Those states are: Idaho (Human Rights Commission Pre-employment Inquiry Guide) and Missouri (Missouri Guide to Pre-employment Inquiries).

[31] Alaska (Alaska Admin. Code tit. 13 § 68.310(b)(3)); ((District of Columbia Code Ann. § 2-1402.66; Hawaii (Hawaii Civil Rights Commission Guideline for Pre-Employment Inquiries); and Ohio (Ohio Civil Rights Commission's "A Guide for Application Forms and Interviews").

[32] Haw. Rev. Stat. § 378-2.5(a)-(b).

[33] Cal. Lab. Code § 432.8.

[34] Mass. Gen. Laws ch. 151B § 4(9)(ii).

[35] Those states are: Missouri (Missouri Guide to Pre-employment Inquiries); New Hampshire (New Hampshire Commission for Human Rights guidelines); New Jersey (New Jersey Guide to Pre-employment Inquiries); Rhode Island (Rhode Island Commission for Human Rights guidelines); South Dakota (South Dakota Division of Human Rights Pre-employment Inquiry Guide); and Utah (Utah Industrial Commission, Anti-Discrimination Division Pre-employment Inquiry Guide).

[36] Some state laws complicate matters further by imposing different notice disclosure requirements than those in FCRA. For example, California, Illinois, Minnesota, and Oklahoma require employers to furnish employees with a copy of the report regardless of whether any action is taken based on the report. Cal. Civ. Code § 1786.20(a)(2) (California); 20 Ill. Comp. Stat. Ann. 2635/7(A)(1) (Illinois); Minn. Stat. § 13C.03 (Minnesota); Okla. Stat. tit. 24, § 148 (Oklahoma).

[37] Cal. Civ. Code § 1786.18(a)(7) (California); Mont. Code Ann. § 31-3-112(5) (Montana); Nev. Rev. Stat. 5698C.150(2) (Nevada); N.M. Stat. Ann. § 56-3-6(a)(5) (New Mexico—note there the state imposes a complete bar on reporting of arrest records).

[38] Cal. Civ. Code § 1786.18(a)(7) (California); N.M. Stat. Ann. § 56-3-6(a)(5) (New Mexico); N.Y. Bus. Law § 380-j(a)(1) (New York).

[39] Kan. Stat. Ann. §§ 50-704(a)(5) & (b) (Kansas); Md. Code. Ann. §§ 14-1203(a)(5) &(b)(3) (Maryland); Mass. Gen. Laws 93 §§ 52(a)5 & (b)(3) (Massachusetts); N.H. Rev. Stat. Ann. §§ 359-B:5(I)(e) & 5(II)(c) (New Hampshire).

[40] N.Y. Gen. Laws §§ 380-j(f)(l)(v) & (j)(f)(2)(iii) (New York); Tex. Bus. & Com. Code Ann. §§ 20.05(a)(4) & (b)(3) (Texas).

[41] While the FBI database is a nationwide government database, it still relies on information provided by the states. According to certain Members of Congress, this information is not always as comprehensive as it could be. In the 107th Congress, legislation (H.R. 4757) was introduced to improve the flow and quality of the information for the database that states provide to the FBI.

[42] Tim McGlone, *Federal Judge Adds Some More Years to Convicted Pedophile's Prison Term,* Virginia-Pilot and Ledger-Star (May 17, 2002).

[43] While the Vail letter only addresses whether FCRA applies to sexual harassment investigations, a subsequent FTC opinion letter states that the FCRA applies to <u>any</u> investigation of employee misconduct. *See* August 31, 1999, letter from David Medine, Federal Trade Commission Associate Director, Division of Financial Practices, to Susan Meisinger; *see also* March 31, 2000, letter from Robert Pitofsky, Federal Trade Commission Chair, to Congressman Pete Sessions; Statement of Federal Trade Commission before the House Banking and Financial Services Committee, May 4, 2000.

[44] *See infra* note 147.

[45] Statement of Federal Trade Commission Before the House Banking and Financial Services Committee Subcommittee on Financial Institutions and Consumer Credit (May 4, 2000).

[46] *See generally* testimony concerning employer investigation into employer misconduct before the House Banking and Financial Services Committee Subcommittee on Financial Institutions and Consumer Credit (May 4, 2000); *see also, e.g.,* Amanda Fuchs, *The Absurdity of the FTC's Interpretation of the Fair Credit Reporting Act's Application to Workplace Investigations: Why Courts Should Look Instead to Legislative*

History, 96 Nw. U. L. Rev. 339 (2001); Theresa Butler, *The FCRA and Workplace Investigations,* 15 Lab. Law. 391 (2000); Meredith Fried, *Helping Employers Help Themselves: Resolving the Conflict Between the Fair Credit Reporting Act and Title VII,* 69 Fordam L. Rev. 209 (2000); and Kim S. Ruark, Comment, *Damned if You Do, Damned if You Don't?,* 17 Ga. St. U.L. Rev. 575 (2000).

[47] 2002 WL 31132883 (S.D.N.Y. 2002).

[48] *Id.* at 2-3; *see also McIntyre v. Main Street & Main Inc,* 2000 US Dist. Lexis 19617 (N.D. Cal. 2000) (holding that plaintiff had not shown outside counsel's investigation into sexual harassment violated FCRA because it had not shown counsel regularly conducted such investigations).

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Testimony Before the Subcommittee on Financial Institutions and Consumer Credit
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Mr. Chairman, Members of the Subcommittee my name is Chris Petersen. I am a partner in the law firm of Morris, Manning & Martin, LLP and co-chair of the firm's Privacy and Security Practice Group. Over the past three years the firm has provided privacy advice to over 50 different insurance-related entities including insurance companies, agencies, trade associations and business associates or service providers.

I am testifying today on behalf of one of those clients, the Health Insurance Association of America ("HIAA"). HIAA is the nation's most prominent trade association representing the private health care system. Its nearly 300 members provide the full array of health insurance products, including medical expense, long-term care, dental, disability, and supplemental coverage to more than 100 million Americans.

My testimony today will focus on the continuum of federal and state privacy laws and the interplay among these various laws. The testimony will only focus on the major privacy laws regulating the insurance industry. These laws include the federal Fair Credit Reporting Act; HIPAA Privacy Rule, the Gramm-Leach-Bliley Act; NAIC/State Privacy Information Acts; and State-Based Information or Event Specific Privacy Laws.

The ordering of these laws generally represents the impact that these laws have on the insurance industry. However, subjective ranking of the law's impact is influenced by several factors. For instance, a single state health plan with very little state regulation might find the HIPAA Privacy Rule to have the greatest impact on its operation. On the other hand, large insurers implementing national, uniform privacy policies and procedures could find that individual state specific laws probably create the greatest challenges.

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When analyzing privacy laws insurance entities must begin by answering some initial questions. First, what types of entities does the law regulate: financial institution, insurance institution, health plan, licensee of a state insurance department, etc
Second, insurance entities must determine what kind of information is the law protecting: financial, medical, personal, protected health information, specific health information, etc. Each law, and quite often-individual states, takes unique approaches to regulating the uses and/or disclosures of the information that insurance entities gather and possess. The following is a summary of the major laws that regulate insurance entities uses and disclosure of information.

Federal Fair Credit Reporting Act
("FCRA")

FCRA regulates "consumer reporting agencies" and the uses of "consumer reports." Under the FCRA, a consumer reporting agency is an entity "which, for monetary fees, dues, or on a cooperative nonprofit basis, regularly engages in whole or part in the practice of assembling or evaluating consumer credit information or other information on consumers for the purposes of furnishing consumer reports to third parties, and which uses any means or facility of interstate commerce for the purpose of preparing or furnishing consumer reports." For insurance purposes, the key component of the definition is whether one "furnishes consumer reports to third parties."

A consumer report is any communication of any information that bears "on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living which is used or expected to be used or collected in whole or in part for purposes of servicing as a factor in establishing the consumer's eligibility for...insurance to be used primarily for personal, family or household purposes." The statute, however, contains two key exceptions to the definition of a consumer report.

First, the term consumer report does not include a report containing information solely as to transactions or experiences between the consumer and the person making the report so long as the information is only shared among companies related by common ownership or affiliated by corporate control. Second, a consumer report does not include the communication of "other information" among affiliates if the sharing of the "other information" is disclosed to the consumer and the consumer is given the opportunity, before the information is shared, to direct that such information not be shared, i.e., they must be granted the right to "opt out" of the information sharing. Note that these exceptions only apply to the sharing of information with affiliates. The exceptions are not available if the entity shares the information with non-affiliated third parties.

The FCRA allows limited sharing of consumer reports, i.e., the sharing of information that is not related to the entity's own transactions or experiences or the sharing of information for which the entity has not provided the right to opt out of the sharing. For insurance purposes, consumer reports may only be furnished to "a person who intends to use the information in connection with the

underwriting of insurance involving the consumer" or to "a person who otherwise has a legitimate business need for the information in connection with a business transaction that is initiated by the consumer or to review an account to determine whether the consumer continues to meet the terms of the account." However, insurers and other entities that qualify as a consumer reporting agency may not share, without authorizations, consumer reports that contain medical information.

As the Committee is aware, important provisions of the FCRA are up for reauthorization. The HIAA supports the reauthorization of the FCRA.

Standards for Privacy of Individually Identifiable Health Information ("HIPAA Privacy Rule")

As a general rule, those insurers that meet the definition of a health plan may not use or disclose protected health information, except as permitted or required by the HIPAA Privacy Rule. The HIPAA Privacy Rule only mandates two types of disclosures: 1) disclosures to individuals who have requested access to their protected health information under the Privacy Rule's access requirements; and 2) when required by the Secretary of Health and Human Services to investigate or determine the health plan's compliance with the Privacy Rule. The HIPAA Privacy Rule does not mandate any uses of protected health information.

Although not mandated by the HIPAA Privacy Rule, the Privacy Rule permits health plans to make disclosures that are required by other applicable law. These disclosures are not "mandatory disclosures" under the Rule, but obviously health plans must comply with the provisions of these other laws regarding required disclosures.

In addition, the HIPAA Privacy Rule provides for six instances under which a health plan is permitted to use or disclose protected health information. The permitted uses and disclosures are: 1) to the individual; 2) for treatment, payment or health care operations; 3) incidental uses and disclosures that occur as a byproduct of a permitted use or disclosure; 4) pursuant to an authorization; 5) disclosures related to health care facility directories and disclosures to persons involved in an individual's care; and 6) other enumerated uses and disclosures for certain public policy purposes. Each of these permitted disclosures in discussed in more detail below. It does not appear that any of these permitted uses or disclosures would allow a health plan to disclose protected health information to another financial institution for use in that institution's credit granting process.

If an individual specifically seeks access to their information under the HIPAA Privacy Rule's access and accounting provisions, health plans are generally required to disclose the information to the individual. All other disclosures to individuals are permissive; it is the health plan's decision as to whether to disclose the information.

Health plans may use and disclose protected health information for "treatment", "payment" and "health care operations". Health care operations encompass a fairly broad category of uses and disclosures necessary to administer a health plan's business and provide benefits to covered individuals. Many of a health plan's routine uses and disclosures fall under the health care operations umbrella. Examples include underwriting, reinsuring, medical review, legal services, fraud detection, customer service, resolution of internal grievances, creating, renewing and replacing coverage, selling or transferring business, etc

Payment also encompasses a fairly broad category of uses and disclosures. It includes activities undertaken to obtain premiums, determining responsibility for coverage and provision of benefits, coordination of benefits, subrogation of health claims, billing, claims management, medical necessity determinations and utilization review. Health plans generally will not be involved in treatment activities.

The HIPAA Privacy Rule permits certain incidental uses and disclosures of protected health information that occur as a result of a use or disclosure otherwise permitted by the Rule. An incidental use or disclosure is a secondary use or disclosure that cannot reasonably be limited in nature, and that occurs as a by-product of an otherwise permitted use or disclosure. However, an incidental use or disclosure is permissible only to the extent that the health plan has applied reasonable safeguards and has implemented, if applicable, the minimum necessary standards. An example of an incidental disclosure is when someone walks into an office and overhears a telephone conversation.

Health plans may use or disclose protected health information pursuant to a valid authorization. If a health plan uses or discloses information pursuant to an authorization, the plan's uses and disclosures of the protected health information must be consistent with the authorization.

Under some circumstances, health plans may use or disclose protected health information to a family member, other relative or a close personal friend of the individual or other person identified by the individual who is involved in the individual's if the information is directly relevant to the person's involvement with the individual's care or payment related to the care. An example might be when a spouse calls regarding payment under the other spouse's insurance coverage and the other spouse does not object to the disclosure. Health plans may also use or disclose information to notify a family member, personal representative or any other person responsible for the care of the individual of the individual's location, general condition or death.

In order to make these uses or disclosures, the health plan must, if the individual is present or was available prior to the use or disclosure, either 1) obtain the individual's agreement, 2) provide the individual with an opportunity to object (health plans may not make the disclosure if the individual objects) or 3) reasonably infer from the circumstances that the individual does not object to the disclosures. If the individual is not present or the opportunity to agree or object cannot practicably be provided, health plans may still make the disclosure if they determine it is in the individual's best interest to make the disclosure.

The HIPAA Privacy Rule specifically states that the following additional types of uses and /or disclosures are permitted without an authorization: 1) uses and disclosures required by law; 2) uses and disclosures for public health activities; 3) disclosures about victims of abuse, neglect or domestic violence; 4) uses and disclosures for health oversight activities; 5) disclosures for judicial and administrative proceedings; 6) disclosures for law enforcement purposes; 7) uses and disclosures regarding decedents such coroners and funeral directors; 8) uses and disclosures for organ and tissue donations; 9) uses and disclosures for research purposes; 10) uses and disclosures to avert a serious threat to health or safety; 11) uses and disclosures for specialized government functions such as the military or secret service; and 12) disclosures for workers' compensation coverage purposes.

I do not believe that the HIPAA Privacy Rule's permitted disclosures would allow a health plan to disclose health information to another financial institution in order for that financial institution to make credit decisions regarding the individual that is the subject of the information without the individual's signed authorization.

The HIPAA Privacy Rule's provisions regarding the application of the minimum necessary standards do not apply to uses and disclosures of protected health information made to the individual, made pursuant to an authorization, uses and disclosures that are required by law or uses and disclosures that are required for compliance with the HIPAA Privacy Rule. All other permissive uses and disclosures are subject to the Privacy Rule's minimum necessary requirements.

The HIPAA Privacy Rule provides that any privacy standard or requirement under the Privacy Rule that is "contrary to a provision of state law preempts the provision of state law. The HIPAA Privacy rule defines "contrary" as 1) a state law that would make it impossible for a health plan to comply with both state and federal requirements or 2) a state requirement that makes creates an obstacle for health plans to meet the objectives of the HIPAA Privacy Rule.

The are several important exceptions to the HIPAA Privacy Rule state preemption requirement that health plans must consider when trying to determine whether to apply federal vs. state law. The most important of these exceptions is that the HIPAA Privacy Rule will not preempt any state law that relates to the privacy of health information that is "more stringent" that the Privacy Rule.

The HIPAA Privacy Rule provides some guidance as to when a state law is more stringent that the Privacy Rule. Two important areas where a state law regarding a use or disclosure will be more stringent when the state law meets on of the following criteria:

1. The state law prohibits or restricts a use or disclosure which would otherwise be permitted under the federal rules; or

2. The state law provides greater rights of access and amendments.

The Privacy Rule also includes a catchall category that state law is more stringent when it provides greater privacy protection for the individual.

Privacy of Consumer Financial and Health Information Regulation ("Model GLBA Regulation")

In 1999 Congress, by enacting GLBA, established a statutory framework under which all financial institutions are required to protect the privacy of their customers' nonpublic personal information. Under GLBA state insurance authorities are charged, under state insurance law, with enforcing GLBA's privacy requirements with respect to "any person engaged in providing insurance..." In order to assist state insurance officials in enforcing GLBA's privacy requirements, the NAIC drafted the Model GLBA Regulation as a model for states to adopt. A significant majority of states adopted privacy rule based on the Model GLBA Regulation.

The model provides that before an insurance entity discloses any nonpublic personal financial information about an individual to a nonaffiliated third party, the insurance entity must first give the individual the opportunity to say he/she does not want his/her financial information to be disclosed. This is known as the individual's "opt out" right. In general terms, the regulation states that before an insurance entity can share a person's information the insurance entity must do the following:

- Give the individual a privacy notice;
- Give the individual an opt out form; and
- Give the individual a reasonable period of time (in most cases 30 days) to decide whether he/she wants to opt out.

Insurance entities are only permitted to disclose the information if the individual does not opt out.

There are important exceptions to the Model GLBA Regulation's general requirement. The first exception allows insurance entities to share information related to insurance functions and the public good. Examples include:

- Disclosing information to protect against or prevent fraud;
- Providing information to rating agencies;
- Replacing group coverage;
- Disclosing information as part of a sale or merger;
- Complying with federal, state or local law;
- Responding to a subpoena or summons; and
- Responding to judicial or regulatory authorities with jurisdiction over your business.

The second exception allows insurance entities to disclose information for processing and servicing transactions that have been requested by the insurance entity's consumers and/or customers. Examples include:

- Disclosing information to underwrite products;
- Sharing information in order to administer benefits or help process claims;
- Disclosing information to process premium payments;
- Providing confirmation statements; and
- Sharing information to recognize incentives or bonuses associated with insurance transactions.

The final exception allows insurance entities to disclose financial information to outside service providers and to do joint marketing with other financial institutions without providing an opt out notice. Examples include:

- Using an outside mail fulfillment business to send marketing letters to customers;
- Using an outside call center to conduct telemarketing; and
- Giving your customer list to another insurance company or bank in order to conduct joint marketing efforts.

The Model GLBA Regulation includes special rules regulating disclosures of nonpublic personal health information. Insurance entities may not rely on the opt out rule to disclose nonpublic personal health information. Insurance entities must either have the individual's authorization to disclose the information or the disclosure must be allowed under the regulation's permitted exceptions. Generally, the regulation allows an insurance entity to disclose information in order to service a transaction that a consumer requests, to conduct insurance functions or to make disclosures that are in the "public good." The permitted disclosures are similar to the disclosures described above for financial information, but the joint marketing exception is not available for disclosures of health information. The Model GLBA Regulation also expressly permits disclosure of health information without authorization for any activity that the HIPAA Privacy Rule permits without authorization.

Although the Model GLBA Regulation permits certain disclosures of health information, insurance entities are not permitted to disclose health information to another financial institution in order for that financial institution to make credit decisions regarding the individual that is the subject of the information without the individual's signed authorization.

NAIC Insurance Information and Privacy Protection Model Act
("1982 Model Act")

In 1982 the NAIC adopted its first comprehensive privacy model. This model, the 1982 Model Act, provides that insurance entities shall not disclose any personal information (including medical record information) and privileged information about an individual collected or received

in connection with an insurance transaction unless the disclosure is authorized or specifically allowed under the Act.

The 1982 Model Act specifically allows disclosures of information for insurance functions such as conducting audits, peer review, the sale or transfer of a block of business. The Act also permits insurance entities to disclose information for public good functions such as disclosures to insurance officials, in response to judicial orders, for fraud detection, etc.

The Act also limits certain disclosures that are made for marketing purposes. An insurance entity may disclose information to an affiliate for marketing purposes so long as the marketing is for an insurance product or service and the affiliate agrees not to disclose the information for any other purpose or to an unaffiliated purposes. Insurance entities may also disclose personal information, excluding medical record information and privileged information, to any person for marketing purposes but only if the individual has been given the opportunity to indicate that he or she does not want personal information disclosed for marketing purposes and the individual has given no indication that he or she does not want the information disclosed.

The 1982 Model Act does not permit insurance entities to disclose health information to another financial institution in order for that financial institution to make credit decisions regarding the individual that is the subject of the information without the individual's signed authorization.

State-Based Information or Event Specific Privacy Laws

In addition to the comprehensive privacy laws discussed above, most states have enacted statutes that protect specific types of health information. Generally, these statutes regulate the uses and/or disclosures of "sensitive" information. The following are examples of the types of information where there is significant state regulation: domestic abuse; genetic information; mental health information; reproductive health; sexually transmitted diseases; and substance abuse treatment.

Condition specific laws further restrict the use and/or disclosures of protected health information. These laws limit insurance entities abilities to use the protected information. They also usually require an authorization or informed consent before the information may be disclosed.

I am not aware of any state-specific privacy law that allows an insurance entity to disclose health information to a third party for the other party to make credit decisions. Even if such a law existed it would likely be preempted as contrary to the HIPAA Privacy Rule.

As you can see from my comments, the health insurance industry has a long history of protecting the health and financial information in it possession. This history has its basis in law, industry practices and, most importantly, the needs of the customer.

Thank you for the opportunity to appear before the Subcommittee. The Health Insurance Association of America looks forward to working with the Subcommittee on this important issue.

Bashen
CONSULTING
EEO Solutions for the Proactive Employer

June 17, 2003

United States House of Representatives
Subcommittee on Financial Institutions and Consumer Credit
1006 Congress, 2129 Rayburn House Office Building
Washington, DC 20515-6050

To The Honorable Committee:

Bashen Consulting extends its gratitude to the Subcommittee on Financial Institutions and Consumer Credit ("Committee") for the opportunity to testify regarding the Fair Credit Reporting Act ("FCRA") and investigations conducted by outside consultants and attorneys ("consultants") regarding civil rights violations and employee misconduct. It is imperative to analyze the FCRA and civil rights laws collectively, rather than evaluating these complex issues only in the FCRA context. After such an examination, the Committee will undoubtedly conclude that investigations regarding civil rights violations and employee misconduct must be exempt from the FCRA's required procedures.

FCRA and the FTC

It is acknowledged that the FCRA was enacted by Congress in response to the increasing public concerns about the rights of consumers and the expanding use of credit in our society. Consumer reports are completely discretionary, and have been historically designed to garner personal financial, credit, and other general information to ascertain an applicant's eligibility for employment. The FCRA, however, was not enacted to prevent, identify, and remedy workplace discrimination based on a consumer's race, color, religion, sex, national origin, or any other protected categories. None of the Federal Trade Commission's ("FTC") standard publicized literature references workplace discrimination or harassment. Nonetheless, the FTC *Vail* opinion letter has expanded the FCRA's purview to include claims of illegal discrimination and harassment in the workplace. As a result, civil rights laws that have protected employees (consumers) for 35 years are in jeopardy.

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Consultants and Consumer Reporting Agencies

Bashen Consulting is a small minority owned human resources consulting firm that investigates allegations of civil rights violations and employee misconduct. Bashen's consultants have collectively investigated thousands of claims involving discrimination and employee misconduct, and not one credit report has ever been requested regarding any complainant, the alleged offender, or witness. Credit reports and credit histories are completely irrelevant to discrimination investigations. Civil rights and employee misconduct investigations examine *specific* allegations of illegal activities. Conversely, consumer reports and consumer investigative reports provide *general* information regarding a consumer's "...character, general reputation, personal characteristics, mode of living..." for "...employment purposes...".

Civil Rights Laws

The Civil Rights Act of 1964 and 1991, and similar state and municipal laws, impose an affirmative obligation on employers to investigate discrimination complaints. Civil rights investigations are not discretionary, in contrast to investigative consumer reports. Under civil rights laws, employers risk liability for the acts of employees, vendors, and customers who discriminate against employees on the basis of race, religion, color, national origin, ancestry, disability, medical condition, sex, or age. The Supreme Court affirmed the duty to investigate complaints of harassment, establishing an affirmative defense to liability only when employers exercise reasonable care to "correct promptly any...harassing behavior."[1] Further, the Equal Employment Opportunity Commission ("EEOC") issued guidelines[2] that require an employer to investigate workplace harassment.

Employers that wish to assert the affirmative defense afforded by *Faragher* and *Ellerth* must a.) exercise reasonable care to prevent and correct promptly any harassing behavior, and b.) must prove that the complaining employee failed to use any preventative or corrective opportunities provided by the employer or to avoid harm otherwise. Simply, an employer must have a widely disseminated anti-harassment policy and a complaint procedure to protect employees (consumers). Prompt, thorough, impartial, objective, confidential, and competent

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[1] *Faragher v. City of Boca Raton,* 118 S. Ct. 2275 (1998); *Burlington Industries, Inc. v. Ellerth,* 118 S. Ct. 2257 (1998).

[2] EEOC Policy Guidance on Sexual Harassment and EEOC Enforcement Guidance: Vicarious Liability for Unlawful Harassment by Supervisors (June 18, 1999).

investigations are imperative to any effective anti-discrimination policy and complaint procedure, and are required by law and EEOC regulations. For these reasons, many employers retain independent, expert consultants to ensure that proper investigations are conducted.

Impact of *Vail* Letter/FCRA Procedures

The FTC *Vail* opinion letter undermines the preventative and remedial essence of all civil rights laws by discouraging employees from complaining of harassment; by inhibiting employee witnesses from participating in harassment investigations; and by stifling witness candor. Competent discrimination investigations are the only available means to assess the allegations, issues, facts, and the appropriate remedial measures, when applicable. The opinion stated by the FTC in the *Vail* letter requires employers to garner written authorization from alleged harassers before consultants could prepare investigative reports regarding the alleged civil rights violations. There is no such requirement under any of the discrimination laws, and such a requisite would be grossly inappropriate in a civil rights framework because the purported violator would have control over the investigation. The EEOC guidelines state, "The alleged harasser should not have supervisory authority over the individual who conducts the investigation and should not have any direct or indirect control over the investigation."

Pursuant to the FTC *Vail* opinion letter and Section 604 of the FCRA, the employer is required to give the harasser a copy of the consultant's report if the allegations are substantiated and legally mandated remedial measures are implemented against the harasser. But first, the employer must wait five days before effecting remedial measures, which negates another civil rights law mandate: the remedial measures must be prompt or the employer faces greater consequences. Also, the harasser will still have contact with the complainant, which may create a volatile situation that could spark increased harassment, witness intimidation, threats, and/or violent reprisals. Giving confirmed harassers copies of consultants' reports will breach confidentiality, and the harassers will know who was interviewed and the content of their interviews. Civil rights laws and the EEOC regulations require confidentiality.

Employees will be chilled from reporting civil rights violations if they know the alleged offender will receive a copy of the report. The EEOC guidelines state, "An employer should make clear to employees that it will protect the confidentiality of harassment allegations to the extent possible" and "information about the allegation of harassment should be shared only with those who need to know about it." Complainants and witnesses are usually hesitant to speak with any investigator, even when reasonable confidentiality is promised. But such a

promise is typically the only reason most witnesses agree to be interviewed. Breaching confidentiality to comply with the FCRA's procedures will decimate most attempts to curb workplace discrimination, and consumers will suffer the most. Imagine if the culprit is an officer, executive, supervisor, respected associate, co-worker they fear, or a peer or supervisor who has a vengeful or violent propensity. Employees will lose faith in the anti-harassment policy and the complaint procedure, and the harassment may continue unabated. According to the EEOC guidelines, a complainant may assert that he or she did not use an employer's complaint procedure because he or she perceived it as ineffective. If proven, an employer may lose the affirmative defense. This is certainly inconsistent with the spirit and the letter of civil rights laws which are to prevent, identify, and redress workplace discrimination.

Disclosing a discrimination investigative report to the harasser may also expose the employer to more retaliation claims. The complainant and witnesses adverse to the harasser may perceive that the harasser is treating them more harshly because the harasser is now able to identify them as his or her accusers. There must be an adverse employment action to sustain a viable retaliation claim, but the perception, not a genuine adverse employment action, may precipitate a retaliation claim which forces an employer to incur the time and expense to investigate and manage a complaint that could have been avoided. Civil rights investigative results must be limited to those individuals with the qualified privilege and the need to know. There is no FCRA mandate that the alleged harasser must maintain confidentiality once he or she secures a copy of an investigative report. Consequently, all employees who do not have the qualified privilege status should be precluded from reviewing any type of civil rights investigative report to assure reasonable confidentiality. This will mitigate future liabilities that are varied and potentially immense.

EEOC Guidelines

The EEOC dictates that employers should ensure that "prompt, thorough, and impartial" investigations are conducted when complaints are made. Impartial investigations are more readily attained by independent consultants who do not have personal or professional relationships with the complainants, witnesses, and the accused. Further, an independent consultant does not have a vested interest in a favorable outcome, and is often perceived as detached and neutral by the employees and the EEOC. Accurate investigative findings and conclusions afford greater protection to the consumer and the employer. Internal personnel typically have many other duties that are extraneous to the exhaustive discrimination complaint process, and they simply need a third party consultant to conduct investigations. Many companies do not have qualified internal human resources or legal personnel to

investigate alleged civil rights violations, and those that do are typically inundated with complaints. Outsourcing to competent consultants solves both problems.

According to the EEOC guidelines, "The employer should ensure that the individual who conducts the investigation will objectively gather and consider the relevant facts." Objectivity is imperative to discrimination investigations, especially in harassment cases where witnesses must be asked proper questions and credibility must be weighed. Many employers and employees are concerned that internal personnel are too familiar with the employees and the complaint circumstances to be truly objective. This potential objectivity dilemma, actual or perceived by employees, the EEOC, federal and state court judges, should never be applicable to independent consultants who report all facts; good, bad, or innocuous.

The EEOC states, "Whoever conducts the investigation should be well-trained in the skills that are required for interviewing witnesses and evaluating credibility." Many internal personnel may lack the necessary training and experience to adeptly investigate alleged civil rights violations or employee misconduct. Others are concerned about impartiality and objectivity. Very few from either category have the time to remain current on the continual changes in state and federal laws, which are essential to quality civil rights investigations. Consequently, employers routinely outsource this specialized task to qualified consultants who conduct timely, thorough, impartial, objective, confidential, and competent investigations. Complainants may not use a complaint procedure that they perceive as biased, subjective, and administered solely by internal personnel. They may accordingly attempt to defeat the affirmative defense by establishing that the employer's reporting procedure is defective. "Negligent investigation" is becoming an increasingly popular allegation in discrimination litigation. It is much more difficult to prove if experienced, independent consultants conduct the investigations.

Disputing Consumer Reports

Section 611 of the FCRA provides the means for a consumer to dispute the details of a consumer report, which is understandable in the fair credit reporting context; this information is most often finite and should be accurately reported. A creditor must stop reporting inaccurate information after the consumer has successfully challenged the findings as inaccurate, and a consumer reporting agency must reinvestigate the consumer's claims. Again, this seems reasonable in the measurable world of financial and credit reporting.

Harassment investigations, conversely, are typically very convoluted at the inception. These investigations are commonly fraught with innuendo and recrimination, and perhaps importantly, the perceived or actual *intent* of the harasser and the complainant. Intent is further muddled by witness statements. Under Section 611 of the FCRA, an alleged harasser could dispute the complainant's allegations as inaccurate or false, which usually happens anyway in civil rights investigations. But the FCRA gives the harasser greater dispute latitude by empowering him or her to assert that it was not his intent to harass or discriminate against another employee. Thus, he or she will assert that the reported information is inaccurate or false. How, then, could the complainant or the employer controvert the alleged harasser's dispute when intent is the issue under consideration? This is further complicated by witnesses who give similar or vastly different accounts of the alleged conduct. In this situation, which is common in discrimination investigations, should the complainant and the employer's investigating consultant be forced to stop reporting the behavior as harassment pursuant to the FCRA? Should the consultant be forced to reinvestigate, pursuant to the FCRA, simply because the harasser denies that he or she intended to harass or discriminate? What if the conduct did not constitute a civil rights violation, but violated a company policy that mandates disciplinary action? Will the harasser be able to dispute the findings as inaccurate? Should the harasser be able to sue the employer for allegedly breaching any one of the aforementioned FCRA procedures? Civil rights laws and common sense compel the obvious response: "absolutely not." However, these are genuine issues made possible by the FTC's interpretation of the FCRA in the *Vail* letter. Most employees who are accused of discrimination will initially, and instinctively, deny the charges in part or in whole. Individuals who violate civil rights laws or company policies seldom confess. Intent is not finite; it is nuance wrapped in subtle shades of gray. A competent investigator must possess the skills, impartiality, objectivity, and experience to discern truth from fiction, and then reasonably determine if some type of personnel policy breach or legal violation has occurred.

The FTC opinion would also compromise the various privileges afforded by the Federal Rules of Civil Procedure, and probably most state rules of civil procedure, such as attorney-client privilege, party communications, work-product, and reports that are prepared by consultants in anticipation of litigation. Discovery issues are decided during litigation by judges on a case-by-case basis. The FTC opinion would require employers to give the confirmed harasser a copy of the investigative report without filing a lawsuit, which would eliminate the benefit of judicial consideration that may preclude the production of the documents or portions of the documents. All of these safeguards and privileges are forfeited under the FTC's production requirement.

Internal Investigating Personnel/Outside Consultants

Like internal investigating personnel, outside consultants who conduct civil rights and employee misconduct investigations should be exempt from the FCRA procedural requirements. Employers and employees alike want the most qualified, objective professionals conducting discrimination investigations to better protect all parties. Such investigations are more readily obtained by independent consultants who specialize in these types of investigations. It is reasonable to conclude that an employee (consumer) accused of discrimination would want a competent, neutral party to investigate

the allegations against him or her, rather than inexperienced internal personnel who may be perceived as having a vested interest in a particular outcome.

Failure to Comply with FCRA Requirements

Outside consultants who do not comply with the FCRA procedures are exposed to potential lawsuits by the subjects of their investigations. They may subsequently assert that they were improperly disciplined or terminated because they did not have the opportunity to respond to the investigative report that resulted in the adverse action. If the *Vail* opinion letter is adopted as policy by the courts, then the outside consultant could be accused of "willfully" violating the FCRA, thereby exposing the consultant to punitive damages.

Consultants could chose not to "regularly" conduct discrimination investigations. Of course, this means consultants will not possess the cutting-edge expertise that is essential to analyze complex civil rights issues. This expertise is derived from knowledge of the ever-changing laws and investigative experience, and both are absolutely imperative to protect employees. The alternative is to allow less qualified internal personnel or consultants to conduct the investigations.

The many consulting firms, law firms, partnerships, and other corporations that employ scores of professionals to conduct independent investigations could be forced out of business if the FTC's interpretation of the FCRA obligates companies to internalize employee misconduct investigations. This could result in the dissolution of an entire industry, and will have grave consequences for employees (consumers) whose discrimination claims will be controlled exclusively by internal personnel. Employers will also suffer if they are forced to internalize discrimination investigations; innumerable complaints will be mishandled and improperly investigated. Increased litigation and inflated money damages against employers under various federal and state civil rights laws will be the result. Decreased employee morale, diminished productivity, and further polarization between the races and sexes are indirect, long-term consequences of the FCRA's infringement upon civil rights laws.

Conclusion

There is absolutely no detriment to consumers when outside consultants investigate alleged civil rights violations in the workplace. Indeed, a qualified agent will provide the necessary expertise, knowledge, and experience to conduct thorough investigations that are required by law and the EEOC guidelines. Outside consultants also afford objectivity, impartiality, timeliness, and confidentiality. All consumers are entitled to fair and complete investigations conducted by competent professionals. Expert

consultants minimize the possibility of improper decisions that adversely affect consumers. The FTC's interpretation of the FCRA compromises this process, which, ironically, imperils the very consumers the FCRA was created to protect. Thus, civil rights and employee misconduct investigations must be exempt from the FCRA. We respectfully implore the Committee to amend the FCRA accordingly.

Very truly yours,

Janet Emerson Bashen
President and CEO

Margaret Plummer
Director of Operations

GEORGETOWN UNIVERSITY

Institute for Health Care Research and Policy

Testimony before the

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

on

The Role of the Fair Credit Reporting Act in Employee Background Checks and the Collection of Medical Information

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June 17, 2003

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I. INTRODUCTION

Mr. Chairman and Members of the Subcommittee on Financial Institutions and Consumer Credit: Thank you for the opportunity to testify before you today on the role of the Fair Credit Reporting Act (FCRA) and the collection of medical information.

My name is Joy Pritts. I am an assistant research professor at Georgetown University's Health Policy Institute. My work at Georgetown focuses on state and federal laws that protect the privacy of medical information and how these laws interact.

Today, a vast array of organizations and persons can collect and use medical information. They range from health care providers to insurers to banks to employers. There is no one federal law that protects the privacy of health information in the hands of these various stakeholders. In spite of repeated Congressional efforts, the use and disclosure of medical information continues to be governed by a patchwork of legislation and regulations that apply different standards to different sectors of the marketplace.

The Fair Credit Reporting Act (FCRA) is but one piece of this patchwork. I have been asked to testify today on the Fair Credit Reporting Act, how it governs the collection of medical information and how it interacts with the privacy provisions of two other major federal laws: The Gramm-Leach-Bliley Act (GLBA) and the Health Insurance Portability and Accountability Act.

In order to put these laws in perspective, I will first address how health care consumers believe their medical information should be treated.

II. PUBLIC NEED AND DEMAND FOR CONFIDENTIAL TREATMENT OF MEDICAL INFORMATION

The American public is very concerned about the confidentiality of their medical information. In a poll conducted by the Gallup Organization in 2000, 79 % of adults reported that it is very important to keep their medical records confidential. People are afraid that their medical records will fall into the wrong hands, leading to discrimination, loss of employment, loss of benefits, and unwanted exposure.

Consumers are particularly concerned about banks and insurance companies having access to their medical information. The 2000 Gallup survey reported that an overwhelming 95% of those polled opposed allowing banks to see their medical records without their permission. Similarly, 82% opposed allowing insurance companies to see their medical records without their authorization.

In many cases, consumers have acted on these concerns. A 1999 survey by Princeton Research Associates for the California HealthCare Foundation found that one out of every six adults engages in some sort of privacy protective behavior to keep their medical information confidential. These consumers pay out of pocket for care that is covered by insurance, doctor-hop, provide inaccurate information, and avoid care altogether to protect themselves against their health information falling into the wrong hands. We can only imagine how these numbers would increase if health care consumers were fully aware of how their medical information could be

shared among various organizations. The privacy protective behavior that results from these concerns is bad both for the individual health care consumer and for public health. It can result in the inadequate care or undetected and untreated health conditions for the individual consumer. It can also result in inaccurate and incomplete patient data, which compromises the integrity of health research and public health initiatives. Thus, failing to adequately protect the confidentiality of health information can have widespread adverse consequences on both individual and public health.

Yet, the federal laws in effect today do just that. They fail to cover all of those who collect and maintain medical information and they fail to impose adequate standards on those entities that they do cover.

III. FCRA, GLBA AND HIPAA: A PATCHWORK OF PRIVACY PROTECTIONS

Currently, the use and disclosure of medical information is governed by a patchwork of federal legislation and regulations. My testimony today will focus on the Fair Credit Reporting Act (FCRA), the Gramm-Leach-Bliley Act (GLBA), and the Health Insurance Portability and Accountability Act of 1996 (HIPAA), how they govern the sharing of medical information among affiliates and how these acts interact.

Three central issues evolve when these laws are reviewed. First, these laws do not adequately protect the privacy of medical information. Second, it is unclear to what extent states can remedy these gaps. Third, it is unclear which federal law prevails when their standards conflict.

Fair Credit Reporting Act

The FCRA does not adequately protect much medical information collected by banks, insurers, and other financial institutions. FCRA primarily restricts the use and dissemination of credit reports by banks and other financial institutions. A vast quantity of information escapes these restrictions, however, because it is falls outside of the definition of "credit report." Financial institutions are free to distribute *without limitation* information about their own transactions and experiences with consumers. This transaction and experience information can, and often does, include medical information.

Many financial institutions collect medical information in the course of conducting their business. For example, life insurers collect medical information in the application process. Property and casualty insurers may collect vast amounts of health information in the course of their claims process. Banks may collect health information in the course of selling annuities or credit insurance. Banks that issue credit cards may have the additional capacity to data mine credit card information, which can contain information on payments for health care services. Under FCRA, this transaction and experience information, which includes medical information, can be shared freely among affiliates without any permission from the consumer.

Affiliates also may share financial information (other than transaction and experience information) so long as they give the consumer notice and the opportunity to opt out. This

regulatory scheme is based on two erroneous assumptions: That the notices provided will actually be readable by the general public; and that most consumers would give their permission if asked. An opt-out essentially presumes permission unless the consumer takes some affirmative action. The notices provided by financial institutions, however, are largely written in legalese and are incomprehensible to most consumers. Furthermore, polls have repeatedly shown that consumers want to be asked *before* their health information is shared with others.

The irony of the situation is hard to ignore. The vast majority of Americans oppose allowing banks and insurers to see their medical information without their permission. Yet the law permits this very activity.

The increase in the consolidation of the financial services market combined with the advances in technological capacity only threatens to exacerbate these threats to privacy.

FCRA should be amended to afford greater protection to medical information. Consumers should be asked in advance, in plain language, whether they want their information shared in this fashion. Financial institutions should be prohibited from using medical information to provide credit.

The banking industry asserts that it does not use not medical information for making credit determinations. But an April 1993 U.S. Department of Health and Human Services task force report cited the case of a banker who also served on his county's health board. The banker apparently cross-referenced customer accounts with patient information and called due the mortgages of those suffering from cancer.

Furthermore, the fact that the banking industry does not engage in certain behavior now is no guarantee that it will not do so in the future. Fifteen years ago, it was virtually unheard of for insurers to use consumer credit histories to determine insurance premiums or whether to cancel or renew an insurance policy. Now, it is becoming increasingly commonplace. Who can say whether using medical information for credit decisions will develop along the same lines?

The time to prohibit such practices is *before* they become engrained as a standard business practice. As we have seen from the development of the Health Privacy Rules promulgated under HIPAA, once an information sharing practice becomes acceptable it is almost impossible to retract it.

A further concern with FCRA is the manner in which it potentially affects state law. Some states have taken steps to impose protections on the sharing of financial information that go beyond those provided by FCRA. It is unclear whether these state protections would survive a legal challenge. FCRA preempts states from enacting laws "with respect to the exchange of information among persons affiliated by common ownership or common corporate control." Some stakeholders interpret this provision narrowly and assert that FCRA only preempts state laws that govern consumer reports. Others, however, read this provision broadly and claim that it preempts states from enacting *any law* that governs the sharing of any information among affiliates. If this latter construction were accurate, a state would be prevented from requiring a

financial institution from obtaining consumers' permission (opt in) before sharing medical information with affiliates.

The simplest manner of resolving this ambiguity is to allow the preemption provision of FCRA to expire as scheduled on January 1, 2004. At a very minimum, FCRA should clarify that it does not preempt state laws that impose greater restrictions on the sharing of medical information.

The inadequacies of the FCRA have not been resolved with subsequent legislation. To the contrary, the Gramm-Leach-Bliley Act continues the pattern of allowing medical information to be shared freely among affiliated entities.

Gramm-Leach Bliley Act and the Fair Credit Reporting Act

GLBA was enacted in 1999 to enhance competition by permitting the affiliation of banks, security firms, insurance companies, and other providers of financial services. The premise was to promote "one stop shopping" for financial services.

Recognizing that the creation of integrated financial services firms would exacerbate threats to consumers' privacy, Congress incorporated Title V into GLBA. Title V governs the privacy of personally identifiable financial information held by financial institutions. "Personally identifiable financial information" is defined broadly as including any information that is provided by a consumer to a financial institution to obtain a financial product or service or that a financial institution obtains about a consumer in connection with providing a financial product. Title V therefore governs any medical information that is provided to or obtained by a financial institution about an individual in connection with a financial service or product.

The "protection" afforded by Title V is *de minimus*. Title V permits affiliates to freely share medical information *without* any permission from the individual. As for disclosures to non-affiliates, Title V only requires notice of the potential disclosure and an opportunity to opt-out. There is *no* opt out provision for affiliates in GLBA. Neither is there a right to opt out of sharing with non-affiliated third parties when there is a joint marketing relationship between the financial institution and the other party.

As discussed above, many financial institutions such as life insurers, banks, and property and casualty insurers collect medical information in the course of conducting their business. Under GLBA these financial institutions can freely exchange this information. For example, under GLBA, a bank would be permitted to obtain and use medical information from a life insurer to determine eligibility or set the rate for a credit card or mortgage. This simply should not be permitted.

Congress provided the potential for some relief for consumers by including in GLBA a provision that essentially provides that Title will not preempt state laws that offer greater protection. A few states have moved in this direction.

It remains unclear, however, how far states can go in controlling the flow of consumer information among affiliates. The confusion stems from the presence in Title V of two provisions that address the preemption issue in what may be seen as a contrary fashion. Section 507 provides that Title V does not preempt state laws that offer greater privacy protections than GLBA This provision would preserve a state law that requires an opt in for affiliates to share medical information.

Section 506 of GLBA, however, essentially preserves FCRA. As discussed above, FCRA not only allows the sharing of transaction and experience data without the consumer's authorization it also states from enacting laws "with respect to the exchange of information among persons affiliated by common ownership or common corporate control." The question remains: Can states enact legislation that restricts the sharing of consumer information among affiliates? Or are states limited to enacting legislation that only pertains to sharing information among non-affiliated entities? Rather than wait for court interpretation, Congress has a duty to clarify this issue.

As discussed below, the interpretation of FCRA and GLBA remains important due to the limited nature of HIPAA.

Health Insurance Portability and Accountability Act

The primary federal law governing the use and disclosure of medical information is the Health Privacy Rule promulgated under HIPAA by the United States Department of Health and Human Services.[1] While the HIPAA Privacy Rule is extensive, it is by no means comprehensive. Because of the limited authority delegated by Congress, the rule is applicable to only a core group of persons and organizations that hold health information. The HIPAA Privacy Rule directly applies *only* to:

- health care providers that transmit claims-type information electronically;
- health plans; and
- health care clearinghouses.

Thus, HIPAA does *not* apply to most of the entities covered by FCRA and GLBA. HIPAA does not apply to banks, or life insurers, or property and casualty insurers. There is some overlap in that all three laws do govern health plans.

Health plans are financial institutions that clearly possess great quantities of medical information, both from applications for insurance and from claims for payment. HIPAA restricts the manner in which a health plans can use and disclose this health information. These restrictions vary widely depending on the purpose of the use or disclosure and the recipient of the health information. Since this hearing is concerned with affiliate-sharing, I will focus on the issue whether, under HIPAA, a health plan could share health information with an affiliate in order for the affiliate to use the health information for its business purposes. For example, could a health plan share health claims information with an affiliated bank so that the bank could use the information in determining eligibility or setting rates for a loan?

[1] 45 C.F.R. Part 164.

In very general terms, HIPAA would require the health plan to obtain the individual's prior authorization to disclose health information for the business purposes of the affiliate. To continue with the previous example, under HIPAA a health plan could *not* share health claims data with an affiliated bank for the bank to use in determining eligibility or setting rates for loans unless the health plan obtained the individual's prior authorization. HIPAA uses what is essentially an "opt in" approach.

HIPAA's approach to this issue is clearly superior to that of FCRA and GLBA. It is important to remember, however, that HIPAA has a very limited applicability. For instance, HIPAA does not cover life insurers, automobile insurance carriers, workers' compensation carriers, banks, property and casualty insurers and employers. All of these entities can collect medical information in the regular course of their business but fall outside the scope of HIPAA. They are simply not subject to HIPAA's opt in requirements for affiliate sharing. While some of these entities are subject to FCRA and GLBA, both of these have less stringent standards for the sharing of medical information among affiliates.

The area where HIPAA, FCRA and GLBA overlap is also problematic due to the lack of Congressional direction as to which law prevails. Health insurers, for instance, are subject to FCRA, GLBA an HIPAA. The HIPAA Privacy Regulations prohibit behavior that would be permitted under GLBA and FCRA. Furthermore, state laws that may be preserved under HIPAA, which does not preempt state laws that do not conflict with or are more stringent than the federal health privacy standards, could potentially be preempted under FCRA. For example, a state insurance law that requires an opt in to sharing health information with affiliates would be preserved under HIPAA. Under the strictest reading of the FCRA preemption provision (which is incorporated by GLBA), such a state law potentially could be prohibited.

Congress has been silent with respect to how GLBA and FCRA interact with HIPAA. Applying traditional statutory construction rules to determine which statute prevails in this situation is problematic to say the least. Generally, later enacted, more specific statutes prevail. HIPAA was enacted in 1996. While the HIPAA regulations are very specific, the statute itself is fairly general with respect to the privacy or information. The amendments to FCRA permitting experience and transaction sharing among affiliates and preempting state laws were enacted in 1997 and are also fairly general. GLBA was enacted in 1999, after the HIPAA statute but before the HIPAA regulations were promulgated. The HIPAA regulations are extremely detailed. But comparing detailed regulations to statutes is not the norm in conducting an implied repeal analysis.

Congress should clarify that the most stringent standards to sharing health information apply when an entity is covered by more than one statute.

III. CONCLUSION

In spite of some Congressional action, there remain significant gaps in the protection of the use and disclosure of medical information. Bringing all of those who use and disclose medical information within the bounds of federal law can help close these gaps. Additionally, Congress should require that consumers' permission should be obtained before their medical information is shared with banks, insurers and others. Congress should also clarify that state law that provides a higher degree of protection of medical information is preserved. Enacting such protections would bring the laws in line with what health care consumers need and expect.

Statement of the U.S. Chamber of Commerce

ON: "THE ROLE OF THE FAIR CREDIT REPORTING ACT IN EMPLOYEE BACKGROUND CHECKS AND THE COLLECTION OF MEDICAL INFORMATION"

TO: SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT OF THE COMMITTEE ON FINANCIAL SERVICES

BY: CHRISTOPHER P. REYNOLDS

DATE: JUNE 17, 2003

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

Prepared Statement

of

Christopher P. Reynolds

Partner,

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On Behalf

of the

U.S. Chamber of Commerce

Before

Financial Institutions and Consumer Credit Subcommittee

of the

Financial Services Committee

United States House of Representatives

June 17, 2003

10:00 AM Hearing on

"The Role of the Fair Credit Reporting Act in Employee Background Checks and the Collection of Medical Information"

Good morning Mr. Chairman and distinguished members of the Subcommittee. Thank you for asking me to testify before you today.

My name is Christopher Reynolds and I am a partner with the law firm of Morgan, Lewis and Bockius, which serves on the United States Chamber of Commerce Labor Relations Committee. I am here to testify on behalf of the Chamber about the Fair Credit Reporting Act's (FCRA) effect on employee background checks and employer investigations into workplace misconduct.

The Chamber has asked me to speak here today because, as part of my law practice, I frequently conduct sensitive and confidential investigations into potential workplace misconduct and advise clients with regard to legal issues related to those investigations and employee background checks, including issues involving FCRA. More generally, my law practice involves representing employers in discrimination and other employment-related litigation and counseling employers on a broad range of matters, including discrimination, equal employment opportunity, global workplace diversity, regulatory compliance and workforce restructuring. I also regularly speak on such matters and have authored a handbook entitled "The Prevention and Investigation of Sexual Harassment Claims," as well as several white papers on related topics. In addition, I am a member of the American Bar Association' s Labor Section Equal Employment Opportunity Committee, a former co-chair of that organization's National Institute on Sexual Harassment, a member of the Legal Division of the Securities

Industry Association and a member of the Advisory Board of Regulatory DataCorp (RDC).[1]

My understanding is that today's hearing is one of several scheduled to address various issues that may become part of the debate surrounding reauthorization of FCRA's uniform standards provisions. Before addressing the issues specific to today's hearing, the Chamber would like me to stress that reauthorization of these provisions is of *vital* importance to its members, and the entire economy. As you know, FCRA's uniform standards fostered the growth of the national credit system we enjoy today. This credit system has helped facilitate the creation of our whole consumer credit economy, from the miracle of instant credit to the ubiquitous availability of credit cards.

Failure to reauthorize the uniform standards could result in the collapse of this credit system that has become so vital to our economy. In its place, we would have multiple and conflicting state credit rules, creating a complex and costly web of regulation that would confuse and confound both consumers and lenders alike. This could limit the availability of instant credit, and make it more difficult and expensive for consumers to obtain credit for everything from home loans to student loans.

Credit availability is also vital to small businesses, which often rely on access to credit to start new businesses or tied them over during lean times. Thus, a failure to reauthorize could not only jeopardize our consumer economy, but could also stymie the economy's ability to create new jobs through small businesses.

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[1] Launched July 16th, 2002, Regulatory DataCorp, Int'l. LLC ("RDC") was formed for the purpose of aggregating and leveraging public information and regulatory and industry expertise on a global basis to enable clients to better identify and manage legal, regulatory and reputational risks and comply with global regulatory responsibilities. RDC has created a worldwide clearinghouse of public information that conforms to international standards and regulations, and tools necessary for clients to conduct automated due diligence on entities, individuals and transactions on a wholesale, cost-effective and timely basis. RDC's services are designed to help clients identify and manage serious threats posed to global security by money laundering, fraud, corruption, terrorism, organized crime, and other suspicious financial activities.

Reauthorization, however, is not the Chamber's only concern with FCRA. The issue before you today – the effect of FCRA on background checks and workplace investigations – also is of the utmost concern to Chamber members.

Both background checks and workplace investigations play a key role in employer efforts to protect employees, customers, stockholders and the public at large from workplace violence, harassment, financial misdeeds and other dangerous and unlawful acts. While FCRA does not affect every background check or investigation, it does affect many. Specifically, when employers hire experienced and objective third parties to conduct background checks and workplace investigations, as is often practical or necessary for them to do, the background check, and arguably the workplace investigation, must comply with FCRA's numerous notice and disclosure requirements. This is the case even though the check or investigation may have nothing to do with the individual's credit or credit worthiness.

Because FCRA affects background checks and investigations into workplace misconduct differently, I will address each issue separately.

Background Checks

Our primary concern with regard to background checks is not with existing law, but rather that, as part of the reauthorization effort, new provisions will be added to FCRA that could adversely affect employers' ability to obtain reliable job-related background information on applicants or current employees.

As I will explain in greater detail, background checks are an essential employment-screening tool and, increasingly, both the public and the government are demanding that employers expand use of background checks to enhance workplace

security. While the Chamber recognizes that – particularly at this time – it is crucial that security needs be balanced with individual rights, FCRA and other federal laws already provide protections to ensure privacy, accurate reporting and fair use of background checks. Consequently, the Chamber strongly urges you to resist adding provisions that would hamper employers from obtaining reliable, relevant, and job-related background information on applicants and employees. In fact, if you are to make any changes to FCRA that would impact background checks, we recommend it be one that removes impediments FCRA poses to obtaining background checks on contract workers.

Background Checks and Workplace Security

Employers use information gathered from background checks to help screen out individuals who may pose a danger to the workplace or who may be inappropriate for certain jobs. For example, an employer may not want to hire an individual who has multiple recent drunk driving convictions as a school bus driver, or a person with a history of embezzlement as a bookkeeper.

A typical background check contains a review of an individual's criminal history, and sometimes other information pertinent to employment, such as verification of educational or professional credentials or prior work history. For certain positions, such as one where the individual will be responsible for large sums of money, the background check may also include a review of the candidate's credit history.

Available evidence suggests that background checks are effective at revealing information relevant to employment eligibility that the employer may not find elsewhere. For example, Avert, Inc., an Internet-based screening company, found that at least 24 percent of the 1.8 million applicants it screened in 2000 submitted information that was

misleading or negative and 6 percent of the background checks revealed a criminal history.[2] Similarly, in 1998, the Society for Human Resource Management (SHRM) released survey results showing that 45 percent of the employers that conducted background checks at one point or another found an applicant had lied about criminal records.[3]

In addition, at least with regard to criminal activity, statistics show that past criminal behavior can be predictive of future criminal behavior. In 2002 the Bureau of Justice Statistics reported on prisoners released in 1994. The report revealed that 81.4 percent of the prisoners had convictions prior to the one for which they had just served time and, within three years of release, 46.9 percent were convicted of a new offense.[4]

Anecdotal evidence demonstrating the importance of background checks is also readily available. While there are many examples, the case of Ernesto Forero-Orjuela is particularly interesting. Authorities suspected that Forero-Orjuela was a high-level figure in one of the world's largest drug cartels, and Maryland had charged him with the 1991 murder of a Baltimore businessman.[5] He had eluded federal authorities, however, for six years, until he was fingerprinted and had a background check as part of his employment application at Merrill Lynch.[6]

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[2] *Company Finds Plenty of Bogus Info in Job Apps,* Business & Legal Reports (June 12, 2001), retrieved from http://hr.blr.com/elert.cfm?id=362.
[3] Survey is available at http://www.shrm.org/surveys/default.asp?page=available.htm.
[4] Patrick A. Langan and David Levin, *Recidivism of Prisoners Released in 1994,* Bureau of Justice Statistics, Special Report at 2 (June 2002).
[5] Michael James, *Cartel trial could hit Md.; Drug ring suspect awaits extradition on murder charge; 1991 victim from Bel Air; Columbian man's job played a role in his New Jersey arrest,* Baltimore Sun, (Jan. 29, 2000).
[6] *Id.*

The Public and the Government Demand Increased Use of Background Checks

Since the tragic events of September 11, growing concerns over workplace security have fueled an increased public and government demand for use of background checks as an employment-screening tool. In fact, last year, Harris Interactive reported that, according to a recent poll, 53 percent of employees want employers to conduct more detailed background checks.[7] Other studies have yielded similar results.[8]

As for the government, in this session alone, Congress has introduced at least twenty-one different bills requiring background checks for employees that perform specific jobs or work in a specific industry (a list of these bills is attached to this testimony). Some of these bills are driven by national security concerns, such as H.R. 1407 which requires background checks for locksmiths working in judicial or executive branch facilities, or S. 157 which requires background checks for certain employees working in the chemical industry. Others, such as H.R. 439, which requires background checks for workers entering people's homes, or H.R. 1855, which requires background checks for certain health care providers, are aimed at protecting individuals from fraud, theft, violence and other crimes.

The 107th Congress was also active with regard to background check legislation, enacting several laws requiring backgrounds checks for certain airline, port and other transportation workers.[9]

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[7] Harris Interactive, *Privacy and Security: The Mind and Mood of U.S. Employees and Managers* (May 14, 2002).
[8] Bureau of Justice Statistics, *Public Attitudes Toward Uses of Criminal History Information* 32 (July 2001) (NCJ 187663).
[9] Maritime Transportation Security Act of 2002, the USA PATRIOT Act and the Aviation Transportation Security Act.

Many states also have enacted their own laws requiring employers in childcare, or similar industries, to conduct background checks on prospective employees.[10] Even where there are no explicit requirements to conduct a background check, some states implicitly encourage employers to conduct background checks by permitting negligent hiring suits. In these suits, courts may hold an employer liable for an employee's tortious actions, if the employer did not meet a certain standard of care in selecting the employee, including failing to conduct a background check or not conducting the background check thoroughly.

It is clear from these legislative efforts that many in Congress, as well as those in the state legislative bodies and courts, endorse greater use of employee background checks as a tool for increasing safety and security.

Current Regulation of Background Checks Balances Security Needs and Individual Rights

FCRA

FCRA defines "consumer report" as any written or oral communication by a consumer reporting agency (CRA) which bears on a person's creditworthiness, character, general reputation, personal characteristics, or mode of living, if the communication is used or collected in order to determine eligibility for, among other things, employment.[11] Under the statute, a CRA is any organization that regularly assembles consumer reports for a fee.[12] According to both the courts and the Federal Trade Commission (FTC), the

[10] *See, e.g.*, ALA. CODE § 16-22A-5
[11] 15 U.S.C. § 1681a.
[12] *Id.*

agency that enforces FCRA, a criminal background check on prospective or existing employees constitutes a consumer report when it is conducted by a CRA.[13]

Thus, if an employer hires an organization that regularly conducts background checks, such as a private investigator or a company like Choicepoint, the background check falls within FCRA's purview.

Background checks performed by the employer, or by outside organizations that are not CRAs, however, are not regulated by FCRA.[14] Also excluded from FCRA's requirement are "any report[s] containing information solely as to the transactions or experiences between the consumer and the person making the report[s]."[15] For example, if an employer uses an outside organization to conduct drug or psychological testing on a candidate, the test results are not a consumer report because the information is based on transactions or experiences between the candidate and the testing agency.[16]

Despite these exceptions, it appears most of the background checks performed every year are regulated by FCRA,[17] primarily because most employers find it more cost effective to outsource background checks to CRAs.

For covered background checks, FCRA imposes certain requirements on the employer and the CRA to ensure privacy and accurate reporting. Specifically, the employer must notify the employee or applicant and obtain his or her consent before

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[13] *See Lewis v. Ohio Professional Electronic Network,* 190 F. Supp. 2 1049 (S.D. Ohio 2002); *Wiggens v. District Cablevision, Inc.,* 853 F. Supp. 484 (D.D.C. 1994); June 9, 1998 letter from William Haynes, Attorney, FTC Division of Credit Practices to Richard LeBlanc; *see also Using Consumer Reports: What Employers Need to* Know, Federal Trade Commission (Mar. 1999), retrieved from http://www.ftc.gov/bcp/conline/pubs/buspubs/credempl.htm.

[14] 15 U.S.C. § 1681a(d)(2).

[15] *Id.* § 1681a(d)(2).

[16] *See Hodge v. Texaco, Inc.,* 975 F.2d 1093 (5th Cir. 1992).

[17] Ann Davis, *Firms Dig Deep Into Workers' Pasts Amid Post-Sept. 11 Security Anxiety,* Wall Street Journal Online (Mar. 12, 2002) (Choicepoint (a CRA) reports it ran over 5 million background checks last year); *Company Finds Plenty of Bogus Info in Job Apps,* Business & Legal Reports (June 12, 2001), retrieved from http://hr.blr.com/elert.cfm?id=362 (Avert, Inc., an Internet-based CRA, ran over 1.8 million checks in 2000).

initiating the check.[18] The employer must also provide the applicant or employee with a copy of the background check and a summary of his or her rights under FCRA before taking an adverse employment action (*i.e.,* termination, demotion, etc.) based on the check.[19] Following any adverse action, the employer must also provide the individual with the name, address, and phone number of the CRA (including any toll-free telephone number established by a national CRA) and a notice setting forth the individual's right to dispute the accuracy or completeness of any information in the report.[20] The CRA is obligated to reinvestigate the matter free of charge and record the status of the disputed information within 30 days, if the employee or applicant challenges the information in the check.[21]

FCRA also sets certain limits on the information that a CRA may report. Specifically, if the check is done on employees or applicants expected to earn less than $75,000 a year, FCRA prohibits the CRA from reporting information regarding arrest records, civil suits or judgments, or other adverse information from more than seven years prior to the check or according to the applicable statute of limitations, whichever is longer.[22]

Discrimination Laws

Federal discrimination laws limit the extent to which an employer may rely on individuals' criminal history when making employment decisions. Specifically, both the Equal Employment Opportunity Commission (EEOC) and federal courts have said that

[18] 15 U.S.C. § 1681b(b)(2).
[19] *Id.* § 1681b(b)(3).
[20] *Id.* § 1681m(a).
[21] *Id.* § 1681i, note there are exceptions to these rules for checks performed pursuant to national security and on individuals in working in transportation industry. *See Id.* § 1681b(b)(2)-(4).
[22] *Id.*. § 1681c(a) & (b).

basing employment decisions on criminal history can have a disproportionate effect on select minorities, and therefore may run afoul of Title VII of the Civil Rights Act of 1964.[23] To avoid problems with Title VII, the employer must show that an individual's criminal history is "job related" and the employment action is "consistent with business necessity."

State discrimination laws are even more restrictive. Indeed, many prohibit employers from even asking candidates about arrest records and impose limitations on employer inquiries into convictions.[24]

In short, both FCRA and federal and state discrimination laws provide ample protection for individuals undergoing background checks and Congress should not be imposing any greater restrictions at a time where employers are facing increased public and governmental pressure to perform such checks. In fact, if you are to enact any changes to FCRA that affect background checks, we recommend you remedy the problems discussed below arising from FCRA's application to background check on contract workers.

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[23] 42 U.S.C. § 2000e *et seq.; see Equal Employment Opportunity Commission Policy Guidance on the Consideration of Arrest Records in Employment Decisions Under Title VII* (1990) (citing several cases supporting this proposition).

[24] *See, e.g.,* Mass. Gen. Laws ch. 151B § 4(9)(ii). Given protections provided under Federal law (*i.e.* the use of criminal history must be "job related" and "consistent with business necessity"), the Chamber questions the need for these additional state restrictions, particularly to the extent that they prohibit employers from obtaining relevant and important information. A clear example of the problems these state laws can cause was recently reported on by the Washington Post. The article discusses a recent charge against a D.C. high school counselor for the rape of a student. Apparently, in 1996, prior to being hired by the school, the counselor had faced previous rape charges – this time of a 15 year old – but that trial had ended in a hung jury. The school knew of the 1996 charge at the time it hired the employee, but because the charge had not resulted in a conviction, D.C. law prohibited them from using the charge as a basis for refusing to hire the counselor. *See* Sylvia Moreno and Henri Cauvin, *Counselor Faces Sex Charges,* The Washington Post, (June 5, 2003). As this case demonstrates, and as the EEOC recognizes in their guidance on this issue, information about an employee's arrests can be important to hiring and other employment decisions. *See Equal Employment Opportunity Commission Policy Guidance on the Consideration of Arrest Records in Employment Decisions Under Title VII* (1990).

FCRA and Contract Workers

Employers, particularly those in security sensitive and highly regulated industries, often need to ensure that a background check has been run on contract workers. However, employers are reluctant to run these checks themselves because doing so could result in the contractors being deemed employees for tax, labor law, or other purposes.

Thus, employers rely on the contractor (the company supplying the contract workers) to run the checks. However, employers may need to see a copy of the background check in order to verify that the contract worker meets certain criteria. This can cause problems with FCRA, if the contractor regularly provides the background checks. In such circumstances, the contractor may be deemed a CRA and have to comply with FCRA's many requirements.

Again, if you do intend to make changes to FCRA beyond reauthorization, we urge that you address this problem.

Investigations into Workplace Misconduct

I am also here to discuss FCRA's impact on employer investigations into workplace misconduct.[25]

Workplace investigations are a critical part of employer efforts to combat harassment, violence, theft, fraud and other threats to the workplace and, in some instances, national security.

On April 5, 1999, the FTC issued a staff opinion, know as "the Vail letter," which has made it significantly more difficult for employers to conduct investigations. The

[25] Because of the importance of this issue to the Chamber, not only am I testifying hear today, but the Chamber also testified on this issue in 2000 and has sent several letters to the FTC requesting it rescind the Vail letter.

letter was issued in response to an inquiry as to whether employers using "outside organizations" to conduct sexual harassment investigations need to comply with FCRA. The letter states that organizations that regularly investigate allegations of workplace sexual harassment, such as private investigators, consultants or law firms, are "consumer reporting agencies" under FCRA, and that if the employer hires such an organization to conduct an investigation, then both the employer and the CRA must comply with FCRA's notice and disclosure requirements. While the Vail letter only addresses whether FCRA applies to sexual harassment investigations, a subsequent FTC opinion letter states that FCRA applies to any investigation of employee misconduct.[26]

FCRA's notice and requirements include:

1. notice to the employee of the investigation;
2. the employee's consent prior to the investigation;
3. a description of the nature and scope of the proposed investigation, if the employee requests it;
4. a release of a full, un-redacted investigative report to the employee;
5. notice to the employee of his or her rights under FCRA prior to taking any adverse employment action; and
6. that the CRA reinvestigate the matter free of charge and record the status of the disputed information within 30 days, if the individual disputes the accuracy or completeness of the information obtained in the investigation.[27]

The Vail Letter Deters Employers from Using Experienced Outside Investigators

Because it is virtually impossible to conduct an investigation while complying with FCRA's requirements, and because employers and investigators face unlimited liability, including punitive damages, for failure to comply with any of FCRA's many technical requirements, the Vail letter effectively deters employers from using

[26] *See* August 31, 1999 letter from David Medine, FTC Associate Director Division of Financial Practices, to Susan Meisinger; *see also* Statement of Federal Trade Commission before the House Banking and Financial Services Committee, May 4, 2000.
[27] 15 U.S.C. § 1681 *et seq.*

experienced and objective outside organizations to investigate workplace misconduct.[28] Yet, in many cases, an employer must do so in order to comply with obligations under other laws. Thus, the Vail letter often places employers in the untenable position of having to choose between two legal obligations.

While the Chamber believes the FTC should rescind the Vail letter because it misconstrues FCRA and conflicts with Congressional intent, the agency has repeatedly refused to do so, claiming a legislative fix is needed.

The Importance of Outside Investigators

While an employer may avoid running afoul of Vail by performing the investigation itself, there are many instances where a company has no choice but to use an outside investigator. For example, the technical nature of the alleged misconduct may require an expert investigator, such as where the misconduct involves securities fraud. In other instances, such as corporate governance cases, the investigation may involve misconduct by a high-level official and outside objectivity is necessary. In other cases, the employer may simply lack the resources to conduct an in-house investigation.

Even where outside investigators are not necessary, they may be preferred. Indeed, both the courts and administrative agencies have strongly encouraged employers to use experienced outside organizations to investigate suspected workplace violence, employment discrimination and harassment, securities violations, theft or other workplace misconduct.[29] As Assistant Attorney General James K. Robinson said in his

[28] *See* May 24, 2000, letter from Howard Price, U.S. Department of Commerce Contracting Officer, to Jane Juliano and June 14, 2000, letter from Jane Juliano to William M. Daley, Secretary of Commerce, both stating that the Department has stopped hiring outside contractors to conduct discrimination investigations. Several Chamber members have informed us they have also been hesitant to use outside investigators due to the Vail letter.

[29] *See e.g, Burlington Industries Inc. v. Ellerth,* 118 S.Ct. 2257 (1998) and *Faragher v. City of Boca Raton,* 118 S.Ct. 2275 (1998) (clearly delineating employers obligations under Title VII to investigate all

May 4, 2000 statement to this Committee, "[t]he Department [of Justice] and other agencies often strongly encourage companies, as part of their compliance programs, to retain outside counsel to conduct certain internal investigations, on the theory that an outsider is less subject to retaliation or intimidation by supervisors or co-workers and is less likely to be biased by concerns for the company's business with existing or future customers."

The experience of the investigator can also be an issue. For example, according EEOC guidance, "whoever conducts the investigation should be well-trained in the skills that are required for interviewing witnesses and evaluating credibility."[30] Few employers have the resources to keep on staff an individual who is well trained in interviewing witnesses and evaluating credibility.

Yet, because of the Vail letter, employers cannot use outside investigators without risking potential unlimited liability under FCRA.

Why It is Impossible to Conduct an Effective Investigation and Also Comply With FCRA's Notice and Disclosure Requirements

According to the Vail letter, FCRA's disclosure requirements apply to any employment investigation that meets the Act's definitions and is conducted for a fee by an "outside organization." As a result, employers have to obtain consent from employees suspected of theft, discrimination, SEC violations and other improprieties before retaining an outside organization to conduct an investigation.

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employee complaints of sexual harassment); EEOC Enforcement Guidance: Vicarious Employer Liability for Unlawful Harassment by Supervisors, 6/21/99 ("An employer should set up a mechanism for a prompt, thorough, and impartial investigation into alleged harassment [and w]hoever conducts the investigation should be well-trained in the skills that are required for interviewing witnesses and evaluating credibility").

[30] EEOC Enforcement Guidance: Vicarious Employer Liability for Unlawful Harassment by Supervisors, 6/21/99 ("EEOC Guidance").

The absurdity of this was recently highlighted in *Rugg v. Hanac*. In that case, a company's former executive director, relying on the Vail letter, sued the board of directors under FCRA for failing to provide her notice and obtain permission before hiring an outside organization to conduct an investigation which lead to her termination. The board of directors launched the investigation after the City of New York expressed concern with the company's finances following a routine audit. While the court expressed reservations about the validity of the Vail letter interpretation, it nonetheless denied the employer's motion to dismiss and ordered more discovery on the issue of whether the outside investigator regularly conducted such investigations, and therefore is a CRA within the meaning of the statute.[31]

As this case demonstrates, Vail creates serious conflicts between a company's responsibilities under FCRA and a board of director's duties to meet its corporate governance obligations, such as those under the Sarbanes-Oxley Act of 2002.[32] Obviously, the board of directors could not inform or obtain consent from the executive director before launching its investigation that might uncover her own financial improprieties. Nor could it ask the executive director to conduct an in-house investigation into such matters.

This case, however, is only one example of the many conflicts between Vail and employers' duties under other laws. Civil rights laws are another example. As then Chairwoman of the EEOC Ida Castro warned in 2000, "the FTC's conclusion that the FCRA's numerous and highly specific requirements control third-party discrimination

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[31] *See Rugg v. Hanac,* 2002 WL 31132883 (S.D.N.Y. 2002); *see also Friend v. Ancillia Systems Inc,* 68 F. Supp. 2d 969 (N.D. Ill. 1999).
[32] Pub. L. No. 107-204.

investigations has serious unintended consequences for the enforcement of civil rights laws."[33]

Simply put, employers cannot both adhere to FCRA's disclosure and consent requirements and comply effectively with their obligations under federal anti-discrimination laws.

In two 1998 cases, *Burlington Industries, Inc. v. Ellerth*, and *Faragher v. City of Boca Raton*, the Supreme Court delineated employers' obligations under Title VII of the Civil Rights Act of 1964[34] to investigate thoroughly all employee complaints of sexual harassment[35] and to take reasonable care to prevent and promptly correct harassment.[36] An employer who fails to meet these obligations can be found liable for a rogue supervisor's actions and greatly increase the likelihood it will be assessed punitive damages.[37]

Following these decisions, the EEOC issued comprehensive policy guidance, explaining the circumstances under which employers can be held liable for unlawful harassment by supervisors.[38] The guidance, which does not limit its scope to "sexual harassment," but covers all forms of harassment in the workplace, addresses the steps employers should take to prevent and correct harassment. It states that an anti-harassment policy and complaint procedure should contain, among other things,

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[33] Statement of Ida L. Castro before the Committee on Banking and Financial Services, May 4, 2000.
[34] 42 U.S.C. § 2000e *et seq.*
[35] Although *Burlington* and *Faragher* involved claims of sexual harassment, many courts have extended the holdings to allegations of race and other forms of discrimination.
[36] *Burlington Industries, Inc. v. Ellerth*, 118 S.Ct. 2257 (1998) and *Faragher v. City of Boca Raton*, 118 S.Ct. 2275 (1998). These cases dealt with employer liability for a supervisor's actions. Although the standard for assessing liability against an employer for supervisor's actions differs slightly from that of when harassment was done by co-workers, the end result is the same. Again, for the reasons mentioned above, an employer is best served by using experienced and objective outside investigators.
[37] *See Kolstad v. American Dental Association*, 527 U.S. 526 (1999).
[38] *See*, EEOC Enforcement Guidance: Vicarious Employer Liability for Unlawful Harassment by Supervisors, 6/21/99 ("EEOC Guidance").

assurances that employees complaining of harassment and other witnesses will be protected against retaliation; the employer will protect the confidentiality of harassment complaints and records relating to such complaints to the extent possible; the employer will conduct a prompt, thorough, and impartial investigation; and the employer will take immediate and appropriate corrective action when it determines that harassment has occurred.[39]

Clearly, an employer cannot both comply with FCRA's disclosure requirements and the guidelines. Indeed, an employer could be thwarted from performing the investigation altogether if the employee exercised his or her rights under FCRA to withhold consent. Also, advance notice of misconduct investigations could result in destruction of incriminating evidence. Other problems can arise due to FCRA's disclosure requirements. For example, few witnesses would come forward if they knew their testimony would be readily released to the accused harasser.

In short, an employer simply cannot meet its Title VII obligations while complying with FCRA.

In addition to Title VII, Vail thwarts employers' ability to comply with other numerous federal and state laws. For example, under the securities laws, broker-dealers have a statutory obligation to pursue allegations of wrongdoing by their employees and are monitored by self-regulating organizations. Among other things, broker-dealers conduct surprise internal audits and branch office compliance examinations to meet their statutory supervisory obligations. Often, outside consultants are used for these investigations. Moreover, in cases of suspected fraud, it is standard practice for issuers and broker-dealers to hire a law firm to conduct internal investigations. All the problems

[39] *Id.*

discussed above with regard to discrimination investigations are equally applicable to securities investigations.

Similarly, the laws regulating health and safety in the workplace require employers to provide a safe workplace and to investigate potential hazards including exposure to workplace violence. The Federal Drug-Free Workplace Act also imposes a duty on employers to investigate and eliminate drug use in the workplace.

Indeed the list of required employment related investigations is seemingly endless.

Vail Misconstrues FCRA

It is also clear that Vail misconstrues FCRA. There is no evidence in FCRA's text or legislative history that it was intended to apply to investigations of employee misconduct. The title of the statute – The Fair Credit Reporting Act - as well as the first few sentences of the Act are particularly telling on this point. Specifically, FCRA states that Congress found that "the banking system is dependent upon fair and accurate credit reporting. Inaccurate credit reports directly impair the efficiency of the banking system, and unfair credit reporting methods undermine the public confidence in the banking system."[40] Clearly, the legislation was enacted to address the effect of inaccurate credit reports on the banking system and the financial well-being of consumers, rather than employee privacy rights in the face of investigations into specific acts of workplace misconduct. As Committee Chair Oxley and Subcommittee Chair Bachus aptly stated, "Congress did not craft the FCRA to apply to [employment investigations]."[41]

[40] 15 U.S.C. Section 1681(a)(1).
[41] *See also Hartman,* 158 F.Supp.2d at 876 ("There is nothing in the FCRA or its history that indicates that Congress intended to abrogate the attorney-client or work-product privileges, as would be the effect of

In addition, most courts that have specifically considered the letter have either rejected it or seriously questioned its reasoning.[42] As one court put it, the letter "appears to have drawn a false analogy between employment decisions by a present or prospective employer based on information about a consumer's *general status* (such as credit, criminal or family history and the like) and a decision by a present employer about the consumer's *particular workplace conduct* (such as threats of violence)."[43]

While the FTC has acknowledged the problem caused by the Vail letter,[44] it nonetheless has refused to reverse its position, claiming, even as recently as a few weeks ago, that a legislative fix is necessary.[45]

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applying the FCRA's requirements (which include disclosure of the report) to reports of the type at issue in this case").

[42] *See Rugg v. Hanac,* 2002 WL 31132883 (S.D.N.Y. 2002); *Hartman v. Lyle Park District,* 158 F.Supp.2d 869, 876 (N.D. Ill. 2001); *Johnson v. Federal Express Corp.*, 147 F.Supp.2d 1268, 1272 (M.D. Ala. 2001); *Robinson v. Time Warner, Inc.*, 187 F.R.D. 144; 1999 U.S. Dist. LEXIS 14304 at 14 n.2 (S.D.N.Y. 1999).

[43] *Johnson,* 147 F.Supp.2d at 1272.

[44] In the Statement of Federal Trade Commission Before the House Banking and Financial Services Committee Subcommittee on Financial Institutions and Consumer Credit (May 4, 2000), the Commission said:

> The Commission fully appreciates that practical problems may arise in applying all FCRA requirements to investigations by third parties of workplace misconduct. The Commission agrees that there is considerable tension between some of the affirmative requirements that . . . FCRA impose[s] on employers and certain public policy aims of statutes and regulations that, directly or indirectly, compel or encourage investigations of various forms of workplace misconduct. Most notably these include the FCRA requirement that an employer obtain an employee's written authorization before preparing a consumer report, which arguably provides an antagonistic employee the opportunity to thwart a third-party investigation by withholding authorization. We understand this is especially troubling for small employers (who may not have the personnel or expertise to conduct an "in-house" investigation, and any employer who wishes to put a workplace investigation in the hands of an outside entity in order to foster a greater sense of impartiality.
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> ***
>
> Additionally...[b]y alerting the employee to the investigation, it may permit a dishonest employee to destroy or alter evidence, seek to influence potential witnesses, and otherwise impair the reliability of the investigation. The requirements that the employee be provided a copy of the report and that, upon request, "all information" in the consumer reporting agency's file on the employee be disclosed to the employee likewise pose difficulties for thorough investigations. They may have a "chilling effect" on the willingness of *others* (co-workers, witnesses) to participate in the investigation, for they fear retribution or other adverse consequences if their identity is divulged or if sufficient information is available to infer the individuals who gave evidence."

Legislative Fix

Rep. Pete Sessions (R-TX) has introduced H.R. 1543, the Civil Rights and Employee Investigation Clarification Act, which would exempt certain workplace misconduct investigations from FCRA's notice and disclosure requirements. The bill would require, however, that the employer provide the subject of the investigation with a summary of the report, if it takes any adverse action based on the investigation. H.R. 1543 has bi-partisan support and its cosponsors include members of this Subcommittee as well as other members of the full Committee, including Ranking Member Barney Frank.

While the Chamber favors a complete exemption, it realizes that it is often hard to put the genie back in the bottle, and that H.R. 1543 represents a concerted effort on the part of the cosponsors to reach a reasonable compromise between competing interests. We commend them for this effort and urge that this Subcommittee support H.R. 1543.

[45] *See* Prepared Statement of the Federal Trade Commission of the Fair Credit Reporting Act Before the Financial Institutions and Consumer Credit, at 17 n. 48 (June 4, 2003).

Bill #	Title/Description	Sponsor
H.R. 439	Domestic Consumer Safety Act of 2003: To create a system of background checks for certain workers who enter people's homes, and for other purposes.	Andrews (D-NJ)
H.R. 1855	To amend title XVIII of the Social Security Act to require home health agencies participating in the Medicare Program to conduct criminal background checks for all applicants for employment as patient care providers.	Andrews (D-NJ)
H.R. 364	To amend title XIX of the Social Security Act to require criminal background checks on drivers providing Medicaid medical assistance transportation services.	Hooley (D-OR)
S. 769	Private Security Officer Employment Authorization Act of 2003: To permit reviews of criminal records of applicants for private security officer employment.	Levin (D-MI)
S. 958	To amend titles XVIII and XIX of the Social Security Act to prevent abuse of recipients of long-term care services under the Medicare and Medicaid programs.	Kohl (D-WI)
H.R. 2144	To amend title 49, United States Code, to make technical corrections and improvements relating to aviation security, and for other purposes.	Young (R-AK)
H.R. 208	To amend the Social Security Act with respect to the employment of persons with criminal backgrounds by long-term care providers.	Thompson (D-CA)

S. 333	To promote elder justice, and for other purposes.	Breaux (D-LA)
H.R. 18	To amend title XVIII of the Social Security Act to establish additional provisions to combat waste, fraud, and abuse within the Medicare Program, and for other purposes.	Biggert (R-IL)
S. 885	Entitled `Prosecutorial Remedies and Other Tools to end the Exploitation of Children Today Act of 2003'.	Kennedy (D-MA)
S. 131	To amend the Atomic Energy Act of 1954 and the Energy Reorganization Act of 1974 to strengthen security at sensitive nuclear facilities.	Reid (D-NV)
S. 228	To amend title 18, United States Code, to limit the misuse of social security numbers, to establish criminal penalties for such misuse, and for other purposes.	Feinstein (D-CA)
H.R. 637	To amend title 18, United States Code, to limit the misuse of Social Security numbers, to establish criminal penalties for such misuse, and for other purposes.	Sweeney (R-NY)
S. 745	To require the consent of an individual prior to the sale and marketing of such individual's personally identifiable information, and for other purposes.	Feinstein (D-CA)
S. 6	To enhance homeland security and for other purposes.	Daschle (D-SD)
H.R. 1407	To amend title 40, United States Code, to enhance security at executive and judicial branch facilities by	Sessions (R-TX)

	requiring locksmiths who provide locksmith services at such a facility to be credentialed, which includes undergoing a criminal history background check.	
S. 151	To amend title 18, United States Code, with respect to the sexual exploitation of children.	Hatch (R-UT)
H.R. 2145	To condition the minimum-wage-exempt status of organized camps under the Fair Labor Standards Act of 1938 on compliance with certain safety standards, and for other purposes.	Andrews (D-NJ)
S. 157	To help protect the public against the threat of chemical attacks.	Corzine (D-NJ)
S. 1043	To increase security at nuclear power plants – Improve employee background checks under Section 149 of Atomic Energy Act of 1954.	Inhofe (R-OK)
H.R. 2193	To improve port security including background checks	Ose (R-CA)

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ELECTRONIC PRIVACY INFORMATION CENTER

Testimony and Statement for the Record of

Marc Rotenberg
Electronic Privacy Information Center, Executive Director
Georgetown University Law Center, Adjunct Professor

With

Chris Hoofnagle, EPIC Deputy Counsel
Anna Slomovic, EPIC Senior Fellow

Hearing on
The Role of FCRA in Employee Background Checks
and the Collection of Medical Information

Before the

Subcommittee on Financial Institutions and Consumer Credit,
Committee on Financial Services,
United States House of Representatives

June 17, 2003
2138 Rayburn House Office Building

Mr. Chairman, members of the Committee, thank you for the opportunity to testify today regarding the role of the Fair Credit Reporting Act (FCRA) in employee background checks and the collection of medical information. My name is Marc Rotenberg and I am the executive director of the Electronic Privacy Information Center (EPIC), a public interest research organization in Washington. I have taught Information Privacy Law at Georgetown University Law Center since 1990 and I am the coauthor, with Professor Daniel J. Solove, of *Information Privacy Law* (Aspen 2003). I have a long-standing interest in medical record privacy. I served on the Model State Public Health Privacy Law Project, directed by Professor Lawrence Gostin, and I wrote about the issue of preemption in the medical privacy field for the *Journal of Health, Law and Public Policy* in 1995.[1]

Joining me this morning are Chris Hoofnagle and Anna Slomovic. Mr. Hoofnagle is Deputy Council of EPIC and concentrates on the Fair Credit Reporting Act. Ms. Slomovic, Ph.D., is the former Privacy Officer for a managed care organization.

This morning I will provide an overview of the ongoing problem of privacy protection, the scope of the medical privacy rule, the need to protect medical information contained in credit reports. This issue should be of particular concern to this Committee because employers are increasingly using background checks on potential and current employees. Landlords are using credit reports to screen potential renters. Even health clubs are using credit reports as a means of evaluating applications for membership.

The widespread use of credit reports makes it more important than ever to ensure that medical information is not released inappropriately without the knowledge and consent of the individuals and without the necessary obligations that companies that collect and use personal information take on. Current federal and state laws protect medical information in many contexts. However, the protections are now always sufficient, and the connections between various laws are not perfect. I would like to discuss some of the ways in which medical information has been misused in the past, ways in which federal protection of medical information varies under different regulatory regimes, and states actions on protecting health information.

SCOPE OF PROBLEM

Protecting the privacy of medical information continues to be a serious problem in the United States. The misuse of an individual's medical data can result in real harms to that person. Privacy of medical information is undermined when an individual's medical records are not properly safeguarded, misused, or produce adverse and unfair outcomes.

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[1] Marc Rotenberg, *Review: Institute of Medicine. Health Data in the Information Age: Use, Disclosure, and Privacy. Washington, DC: National Academy Press,* Journal of Health, Law, and Public Policy (Spring 1995).

One of the places where medical privacy invasion is felt most acutely is in the workplace. Opening up medical records to employers puts individuals at risk of discrimination based upon their medical conditions. Employees may be harassed, denied medical insurance, fired, or subjected to any number of other negative consequences when their health records are disclosed to employers.

Today doctors are taking extraordinary measures to safeguard patients' files. Some doctors are withholding medical information from health records to help patients keep their medical history private. A recent survey of 344 members of the Association of American Physicians and Surgeons revealed that 87 percent of members surveyed reported that their patients had requested that they exclude data from patients' medical records, and 78 percent of those surveyed complied. In addition, almost one-fifth admitted to making false entries on medical records.[2]

The absence of effective medical privacy protection adversely affects the delivery of medical care. Janlori Goldman, Director of the Health Privacy Project at Georgetown University, observed that a recent survey for the California HealthCare Foundation revealed that one out of six people "withdraws from full participation in their own health care" because of fear that health care information will be used without their permission.[3] The Labor, Justice, and Health and Human Services Departments found that 63% of individuals surveyed for a report would decline genetic testing if employers or insurers could obtain the results.[4]

Still another way an individual's medical information is misused and even exploited is when personal medical records are shared or sold for marketing purposes. Marketing provisions in medical privacy law permit "doctors, HMOs, and other healthcare groups to use personal patient data . . . for marketing purposes."[5], Many on-line health sites collect information about visitors' browsing, buying and clicking habits. According to Ms. Goldman, "The business model of many health sites is based on the collection, use, and resell of personal health data." Many drug companies probably already know much more about us than we want them to.

The challenges of medical record privacy are likely to increase. Some companies are not only collecting medical information, but also DNA sample. Genelex, a genetics company in Redmond, Washington, "has amassed 50,000 DNA samples, many gathered surreptitiously for paternity testing." According to "CEO Howard Coleman[,] 'Siblings have sent in mom's discarded Kleenex and wax from her hearing aid to resolve the family rumors.'" However, whether or not the DNA is collected with an individual's knowledge, the data may be "stored without donors' knowledge. Cell banked for one

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[2] Dana Hawkins, *Guarding medical secrets, at a cost*, U.S. News & World Report, August 13, 2001.
[3] Janlori Goldman and Zoe Hudson, "Virtually Exposed: Privacy And E-Health," *Health Affairs* (California HealthCare Foundation, Nov./Dec. 2000).
[4] Joanne L. Hustead, Aimee Cunningham, & Janlori Goldman, *Genetics and Privacy: A Patchwork of Protections*, prepared for California HealthCare Foundation, Apr. 2002.
[5] Dana Hawkins, *Medical privacy rules give patients and marketers access to health data*, U.S. News & World Report, Jan. 29, 2001.

purpose, such as medical diagnosis, have been shared with or sold to other users for research or profit."[6]

II. LIMITATIONS ON CURRENT PROTECTIONS UNDER FEDERAL LAW

The HIPAA Privacy Rule is designed to protect health information by giving individuals greater control over this information and by limiting uses and disclosures that can be made without explicit individual authorization. Unfortunately, there appear to be several areas in which intended protections fail as health information moves from entities that must comply with the Privacy Rule to ones that are not required to do so. I will now describe the gaps between the HIPAA Privacy Rule and requirements under FCRA.

Definition of protected information is different in financial and health regulations

Under the Privacy Rule, protected health information (PHI) is broadly defined. Individually identifiable information is protected when it relates to an individual's past, present, or future physical or mental health; the provision of health care to an individual; or the past, present, or future payment for the provision of health care to an individual. The HIPAA definition of PHI includes information collected from an individual, as well as information created or received by a health care provider, health plan, employer, or health care clearinghouse.[7]

However, under FCRA, the term "medical information" is defined more narrowly. "Medical information" means information or records obtained, with the consent of the individual to whom it relates, from licensed physicians or medical practitioners, hospitals, clinics, or other medical or medically related facilities.[8]

This definitional difference means that some information protected under HIPAA does not receive protection under FCRA simply because it is not obtained from one of the entities listed in the FCRA definition.

Limitation on the types of entities covered by the Privacy Rule

Congress limited the regulatory authority of the Department of Health and Human Services (HHS) to three specific types of entities, called "covered entities":

Health care providers, who electronically transmit health information in connection with standard transactions
Health plans
Health care clearinghouses[9]

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[6] Dana Hawkins, *Keeping secrets: As DNA banks Quietly Multiply, Who is Guarding the Safe?*, U.S. News World Report, Dec. 2, 2002.
[7] 45 CFR, §160.102 and §164.501.
[8] 15 USC §1681a(1).
[9] P.L. 104-191, SEC. 1172. (a) ("Applicability").

Other entities may be subject to the Privacy Rule indirectly through business associate agreements if they are performing tasks "on behalf" of "covered entities." Examples of business associates include billing companies, law firms, accounting firms, and third-party administrators. Business associate agreements must be in place before PHI is released to these entities. These business associate agreements must stipulate that a business associate will not use or disclose PHI for any purposes not specified in the agreement. The basic principle is that business associates acting on behalf of "covered entities" are subject to the same rules as the "covered entities" themselves with respect to the activities they perform under business associate agreements.

However, if an entity collects health information in a capacity other than "covered entity" or a business associate of a "covered entity," it is not subject to the Privacy Rule. The Department of Health and Human Services acknowledges in the preamble to the December 2000 Privacy Rule that health information collected and used by life insurers, casualty/property insurers, auto insurers, worker's compensation programs, employers and others is not subject to the protections of the Privacy Rule because these entities are outside the HHS statutory authority. It is, therefore, important that adequate protections for health information be provided in laws or regulations that govern these types of entities.

Limitation on protections of health information received by employers

HHS attempted to limit the use of health information by employers because such use could be particularly detrimental to individuals. In order to receive PHI from a "covered entity" employers generally need an individual's signed authorization, explicitly stating by whom and for what purpose PHI is being obtained. In cases where an employer sponsors a group health plan, as defined under ERISA, the group health plan is not permitted to disclose protected health information to the employer plan sponsor without individual authorization until the plan receives a certification that plan documents have been amended to state that the sponsor agrees not to further use or disclose PHI except as permitted or required by law, and not to use health information for employment-related decisions.[10]

However, employers may receive health information from sources other than a "covered entity." Health information received from such other sources is protected under the Privacy Rule. HHS stated in its preamble to the December 2000 Privacy Rule:

> With regard to employers, we do not have statutory authority to regulate them. Therefore, it is beyond the scope of this regulation to prohibit employers from requesting or obtaining protected health information. Covered entities may disclose protected health information about individuals who are members of an employer's workforce with an authorization. Nothing in the privacy regulation prohibits employers from

[10] 45 CFR, Part 164—Security and Privacy, 164.504, Uses and Disclosures, Organizational Requirements, (f)(1) Standard: Requirements for group health plans.

> obtaining that authorization as a condition of employment. We note, however, that employers must comply with other laws that govern them, such as nondiscrimination laws.[11]

If an employer receives health information from a credit reporting agency or another source in the course of a background check on a current or prospective employee, the employer can use this health information in ways that are inconsistent with the Privacy Rule's intention to protect PHI from use or disclosure in employment-related actions without individual authorization.

Limitation on protection resulting from permitted activities

Another limitation on the protection of PHI that is of particular relevance here exists because the Privacy Rule disclosures to credit reporting agencies are part of payment-related activities of "covered entities." In order to facilitate the smooth operation of the health care system and the delivery of high-quality health care, activities related to treatment, payment and health care operations of "covered entities" do not require individual authorization. Disclosures related to these types of activities are also not subject to Accounting of Disclosures, which individuals can request from "covered entities" in order to learn what disclosures have been made without authorization.[12]

The PHI that may be disclosed to credit reporting agencies under the Privacy Rule is limited. The definition of "Payment" includes the following:

> (vi) Disclosure to consumer reporting agencies of any of the following protected health information relating to collection of premiums or reimbursement:
> (A) Name and address;
> (B) Date of birth;
> (C) Social security number;
> (D) Payment history;
> (E) Account number; and
> (F) Name and address of the health care provider and/or health plan.[13]

Although limited, such PHI can, under some circumstances, lead the recipient to infer what medical services have been provided to an individual. Additional information can be gained by learning the specialties of providers who made the report.

As stated in the preamble to the December 2000 Privacy Rule, credit reporting agencies are not subject to the Privacy Rule unless they happen to be "covered entities." After the consumer reporting agency receives PHI, the information is subject to whatever

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[11] 45 CFR, Parts 160 and 164—Security and Privacy, Preamble, Section III, Section-by-Section Discussion of Comments, Relationship to Other Federal Laws.
[12] 45 CFR, Part 164, § 164.528 (a)(1)(i).
[13] 45 CFR, Part 164, § 164.501.

protections are afforded to such information under the regulations governing credit reporting agencies.[14]

Alternative Approaches to Protecting Medical Information Indicate Important Role of States

Entities that operate in multiple states look for a uniform regulatory environment in order to operate efficiently. For health insurers this includes the ability to consolidate service centers and other support operations in order to take advantage of efficiencies of scale and scope. As important as it is to improve efficiency of the health care system, however, federal preemption of state law is not the only way to obtain operational uniformity. State adoption of model laws and regulations is another way to create a uniform operating environment for organizations that operate in multiple states while providing states with the necessary flexibility to customize requirements for the needs of their citizens.

The National Association of State Insurance Commissioners (NAIC) has promulgated the Privacy Model Act that requires "opt-in" for sensitive health information, which is broadly defined. The NAIC Model Regulations, promulgated after the passage of Gramm-Leach-Bliley Act, closely track the requirements of that law for financial information, but provide more stringent protections for the more sensitive health information.

According to the NAIC, most states and the District of Columbia are adopting NAIC's models.

> Twenty-four states planned to promulgate the NAIC Privacy of Consumer Financial and Health Information Model Regulation (the "NAIC model regulation") in its entirety, including the financial and health provisions.
> Nine states planned to promulgate only the financial privacy provisions of the NAIC model regulation. Several of these states already had health information protections in place or intended to follow up with health information protections in the future.
> Four states that previously adopted the 1982 NAIC Privacy Model Act planned to revise their current laws and/or regulations to be consistent with the NAIC model regulation's notice and opt-out provisions for financial information; however, these states planned to keep the 1982 privacy model act's opt-in requirement for health information privacy. The health privacy protections in the new model regulation also require opt-in before the disclosure of health information.
> Nine states planned to keep the 1982 model act in place. [15]

III. RECOMMENDATIONS

[14] 45 CFR, Parts 160 and 164—Security and Privacy, Preamble, Section III, Section-by-Section Discussion of Comments, Relationship to Other Federal Laws.
[15] NAIC press release, April 9, 2001.

1) Require that Medical Information Inferred from Credit Reports be Subject to Strong Protections

Congress established a strong standard for the inclusion of medical information in credit reports. Under the Act, medical information should only appear in the report when it is provided directly from a health provider and the patient has consented to the transfer.[16]

A December 2002 study by the Consumer Federation of America and the National Credit Reporting Association, and a 2003 report of the Federal Reserve highlighted an emerging problem for consumers: despite the protections in the FCRA, some types of medical conditions or treatment can be inferred from items on credit reports.[17] Both studies found that the names of medical creditors could indicate what categories of treatment a consumer received. The current protections of the Act do not cover this loophole, and thus we think it an opportune time for Congress to correct this problem.

Furthermore, certain factors have exacerbated the problem caused by this loophole. The first is that medical collections commonly appear in credit reports, which exposes personal medical information to any person or business which requests a credit report. The Federal Reserve report found that 52 percent of collection actions are associated with medical bills.[18] Most of these collection items, however, are for small amounts. Sixty-six percent of medical collections are for amounts under $250.[19]

Second, medical organizations are beginning to use more aggressive collections techniques.[20] Mounting evidence suggests that health care providers are more vigorously pursing consumers because insurance companies frequently reject or dispute claims.[21] Even if the insurer ultimately pays the claim, a collections item will remain on the consumer's report for seven years. To remove the collections item, the consumer must prove that it was a factual error.

The consequences of this confluence of problems are serious. Individuals' privacy is not adequately protected under the law. Additionally, the Access Project found that providers treat patients with medical collections differently—these consumers are

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[16] 15 U.S.C. § 1681a(i).
[17] *Credit Score Accuracy and Implications for Consumers*, National Credit Reporting Association (NCRA) and the Consumer Federation of America (CFA), Dec. 2002, at http://www.ncrainc.org/documents/CFA%20NCRA%20Credit%20Score%20Report.pdf; Robert B. Avery, Paul S. Calem, & Glenn B. Canner, *An Overview of Consumer Data and Credit Reporting*, Federal Reserve Bulletin, Feb. 2003, at http://www.federalreserve.gov/pubs/bulletin/2003/0203lead.pdf.
[18] *Id.*
[19] *Id.*
[20] *The Consequences of Medical Debt: Evidence From Three Communities*, Access Project, Feb. 2003, at http://www.accessproject.org/downloads/med_consequences.pdf.
[21] Jay MacDonald, *Medical Bills Can Make Your Credit Sick*, Bankrate.com, Aug. 28, 2002; Eve Tahmincioglu, *Is Your Health Insurance Hurting Your Credit*, New York Times, May 12, 2002.

sometimes required to pay upfront for medical care, or sometimes are refused access to care.[22]

To address this problem, we urge Congress to amend the FCRA to obscure the names of creditors or collections agencies that may indicate the consumer's medical condition. We further recommend that Congress shorten the obsolescence periods for negative information when the collection and debt is insubstantial. Medical collections under $250 should not stay on a report for seven years; a shorter time is more appropriate.

2) Allow the Preemption Loophole to Expire

The FCRA, like many other privacy statutes, provides a federal baseline of protections for individuals. The FCRA is only partially preemptive, meaning that except in a few narrow circumstances, state legislatures may pass laws to supplement the protections made by the FCRA.

Congress should not extend the preemption loophole into the future. Consumers will lose important opportunities if preemption is extended—a continued federal ceiling will prevent states from creating additional needed protections. In our system of government, preemption should only be used in limited situations, and generally, preemption is not appropriate for consumer protection legislation.

Our current credit reporting system has thrived under a federal baseline of protections that is supplemented by dozens of stronger state credit reporting laws. We do not operate in a credit reporting system with a single, uniform standard. The Federal FCRA itself grandfathered in several state laws, including California, Vermont, and Massachusetts, as well as settlements made between the attorneys general and the credit reporting agencies.[23] Additionally, the states have passed laws regulating the content and costs of reports, and the duties of users and furnishers. States have passed many stronger privacy laws in many sectors.[24]

Congress should not extend preemption in the FCRA because it will tie the hands of state legislators, and prevent them from performing in their traditional roles as "laboratories of democracy." Justice Brandeis once noted that, "It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."[25]

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[22] *Id.* at Fn. 9, *supra*; *see also* Hugh F. Daly III, Leslie M. Oblak, Robert W. Seifert, & Kimberly Shellenberger, *Symposium: Barriers to Access to Health Care*, Case Western Reserve Univ. Health Matrix: J. of L.-Med. (Winter 2002).
[23] 15 U.S.C. § 1681t.
[24] See Appendix. The citations and summaries of state laws verified were as of May 2003 and were drawn from Robert Ellis Smith, *Compilation of State and Federal Privacy Laws*, Privacy Journal 2002.
[25] *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (Brandeis, J., dissenting).

State laws have not, and will not balkanize the credit system. Under the Supremacy Clause, state legislation that conflicts with, frustrates, or prevents compliance with federal credit reporting laws is automatically preempted.[26]

America's prior experience with privacy legislation clearly favors federal laws that allow states to develop complementary protections. The Electronic Communications Privacy Act, the Right to Financial Privacy Act, the Cable Communications Privacy Act, the Video Privacy Protection Act, the Employee Polygraph Protection Act, the Telephone Consumer Protection Act, the Driver's Privacy Protection Act, and the Gramm-Leach-Bliley Act all allow states to craft protections that exceed federal law.[27]

Related areas of law allow states to formulate stronger protections. In areas such as freedom of information, civil rights law, and environmental regulation, states generally have the power to craft protections for their residents. Consumer protection, in general, is a state activity. Congress, despite giving the Federal Trade Commission (FTC) a consumer protection role, encourages states to create "mini-FTCs." As a result, all 50 states have consumer protection law on deceptive practices.

State legislators are rational actors that have accommodated the interests of consumers and businesses well. An entire appendix to the 1977 Report of the Privacy Protection Study Commission was devoted to "Privacy Law in the States." This portion of the report speaks strongly to the value of state privacy protection:

> Through constitutional, statutory, and common law protections, and through independent studies, the fifty States have taken steps to protect the privacy interests of individuals in many different types of records that others maintain about them. More often than not, actions taken by State legislatures, and by State courts, have been more innovative and far reaching than similar actions at the Federal level. . . the States have also shown an acute appreciation of the need to balance privacy interests against other social values.

The report concludes: "The States have demonstrated that they can, and do, provide conditions for experiments that preserve and enhance the interests of the individual in our technological, information-dependent society."

State consumer protection laws are more consumer friendly. State laws are more accessible to consumer litigants, and often offer longer statutes of limitations. State laws typically afford individuals private rights of action rather than remedies that require the action of a federal agency. They also enable aggressive attorney general action. State legislatures are better suited to tailor laws to communities. State legislatures are closer to their constituents, and are more likely to tailor a law to particular problems.

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[26] *Hines v. Davidowitz*, 312 US 52 (1941).

[27] Respectively at 18 U.S.C. § 2510 et. seq., 12 U.S.C § 3401, 47 USC § 551, 18 USC § 2710, 29 USC § 2009, 47 USC § 227, 18 U.S.C. § 2721, and 15 U.S.C. § 6801.

Furthermore, information, more than any other product, can be tailored with technology in order to comply with disparate state requirements. In fact, the same companies lobbying for a uniform state standard for credit reporting already classify consumers into dozens of categories from "blue blood estates" to "hard scrabble" farmers. If technology has given these companies the ability to discriminate among individuals who live on the same block; it can also enable these companies to comply with differing state requirements on credit.

3) Adopt Opt-In Framework for Affiliate Sharing

The problems described above will be exacerbated under the current affiliate-sharing rules that make it too easy for personal information concerning consumers, including transactions that reveal medical services and condition, to be disclosed to others and to be incorporated into consumer profiles.

We recommend that Congress adopt an opt-in framework to grant individuals greater control of their to medical, financial, and other information that may be shared among corporate affiliates. The complex corporate ownerships made possible by Gramm-Leach-Bliley pose new risks to individuals' privacy. Financial holdings companies may now amass a vast amount of information about their customers. Affiliates may include banks, insurance companies, securities firms, as well as institutions that significantly engage in financial activities, such as retailers that issue credit cards, auto dealerships that lease vehicles, and entities that appraise real estate. The law allows these companies to merge into large financial holding companies, and also merge their customers' data into one consolidated database. This data may include financial, medical and other sensitive information.

Some financial holding companies have thousands of affiliates, making it exceedingly difficult for consumers to understand what companies may have access to their sensitive information. CitiGroup, Inc., for example, has over 2,700 corporate affiliates.[28] Similarly, Bank of America has almost 1500.[29] Given this vast scope of possible affiliate sharing, we believe that opt-in is the best approach to apportion rights between individuals and business interests in affiliate sharing.

Having mentioned the scope of CitiGroup's affiliate network, it is important to note that Travelers Group, in its 1998 acquisition of Citicorp properties, agreed to keep its customer health and medical information confidential.[30] Travelers indicated that it would share medical information "only with the customer's consent or under very limited

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[28] *Financial Privacy and Consumer Protection Hearing Before the Senate Comm. on Banking, Housing and Urban Affairs*, 107th Cong., Sept. 19, 2002 (statement of William H. Sorrell, Attorney General, State of Vermont).
[29] *Id.*
[30] Federal Reserve Press Release (Sept. 23, 1998), at http://www.federalreserve.gov/boarddocs/press/BHC/1998/19980923/19980923.pdf.

circumstances."[31] This agreement demonstrates that even large, complex financial services entities can accommodate opt-in.

IV. ADDITIONAL ISSUES

Mr. Chairman, I would like to bring to the Committee's attention two additional issues that are not specifically related to medical record privacy, but that do implicate the work of the Committee as it considers the ongoing importance of the financial privacy laws. The first issue concerns the expanded use of background checks. The second relates to information obtained just this week by EPIC, under the Freedom of Information Act, concerning the compliance with the privacy provisions contained in the Financial Services Modernization Act.

Employee background checks are being used more frequently as a result of the September 11, 2001 attacks.

A simple conviction or arrest for a minor crime can result in someone not being able to obtain a job—even one that requires minimal responsibility or does not involve security sensitivity. For example, Eli Lily, in response to the September 11, 2001 attacks, hired ChoicePoint to perform investigations on thousands of contract workers.[32] Lily's concern was reasonable enough—the company is the dominant producer of insulin in the world. But the result of the background checks was not reasonable. A pipe insulator at the company was fired for accidentally bouncing a $60 check. One person was dismissed because the records check revealed a fourteen-year-old misdemeanor marijuana possession charge. Another was dismissed for a crime that he did not commit.

The FCRA addresses background checks by requiring employee consent, and by limiting the scope of the file for certain employees. A limited file (one that does not contain bankruptcies more than ten years old, other negative information more than seven years old, an other adverse information more than seven years old) is delivered to employers where the position pays less than $75,000/year. This figure is too low in today's dollars.

Congress should limit the contexts in which a report can be obtained for employment purposes. These should be limited to jobs where employees handle large sums of money, or are genuinely security-sensitive. It is clear now that the current standard—consent—is too low, as even menial jobs require background checks. The other provision that limits the content of the report if the job pays less than $75,000, is also inadequate.

FTC Documents Obtained by EPIC under FOIA Indicate Ongoing Problems with Opt-out

[31] *Id.* at 84.
[32] Ann Davis, *Firms Dig Deep Into Workers' Pasts Amid Post-Sept. 11 Security Anxiety,* Wall Street Journal, Mar. 12, 2002.

Documents obtained this week by EPIC from the Federal Trade Commission, under the Freedom of Information Act, show that a majority of the complaints, received by the Commission, concerning compliance by large New York-area banks, with laws that allow individuals to opt-out, are about Citibank. In fact, fifteen of the twenty total complaints were about alleged Gramm-Leach-Bliley privacy violations by Citibank.

Of those fifteen complaints, nine concerned failed attempts to opt-out. In one complaint, a consumer was told that he was already taken off the list, but continued to receive unsolicited credit card offers. In another complaint, a consumer reported that "Citibank will not allow her to opt-out." Many of the complaints claimed that Citibank provided no phone number to opt-out with their unsolicited credit-card offers, and one complaint claimed that despite the fact Citibank provided online services, it did not have an online form to opt-out. Finally, in a complaint by a husband and wife, each was told to write a letter requesting to be removed from Citibank's credit card offer list. Nevertheless, despite their letters, they continued to receive the unsolicited offers three months later.

These examples underscore the need for an opt-in. From this small sample, we can see that even where consumers take the time to write, call, or e-mail in order to opt-out, Citibank and other financial institutions fail to allow consumers to opt-out. Opt-out is simply not an effective means to safeguard consumer privacy. Opt-in is clearly preferable as the documents obtained from the FTC this week indicate.

V. CONCLUSION

Congress clearly intended to safeguard personal information through passage of the Fair Credit Reporting Act the legislation that led to adoption of the Health Insurance Portability and Accountability Act. But it is also clear that medical record privacy remains a critical concern in the United States today. EPIC urges the Committee to ensure that strong safeguards are established. Specifically, we support efforts to strengthen accuracy and access for credit reports. We further recommend proposal to give consumer control over pre-screening and limit affiliate sharing absent a clear opt-in provision. Most significantly, we urge the Committee to allow the state preemption loophole to expire. Our Constitutional form of democracy, and the development of privacy law and consumer law during the latter part of the twentieth century, made clear that the states must have the freedom to protect the interests of consumers. As we enter the twenty-first century, it is clear that privacy protection is one of the great issues facing the nation and that the states have a central role to play.

ABOUT EPIC

The Electronic Privacy Information Center (EPIC) is a public interest research center in Washington, D.C. It was established in 1994 to focus public attention on emerging civil liberties issues and to protect privacy, the First Amendment, and to

promote the Public Voice in decisions concerning the future of the Internet. More information is available online at www.epic.org.

APPENDIX

Examples of Privacy Safeguards in State Credit Reporting Laws

Arrest, Conviction, and Bankruptcy Records.

- California: CRAs may not report bankruptcies after ten years. Cal. Civil Code 1785.13.
- Massachusetts: CRAs may not maintain arrest records more than seven years old. Mass. Gen. Laws Ann. Ch. 93 § 52.
- New Mexico, Kansas, and Montana: Criminal data must be purged from the report after seven years, bankruptcies must be purged after 14. N.M. Stat. Ann. § 56-3-6; Kan. Stat. Ann. §§ 50-704; Mont. Code Ann. §§ 31-3-112.

Cost of Reports.

- Georgia: Individuals are entitled to two free credit reports from each national credit reporting agency. Ga. Code Ann. § 10-1-393.
- Colorado, Maryland, Massachusetts, New Jersey, and Vermont: Individuals are entitled to a free credit report once a year. Col. Rev. Stat. 12-14.3-105; Md. Comm. Law Code Ann. § 14-1209; Mass. Gen. Laws Ann. Ch. 93 § 59; N.J. Stat. Ann. 56:11-37; 9 Vt. Stat. Ann § 2480c.
- Connecticut: Credit reports are $5. Conn. Gen. Stat. Ann. § 36a-699a.
- Minnesota: Caps the cost of credit reports at $3. Minn. Stat. § 13C.01.
- Maine: Caps the cost of credit reports at $2. 10 M.R.S. § 1316.

Credit Scores.

- California: CRAs must furnish credit scores to individuals for a reasonable fee. Cal. Civil Code 1785.15.1.
- Colorado: CRAs must provide a credit score to the consumer if one is used when extending credit secured by a dwelling. Colo. Rev. Stat. § 12-14.3-104.3.
- Connecticut: Consumers must receive report within five days of receipt of the request; report must include all information in the file, including any credit score. Conn. Gen. Stat. § 36a-696.
- Idaho: Prohibits insurers from raising rates, denying coverage, or canceling a policy primarily based on a credit rating or credit history. Idaho Code § 41-1843.

Duties on Furnishers of Reports.

- Massachusetts: Furnishers must follow reasonable procedures to ensure that the information reported to a CRA is accurate and complete, and furnishers may not provide information to a CRA if there is knowledge of or reasonable cause to believe such information is not accurate or complete. Mass. Gen. Laws Ann. Ch. 93 § 54A(a).
- California: A person shall not furnish information on a specific transaction or experience to any consumer credit reporting agency if the person knows or should know the information is incomplete or inaccurate. Cal. Civil Code 1785.25(a).

Duties on Users of Reports.

- California: Individuals may receive a free copy of their credit report when it is requested by an employer. Cal. Civil Code 1785.20.5.
- Utah: Credit grantors must notify consumers when negative information is furnished to a CRA. Utah Code Ann. 70C-7-107.

Investigative Consumer Reports.

- Arizona: Sources of investigative consumer reports must be furnished to the individual upon request. Ariz. Stat. § 44-1693(A)(4).
- California: Investigative consumer reporting agencies must allow individuals to visually inspect files. Employers must furnish copies of the report to employees. Cal. Civil Code 1786.

Notice to Consumers.

- Colorado: CRAs must notify individuals where there have been eight inquiries on the report within one year or where adverse information is added to the report. Col. Rev. Stat. § 12-14.3-104.

Sale of Personal Information:

- California: Credit card issuers must give notice and an opportunity to opt-out when they sell customer information. Cal. Civil Code 1748.12 (c)(3)(b).
- Connecticut: Selling the names from credit card purchases is prohibited. Conn. Gen. Stat. Ann § 42-133gg.
- Maryland: It is illegal to disclose ATM or credit card numbers Md. Crim. Code § 8-214.
- Vermont: Credit reports can only be used for purposes consented to by the customer, and cannot be used for affiliate sharing without consent. Vt. Stat. Ann. § 2480e.

Use of Medical Information.

- Florida: An individual must be informed when genetic information was used to deny an opportunity. Fla. Stat. Ann. § 760.40(b).

Testimony of

Edward L. Yingling

On Behalf of the

AMERICAN BANKERS ASSOCIATION

Before the

Subcommittee on Financial Institutions and Consumer Credit

Of the

Committee on Financial Services

United State House of Representatives

June 17, 2003

Testimony of Edward L. Yingling
On Behalf of the American Bankers Association
Before the
Subcommittee on Financial Institutions and Consumer Credit
Of the Committee on Financial Services
United States House of Representatives
June 17, 2003

Mr. Chairman, I am Edward Yingling, Executive Vice President of the American Bankers Association (ABA). ABA brings together all elements of the banking community to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional, and money center banks and holding companies, as well as savings institutions, trust companies, and savings banks – makes ABA the largest banking trade association in the country.

Mr. Chairman, we appreciate your holding hearings on the Fair Credit Reporting Act (FCRA) and the issue of protecting customer information, including medical information. There is no higher priority for the banking industry than the responsible use and protection of customer information. The banking industry has a long history of earning the trust of its customers and, in particular, of protecting their private financial information. Indeed, our extensive survey work shows that consumers trust banks more than virtually any other institution to protect their information. Before I address medical privacy specifically, I would like to set the context for this discussion by very briefly outlining the core philosophy of the banking industry regarding responsible use of information and the importance of preserving the FCRA for our economy. Thus, in my testimony today, there are three main themes:

- The cornerstone of successful banking is preserving the trust of our customers and that only can be accomplished by the protection and responsible use of their financial information;

- Preserving a voluntary, national credit reporting system is critical to the U.S. economy; and

- Medical or health information should be private and should not be used in the credit granting process, except in those specific cases where it is directly relevant. In those cases, medical information should only be obtained with the consent of the customer.

Let me briefly discuss each of these themes.

Preserving Trust is the Cornerstone of Banking

The industry values the trust customers have that banking institutions will protect their personal financial information. Not only is protecting privacy the right thing to do, the highly competitive financial market demands it. No bank can be successful without having a strong reputation for protecting the confidentiality of customer information. In fact, our survey work shows this reputation for trust is both strong among consumers and central to banking's place in the competitive marketplace.

We are now in the middle of a revolution in information technology that has dramatically changed the way information is gathered, used and stored. This rapidly changing technological landscape raises exciting new possibilities to provide customers with new and innovative products, to increase convenience, and to lower costs. At the same time, this changing technology raises important questions about the appropriate use of information and the need to make sure we meet the expectations of our customers that information be used responsibly. While technologies have changed, the importance of preserving customer trust and confidentiality of personal information has not – it remains a core value of the banking industry.

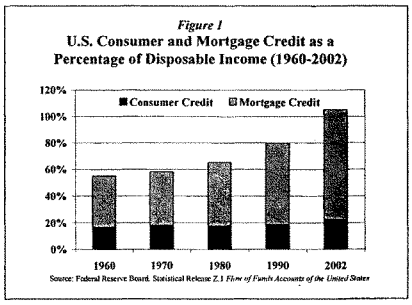
Preserving a National Credit Reporting System is Critical to the U.S. Economy

One of the keys to the strength and resiliency of the U.S. economy is the efficiency of the consumer credit markets. U.S. consumers have access to more credit, from a greater variety of sources, more quickly, and at lower cost than consumers anywhere else in the world. Over the last several years, particularly, the ability of consumers to use portions of their home equity for other

purposes has given them a level of financial flexibility that has helped consumer spending remain strong as other portions of the economy faltered.

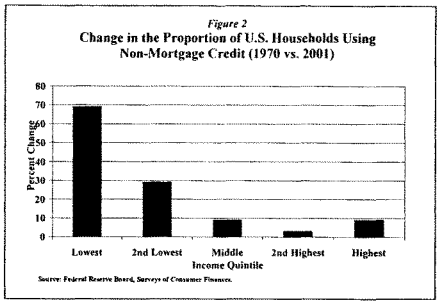
What makes this possible is a nationwide, seamless, and reliable system of credit reporting. Such a system would be impossible without the Fair Credit Reporting Act. For businesses – retailers, insurers, banks, employers, landlords and others – FCRA has helped them to make smart, immediate decisions that keep sales up, prices down and losses at a minimum. For consumers, it means they can walk into an auto dealership and drive off with a new car on the same day. They can move across the country and open a bank account without hassle. Picking up the phone or going online, homeowners can compare mortgage rates across the country and refinance quickly to take advantage of falling interest rates. Consumers can easily take advantage of varied credit card offers to obtain the best credit card deal for them. It allows them to shop around for the best rates on any loan commensurate with their credit history. By enabling complete and accurate credit histories, it has also helped expand credit access to millions of Americans who otherwise might not been able to get it.

These findings are confirmed by a recent study by professors Michael E. Staten and Fred H. Cate entitled *The Impact of National Credit Reporting Under the Fair Credit Reporting Act: The Risk of New Restrictions and State Regulation.* [1] The authors demonstrate that the role of household credit in the U.S. economy, especially mortgage credit, has grown dramatically since the passage of FCRA (see Figure 1). They state: "Credit markets help translate optimism into real economic activity. In this way, *smoothly functioning credit markets facilitate and extend economic expansion.*"



[1] Michael E. Staten is the Distinguished Professor and Director of the Credit Research Center at the McDonough School of Business, Georgetown University and Fred H. Cate is the Distinguished Professor and Ira C. Batman Faculty Fellow at the Indiana University School of Law-Bloomington.

The authors also document the impact of credit reporting on traditionally underserved Americans. They state: "One of the more remarkable achievements attributable to the development of comprehensive credit reporting is the increased access to credit down the household income spectrum in the U.S. over the past three decades." (Refer to Figure 2.) The intuition behind this is straightforward: detailed and reliable information on past payment behavior gives lenders confidence in assessing the creditworthiness of new borrowers and allows them to design products to meet the needs of previously underserved populations. And because the credit-reporting infrastructure helps to support broader access to credit, it can enhance asset and wealth accumulation – an effect particularly pronounced for younger households.



Professors Cate and Staten extend their analyses to the implications of not continuing the preemptions under FCRA which enable a national standard. They conclude that: "Proposals to depart from a national reporting system by allowing states to intervene run the risk of upsetting the carefully balanced interests under FCRA, and diluting the benefits that flow from the existing system." I have made copies of this study, sponsored by the Financial Services Coordinating Council of which ABA is a member, available to this committee.

Simply put, the U.S. credit system works and is the envy of the world. Anything that increases the cost of access to information, or decreases its quality, would reduce the flow of credit in our economy and significantly impact retail sales and the housing markets. With $8 trillion in consumer credit outstanding, even the slightest change or uncertainty about the consistency and completeness of credit histories can have a huge economic consequence. This is why the reauthorization of FCRA, and in particular the pre-emption of state laws which assures a national, consistent and complete system, is so important.

Medical and Health Information In the Credit Granting Process – Limited Use and Only With Customer Permission

It would seem obvious that medical information is at the top of the list of personal information about which consumers are concerned, and, indeed, our survey work confirms that. Throughout its history, the banking industry has protected the medical information of its customers whenever that information has been made available to banks. Therefore, our approach to medical information is straightforward. With respect to banks, ***medical information should only be used for the express purpose for which it is provided and should not be shared without the express consent of the customer***. More specifically, concern has been expressed that lenders might use medical information obtained elsewhere in making a credit decision. ABA's position is that such use of medical information in a credit decision obtained without the knowledge and consent of the borrower is just plain wrong. Let me explain further.

The general approach is that medical and health information should not be used at all when making credit decisions. However, there are a limited number of instances where medical information is relevant – for example, in sole proprietorships or small businesses where the franchise value of the firm hinges on one or two key individuals. In such cases, insurance on the key individuals might be required. However, in those instances, the prospective borrower will know what information is required, and can expressly consent to its being obtained and used. Otherwise the lender should not obtain medical information.

Thus, in general, medical and health information should not be sought during the credit-granting process. In those types of loans where it is directly relevant, the information should only be obtained with the consent of the potential borrower. Finally, any such information obtained should be kept strictly confidential by the lender.

ABA has been a leader in helping banks assess every aspect of how they collect, use and distribute information – from who sees the information, to how it is stored and updated; from how it is used to benefit the customer, to how it is protected. For example, three years ago, we convened a select group of bankers to work on privacy issues. One of the many results of this task force was a Privacy Toolbox designed to help banks assess their information practices, comply with the

requirements of the Gramm-Leach-Bliley Act (GLB Act), train employees on handling sensitive information, and communicate to customers about how their information is protected.

ABA's Privacy Task Force went further in this toolbox than just the requirements of GLB Act to address both medical privacy and identify theft. Regarding medical privacy, the Task Force believed it important to reassure customers and the public at large that, to the extent banks possess medical information on a customer, it will be held sacred. This would include, for instance, information on payments made by a customer to a medical facility. Therefore, ABA's task force set forward the following principle:

> **Medical Information Will Not Be Shared**
>
> Financial institutions recognize that, when consumers provide medical information for a specific purpose, they do not wish it to be used for other purposes, such as for marketing, or in making a credit decision. If a customer provides personal medical information to a financial institution, the financial institution will not disclose the information, unless authorized by the customer.

In addition, we encouraged banks to either add language to their privacy policies – or create a separate privacy document – promising to keep medical information confidential.

Conclusion

Mr. Chairman, the banking industry is built on trust. Protecting customer information is absolutely necessary to maintaining that trust. How information is collected, used, and protected is an issue not just for banks; it is an issue of economic health for our nation. Efficient consumer credit markets are vital to a thriving economy, and efficiency demands a nationwide, seamless, and reliable system of credit reporting. Such a system would be impossible without the Fair Credit Reporting Act. Protecting medical and health information is extremely important and should only be used when directly relevant to the credit granting process, and then only with the permission of the potential borrower.

Mr. Chairman, the ABA appreciates the opportunity to testify today, and I would be happy to answer any questions you, or the subcommittee members, may have.

The Impact of National Credit Reporting Under the Fair Credit Reporting Act:

The Risk of New Restrictions and State Regulation

Michael E. Staten
Fred H. Cate

American Bankers Association
American Council of Life Insurers
American Insurance Association
Securities Industry Association

FSCC Financial Services Coordinating Council
Representing America's Diversified Financial Services Community

This booklet was developed for the Financial Services Coordinating Council, a coalition of the American Bankers Association, the American Council of Life Insurers, the American Insurance Association, and the Securities Industry Association.

The study analyzes the question of how well the national credit reporting system under the Fair Credit Reporting Act (FCRA) has served the public. The issue is very timely, as amendments to FCRA that preempt state law are set to expire on January 1, 2004. Those preemptions affect provisions of FCRA considered to be the most important for preserving a national and voluntary credit reporting system. The authors conclude that: "Proposals to depart from a national reporting system by allowing states to intervene run the risk of upsetting the carefully balanced interests under FCRA, and diluting the benefits that flow from the existing system."

The Council wishes to express its appreciation to the authors: Professors Michael E. Staten and Fred H. Cate. Mr. Staten is the Distinguished Professor and Director of the Credit Research Center at the McDonough School of Business at Georgetown University. Under his direction since 1990, the Center has gained a national reputation for analysis of the economics of consumer credit markets. Mr. Cate is a Distinguished Professor and Ira C. Batman Faculty Fellow at the Indiana University School of Law-Bloomington and senior policy advisor in the Hunton & Williams Center for Information Policy Leadership. He is an internationally recognized authority on privacy and information law. Both authors have testified before Congress on issues related to privacy and information, and both have published extensively in this field.

For additional copies or information about the FSCC, please contact Phil Anderson, Executive Director, 202.624.2192 or visit www.fsccnews.com.

The Impact of National Credit Reporting Under the Fair Credit Reporting Act:

The Risk of New Restrictions and State Regulation

Michael E. Staten[1]
Fred H. Cate[2]

[1] Distinguished Professor and Director of the Credit Research Center at the McDonough School of Business, Georgetown University.

[2] Distinguished professor and Ira C. Batman Faculty Fellow at the Indiana University School of Law-Bloomington, and senior policy advisor in the Hunton & Williams Center for Information Policy Leadership.

FSCC Financial Services Coordinating Council
Representing America's Diversified Financial Services Community

Executive Summary

Since 1971 the U.S. credit reporting system has operated under the Fair Credit Reporting Act (FCRA). In 1996 Congress amended the FCRA to address a variety of concerns related to the proper uses of credit report information, its accuracy, and consumer privacy. Those amendments reflected a careful balancing of these interests. A critical component of that balance was preemption of state laws affecting those provisions of the FCRA that were considered most important for preserving a voluntary, market driven credit reporting system that supported widespread access to credit.

However, in the face of dramatic changes in technologies, commerce, and markets, Congress provided that preemption would expire on January 1, 2004. That compromise ensured that there would be both an opportunity and a need to assess the impact of imposing uniform national standards and to reevaluate the FCRA in an evolving national market.

As the January 1, 2004 deadline nears, Congress is being asked to consider dropping federal preemption from the FCRA and allowing states to regulate the central elements of credit reporting. Abandoning uniform national standards would mark a radical change in a credit reporting system that has evolved almost entirely without state or local regulation of its core functions. Such a step puts at risk the benefits that flow from the existing national reporting system—the foundation for the most dynamic consumer and mortgage credit markets in the world.

Given the magnitude of this threat, preemption should not be abandoned without first assessing (1) how well the current national credit reporting system under the federal FCRA has served the American public and economy, and (2) the risks to consumers and commerce of adopting significant new restrictions on credit reporting or of subjecting that national system to state and local regulation.

All of the relevant economic analyses, case studies, policymaker statements, and government and industry reports provide a remarkably consistent response to these two inquiries. They demonstrate that the voluntary national credit reporting system that has evolved under FCRA has generated extraordinary benefits for individual consumers and the nation as a whole. National credit reporting has helped to make the United States the world leader in the development of competitive consumer and mortgage credit markets. Proposals to depart from a national reporting system by allowing states to intervene run the risk of upsetting the carefully balanced interests under FCRA, and jeopardizing the benefits that flow from the existing system.

Benefits that Flow from the Existing National Credit Reporting System

The U.S. national credit reporting system is unique in achieving a remarkable combination of (a) widespread access to credit across the age and income spectrum, (b) relatively low interest rates on secured loans (e.g., home mortgages, automobiles), (c) exceptionally broad access to open end, unsecured lines of credit (e.g., bank card products), and (d) relatively low default rates across all types of consumer loans.

The following categories summarize the extraordinary benefits that consumers and the U.S. economy enjoy as a result of the national credit reporting system supported by the FCRA:

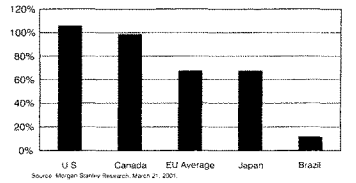
1. Consumer Access to Credit

Broader Credit Access Across the U.S. Population

Consumer and mortgage credit underpins much of the consumer spending that accounts for over two-thirds of U.S. gross domestic product and has been a key driver of U.S. economic growth. Mortgage credit financed the vast majority of the 516,000 single-family homes that U.S. consumers bought every month, on average, during 2001—accounting for about 14 percent of U.S. GDP. Consumer credit financed the vast majority of the 1.4 million cars, SUVs, and light trucks that U.S. consumers purchased or leased every month.

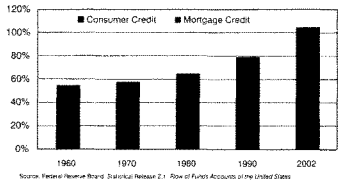
In 2001, 75 percent of U.S. households participated in the consumer and mortgage credit markets. Sixty-eight percent of U.S. households owned their own homes, and nearly two-thirds of these homeowners had some type of mortgage loan. Nearly a third of all households had automobile loans or leases. About 73 percent of all households owned at least one general purpose credit card (e.g., Visa, MasterCard, Discover, American Express) in 2001. The average U.S. consumer-borrower had eleven open accounts (seven credit cards, four installment or real-estate-secured loans). Credit market participation is remarkably wide and deep.

Figure 1
Total Household Credit as a Percentage of Personal Disposable Income (2000)



Source: Morgan Stanley Research, March 21, 2001.

Figure 2
U.S. Consumer and Mortgage Credit as a Percentage of Disposable Income (1960-2002)



Source: Federal Reserve Board, Statistical Release Z.1, Flow of Funds Accounts of the United States.

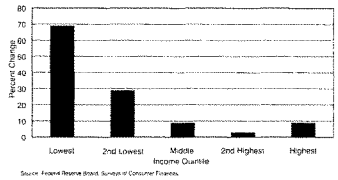
Consumer Credit and the U.S. Economy

U.S. credit markets facilitate and extend economic expansion by reducing liquidity constraints. Consumer credit allows households to transfer consumption from periods where household income is high to periods where income is low. U.S. credit markets are the most efficient in the world at allowing households to smooth their consumption patterns over time, rather than postpone major purchases until incomes and asset holdings build to sufficient levels.

Credit provides a "bridge" to tens of millions of households that can sustain them through temporary disruptions and declines in incomes, thus helping to neutralize the macroeconomic drag associated with these events, lowering the risk of outright recession, and reducing the magnitude of downturns when they do occur.

The importance of consumer credit markets to the strength and resiliency of the U.S. economy is a direct consequence of the credit reporting system. A recent study of 43 countries found that total bank lending to the private sector (scaled by country GNP) is larger in countries where information sharing is more solidly established and intense.

Figure 3
Change in the Proportion of U.S. Households Using Non-Mortgage Credit (1970 vs. 2001)



Source: Federal Reserve Board, Surveys of Consumer Finances.

Impact of Credit Reporting on Traditionally Underserved Americans

Equally remarkable is the increased access to credit across the income spectrum over the past three decades. Figure 3 displays the change in the percentage of U.S. households that used non-mortgage credit between 1970 (the year before the FCRA took effect) and 2001. The largest gains were in the lower end of the income spectrum. The proportion of households in the lowest fifth of the income distribution who had access to consumer credit jumped by nearly 70 percent over the period. By contrast, growth in the highest and second highest income quintiles averaged less than 5 percent. Accessible credit information "democratizes" financial opportunity.

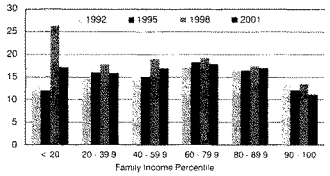
Table 1. Home Ownership Rates Among Younger Borrowers

Country	% Home Ownership Among Population Aged 26-35	Average % Downpayment, 1991-1995
United States	49.3	11
United Kingdom	63.8	5
Spain	40.0	20
France	35.0	20
Italy	23.2	40
Germany	18.5	20

Source: Chiuri and Jappelli, 2002.

The U.S. credit reporting system helps families break the stubborn cycle of low economic status from generation to generation. Credit is essential to home ownership, which is one of the most important steps in the accumulation of wealth. Home ownership rates among younger households vary substantially across developed countries, due in large part to differences in credit reporting. Lenders in the United States, Canada, and the United Kingdom can require less collateral (i.e., a lower down payment) as a hedge against the likelihood of default because borrower credit histories are more complete. These countries are among the leaders in terms of home ownership among younger households. In contrast, in countries where the exchange of credit history data is far more limited (e.g., France, Italy and Spain) down payments are higher and the degree of home ownership among younger households is significantly lower.

Figure 4
U.S. Households: Median Ratio of Debt Payments to Family Income



Source: Federal Reserve Board, Survey of Consumer Finances

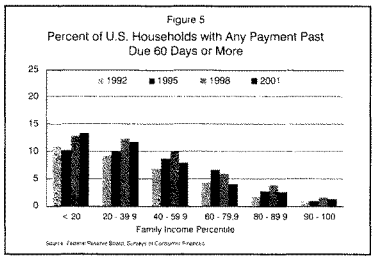
These benefits of credit reporting are especially great for minorities. Between 1989 and 1998, home ownership rates rose more sharply for African Americans, Hispanics, and lower-income families than for other groups, but only a small part of these gains were attributable to improvements in their incomes or economic circumstances. Innovation among mortgage lenders in terms of risk measurement and the ability to develop and tailor new products for specific population segments accounted for much of the gains, all of which depended upon a robust credit reporting system.

2. More Accurate Decision-Making

Because credit reports are compiled over time, from a wide range of sources, and updated daily, creditors (as well as insurers, employers and other businesses with a permissible purpose) can see a far more complete picture of present *and* past credit behavior. These data, reflecting a borrower's own past payment history, replace face-to-face attempts to evaluate character and capacity (common a generation ago) with a less invasive, more accurate assessment based on documented prior behavior. Lending decisions are faster and more equitable. There is less opportunity for the loan decision to be influenced by factors other than how the borrower has handled credit in the past, and standardized credit report data make it easier for regulators to verify compliance with antidiscrimination and other lending laws.

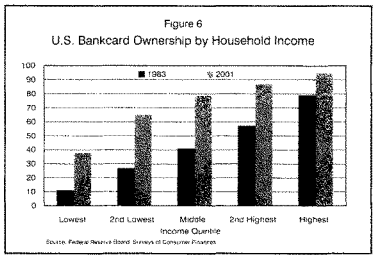
Credit reporting thus improves the performance of the entire market, lowering the costs of making credit available and increasing the number of Americans who qualify for credit. According to one recent study, if creditors did not have access to the full range of credit information currently available in the United States, they would extend new credit to *11,000 fewer* customers for every 100,000 applicants. As Federal Reserve Board Chairman Alan

Greenspan has noted, access to personal credit history data makes individual financial institutions *"more creditworthy and efficient,"* and the U.S. financial services sector *"more transparent and stronger in general."*



Furthermore, credit reports (and the scoring models they make possible) allow lenders to be proactive in *preventing* debt problems, even for existing accountholders. Credit report data allow creditors to prevent overextension. Consequently, U.S. delinquency rates are remarkably low. In the fourth quarter of 2002 only 3.9 percent of all mortgage borrowers in the United States were delinquent 30 days or more. Only 4.6 percent of all credit card borrowers were delinquent 30 days or more on their accounts. Sixty percent of U.S. borrowers *never* had a payment delinquent 30 days or more in the previous seven years.

Moreover, the share of household income devoted to debt service is remarkably similar across all income groups, suggesting that previously underserved groups are not generally taking on more new credit than they can handle. As a group, households in the lower two-fifths of the income distribution do not carry greater debt burdens than higher income households, and their burden has not significantly increased over the past decade. Similarly, there is no evidence that households in the lowest two-fifths of the income distribution experienced any greater increase in delinquency (in percentage terms) over the past decade than households in the other groupings. Robust, national credit reporting has thus not only made it possible for more people to have access to more credit, but to do so without increased defaults.



3. Enhanced Competition

Because it dramatically reduces the cost of assessing the risk of new borrowers, credit report information encourages entry by new lenders and greater competition. Access to national credit report data and the ability to use them to "prescreen" applicants, for example, has transformed the credit card market by facilitating efficient national competition. In the face of that competition, consumer choice has increased dramatically; services such as no-fee cards and cards offering frequent traveler miles or rebates are now commonplace. Credit card rates have plummeted, relative to the late 1980s. The number of Americans with access to

credit cards has soared. The percentage of U.S. households owning at least one general-purpose bank credit card has increased from 43 percent in 1983 to 73 percent by 2001. Overall, 30 million more U.S. households had a bankcard in 2001 than in 1983.

Laws that inhibit the assembly of comprehensive credit reports act as a barrier to competition by giving the dominant incumbent lender a monopoly over the information it possesses about its customers, and denying new market entrants the information needed to provide and market competitive services. In Europe, where comprehensive credit reports are not readily available, financial services are provided by far fewer institutions—*one-tenth* the number that serve U.S. customers. In France, the European Union country with some of the strictest financial privacy laws, seven banks control more than 96 percent of banking assets. The absence of comprehensive credit histories restrains competition and makes it easier to hold customers and capital captive.

Ownership rates of unsecured credit cards are vastly higher in the United States than in Europe. A Morgan Stanley Dean Witter report highlights the critical difference that available credit histories make, noting that "[t]he biggest obstacle to new entrants" in many European countries "is the lack of a centralized credit bureau."

4. Speed and Convenience

The depth of information in U.S. credit reports enhances the speed of credit and other financial service decisions. Even very significant decisions about financing a college education or a new home or writing automobile or homeowners insurance are often made in a matter of hours or minutes, instead of days and weeks as is the case in most other countries, because credit history data is readily accessible. In 2001, 84 percent of automobile loan applicants in the United States received a decision within

Table 2. Credit Card Ownership, 1997 (per 1000 people in population)

Country	Superpremium + Premium	Corporate	Standard	Total
United States	650.4	20.9	945.0	1616.3
United Kingdom	91.3	22.5	546.7	660.5
Belgium	53.0	6.9	197.4	257.3
Netherlands	38.3	9.4	195.9	243.5
Spain	26.5	4.3	212.0	242.8
Sweden	44.2	46.4	85.8	176.4
Germany	39.7	4.6	127.8	172.0
Italy	18.2	9.7	109.1	137.0
France	25.1	3.1	68.3	96.6

Source: Lyn C. Thomas, David B. Edelman, and Jonathan N. Crook, Credit Scoring and its Applications, Society for Industrial and Applied Mathematics, Philadelphia, 2002, p 212.

an hour; 23 percent of applicants received a decision in less than 10 minutes. Many retailers open new charge accounts for customers at the point of sale in less than two minutes. According to Federal Trade Commission Chairman Muris: "Many fail to appreciate that the average American today enjoys access to credit and financial services, shopping choices, and educational resources that earlier Americans could never have imagined. . . . What I personally find most astounding is . . . the 'miracle of instant credit.'" Muris concluded: "This 'miracle' is only possible because of our credit reporting system."

5. Catalyst to Productivity Growth

Portable credit "reputations" give consumers greater mobility and enhance their ability to respond to change. From a labor market perspective, the credit reporting system under FCRA has increased our mobility as a society, so that structural shifts within the economy can cause temporary disruptions but without crippling long-term effects. There is less risk associated with severing old relationships and starting new ones, because objective information is available that helps us to establish and build trust in new locations more quickly. Economist Walter Kitchenman has described the "almost universal reporting" of personal information about consumers as not only the "foundation" of consumer credit in the United States," but also as the "secret ingredient of the U.S. economy's resilience."

In contrast, more restrictive, and inconsistent, credit reporting laws prevent European consumers from taking full advantage of their complete credit histories. The fact that credit *information* is not mobile restricts the mobility of *consumers*, because of the resulting difficulty of obtaining credit from new institutions. In fact, European consumers, although they outnumber their U.S. counterparts, have access to one-third less credit as a percentage of gross domestic product.

6. Reduced Costs

Comprehensive credit reports have improved the competitiveness and efficiency of credit markets, led to powerful improvements in risk-management technology (like credit scoring), and created more product choices and better tools for assessing and managing risks, thereby avoiding delinquencies and defaults. *All of this ultimately lowers the cost of credit to consumers.*

Reliable, centralized, and standardized consumer credit information also makes it possible to pool consumer loans and then sell them to investors. A Tower Group study concluded that U.S. mortgage rates are two full percentage points lower than in Europe because it is possible to securitize and sell mortgage loans. Consequently, American consumers save as much as *$120 billion* a year on $6 trillion of outstanding mortgages because of the efficiency and liquidity that credit report data make possible.

By making refinancing easy and fast, the U.S. credit reporting system also allowed eleven million homeowners to refinance their home mortgages to take advantage of lower interest rates during just a 15-month period in 2001 and early 2002, thereby saving an estimated $3.2 billion *annually* in mortgage payments. Moreover, improved risk assessment and

sharing—by spreading risks over a larger pool of capital and a larger number of investors—lowers the cost of capital, thereby making credit available to consumers more affordably.

The economic benefits of nationwide credit reporting are so great and so ubiquitous that the cost to consumers of having a less robust system could easily range into the hundreds of billions of dollars annually.

7. Public Safety and Security

Credit reports have long proved a useful and convenient way to check for past criminal convictions when employing school bus drivers, child care workers, security guards, and people to fill other sensitive positions. They are an important tool in preventing financial fraud, because they provide a comprehensive picture of an individual's financial dealings. They are also becoming an increasingly potent weapon in the fight against identity theft and terrorist threats.

The Threat of New Restrictions on Credit Reporting

Proposals to abandon preemption, or to enact new federal or state restrictions on those critical aspects of credit reporting that are currently the subject of preemption, threaten the diverse array of benefits that flow from the current credit reporting system under the FCRA. While most aspects of credit reporting are vulnerable to the high costs of state or local regulation, some are especially at risk. This explains why Congress first preempted state-level regulation in these areas in 1996.

The Special Vulnerability of Furnishers of Credit Report Data

Because no one is *required* to provide information to credit bureaus, if furnishers of information faced significant compliance burdens or liability, as would be the case if complying with separate and even inconsistent state laws, they would be more likely to stop contributing the information. Imposing liability for errors or significant additional burdens on the furnishers of consumer data to credit bureaus would discourage firms from reporting. Even the absence of a small amount of relevant information from credit reports could dramatically reduce their usefulness and lead to less accurate credit decisions and less access to credit for people who need it most.

Obsolescence Determinations

The 1996 amendments also precluded states from regulating when data would be considered "obsolete" and therefore could not be included in credit reports. Currently, derogatory information must be excluded from credit reports after seven years (with the exception of a notice of bankruptcy, which may remain for ten years). State-by-state or accelerated obsolescence determinations would undermine the predictive value of credit reports.

Opt-In Consent

The 1996 amendments to the FCRA explicitly authorized the sharing of credit report data among affiliated companies and with anyone for the purpose of marketing credit or insurance opportunities to consumers, provided that consumers are given an opportunity to opt out of that sharing. Proposals to move to an *opt-in* system are certain to impose new costs on consumers because opt-in requires each company to gain explicit consent from each consumer prior to using personal information to target its marketing efforts. Yet consumers are remarkably difficult and expensive to contact individually.

Opt-in is especially inefficient in the context of credit granting because it requires that every consumer be contacted, even though only a portion will qualify for an offer of credit. Those who do qualify will have to be contacted twice—once for permission to use the data and again to make the offer. Moreover, credit bureaus usually have no relationship or direct contact with the consumer. Individuals are less likely to pay attention or respond to requests for consent from companies with which they have no dealings. Put simply, the consensus of studies and company experience is that *conditioning the use of information on opt-in consent is tantamount to banning the use outright.*

This makes an opt-in system for prescreening and sharing credit report data among affiliated companies an especially great impediment to the emergence of new market entrants and the development of innovative products and services, which, in turn, threatens the lower prices and enhanced choice that competition facilitates. Opt-in for prescreening and affiliate-sharing restrains competition and the benefits that flow from it.

National Credit Reporting

Virtually all of the benefits to individuals and the economy from the current U.S. reporting system result from its national character. National credit reporting made possible national competition in the market for credit and other financial services. Moreover, U.S. consumers are remarkably mobile, thanks in part to the ubiquitous availability of credit reports. Regulating credit histories state-by-state would ill serve consumers as they move, commute, and deal with business from across state lines. It would leave holes (potentially large ones) in credit files. Moreover, the fact that those holes could exist would greatly reduce the reliability of credit reports.

The cost of determining which state law or laws applied, and of complying with those laws, could easily undermine the credit reporting system. That system deals in huge volumes of data—over 2 billion trade line updates, 2 million public record items, an average of 1.2 million household address changes a month, and over 200 million individual credit files. Its viability depends on exceptional efficiency and low marginal costs of updates, which, in turn, keep the cost of providing credit reports low. Moreover, a national standard offers better and more consistent privacy protection. This undoubtedly explains why privacy advocates have historically argued for the need to replace state and local laws with a single, uniform privacy standard.

Conclusion

By limiting the term of preemption to seven years, Congress provided a specific opportunity for policymakers to determine how well the national credit reporting system under the FCRA has served the public. The available evidence—economic and otherwise—demonstrates that the voluntary national credit reporting system that has evolved under FCRA has generated extraordinary benefits for individual consumers and the nation as a whole, and has helped to make the United States the world leader in the development of competitive consumer and mortgage credit markets. Proposals to depart from a national reporting system by allowing states to intervene run the risk of upsetting the carefully balanced interests under FCRA, and diluting the benefits that flow from the existing system.

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Introduction

Credit reporting in the United States evolved during the twentieth century as a market-driven response to creditors' need to determine the likelihood that borrowers would repay loans. The credit reporting industry was largely unregulated until passage of the Fair Credit Reporting Act (FCRA) in 1970.[3] In the FCRA, Congress struck a balance that was intended to encourage more voluntary reporting of consumer borrowing and payment histories, while promoting greater accuracy in reporting and addressing consumers' privacy concerns regarding uses of credit report information.

In 1996 Congress amended the FCRA to expand the permissible uses of credit report data, further encourage the accuracy of reported information, and give consumers new opportunities to oversee the use of information about them.[4] The amendments were enacted following years of hearings and debate and continued to reflect the careful balancing of commercial and consumer interests that was the hallmark of the original statute. However, by 1996 a rising tide of state-level privacy legislation was threatening to disrupt the balance by subjecting key elements of the increasingly national credit reporting system to inconsistent state standards.[5] Thus, a critical component of the 1996 amendments that was intended to preserve the national reporting system was the preemption of state and local laws that would impact specific core elements of the credit reporting system.

In the 1996 amendments, Congress preempted those elements of the FCRA that were considered most important for preserving a voluntary, market-driven credit reporting system that protected consumer privacy but also supported widespread access to credit. Specifically, Congress prohibited state laws dealing with:

1. Responsibilities of those who furnish data to be included in a credit report.
2. Responsibilities of persons who take adverse action based on a credit report.
3. Time to investigate and take appropriate action regarding disputed credit report information.
4. Time periods for which specific items of adverse information may be included in consumer credit reports.[6]
5. Sharing of information—not just from credit reports—among affiliates.[7]
6. Use of credit report data for "prescreening" credit information for the purpose of marketing credit or insurance opportunities to consumers, provided that credit bureaus establish and publish a toll-free telephone number that consumers can call to opt out of prescreening.[8]

[3] Fair Credit Reporting Act of 1970, Pub. L. No. 91-508, 84 Stat. 1114 (codified at 15 U.S.C. §§ 1681-1681t).

[4] Consumer Credit Reporting Reform Act of 1996, enacted as title II, subtitle D, chapter 1 of the Omnibus Consolidated Appropriations Act for Fiscal Year 1997, Pub. L. No. 104-208, 104th Cong., 2d Sess. §§ 2401-2422 (Sept. 30, 1996) (codified at 15 U.S.C. §§ 1681-1681t).

[5] The more than 3000 credit bureaus operating in 1971 had shrunk to fewer than 600 by 1996, and those were already well on the way to evolving into three national automated reporting systems—Equifax, Experian, and TransUnion.

[6] 15 U.S.C. § 1681t.

[7] 15 U.S.C. § 1681a(d)(2)(A)(iii). The 1996 amendments excluded two provisions of Vermont law that regulated affiliate-sharing. Vermont Stat. Ann., tit. 9, §§ 2480e(a), 2840e(c)(1).

[8] Id. § 1681b(c)(5).

7. Notices to be included with prescreened solicitations.

8. Summary of consumer rights to be provided to individuals.

States are free to regulate other aspects of the credit reporting system, and they continue to play an important role in enforcement and education, but in the eight areas specified in the statute, federal law alone has controlled since 1996.

However, in the face of ongoing, rapid, and often dramatic changes in technologies and markets, Congress provided that preemption would expire on January 1, 2004. Thus, the compromise that prohibited state-by-state regulation in the core preempted areas also ensured that there would be both an opportunity and a need to assess the impact of imposing uniform national standards, as well as to reevaluate the specific provisions of the FCRA in an evolving national market.

As the January 1, 2004 deadline nears, some privacy advocates and legislators are urging Congress to drop federal preemption from the FCRA and allow states to regulate the central elements of credit reporting. Abandoning uniform national standards would mark a radical change in a credit reporting system that has evolved almost entirely without state or local regulation of its core functions. Such a step puts at risk the existing national reporting system and all of the benefits that flow from it as the foundation for the most dynamic consumer and mortgage credit markets in the world. Preemption should therefore not be abandoned without assessing carefully (1) how well the current national credit reporting system under the federal FCRA has served the American public and economy, and (2) the risks to consumers and commerce of subjecting that national system to state and local regulation or of adopting significant new restrictions on credit reporting.

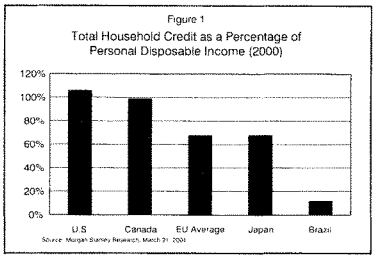
There has been surprisingly little comprehensive study of the overall impact of the robust credit reporting system that has evolved in the United States. In this report, we seek to fill that gap, drawing on the most relevant evidence from diverse sources, including economic analyses, case studies, policymaker statements, and government and industry reports.[9]

Benefits that Flow from the Existing National Credit Reporting System

The most remarkable discovery we have made is the consistency across the wide range of material we have reviewed. Without significant exception, the evidence demonstrates that the balance struck by the FCRA has facilitated the development of the most robust credit information system in the world. In turn, that system has generated extraordinary benefits for individual consumers, businesses, and the U.S. economy. The United States is unique in achieving a remarkable combination of (a) widespread access to credit across the age

[9] This paper focuses primarily on consumer and mortgage credit markets, but it should be noted that the credit reporting system also directly benefits markets for insurance, apartment rentals, cell phones service contracts, utilities, and a variety of other types of transactions.

and income spectrum, (b) relatively low interest rates on secured loans (e.g., home mortgages, automobiles), (c) exceptionally broad access to open end, unsecured lines of credit (e.g., bank card products), and (d) relatively low default rates across all types of consumer loans. Below we describe categories of benefits to consumers and the U.S. economy from the credit markets supported by the FCRA.



Consumer Access and Usage of Credit

Broad Credit Access Across the U.S. Population

Consumer and mortgage credit underpins much of the consumer spending that accounts for over two-thirds of U.S. gross domestic product and has been a key driver of U.S. economic growth. U.S. households collectively hold about $6 trillion in mortgage loans and another $1.7 trillion in auto loans, credit card balances and other personal loans.[10] Total household credit as a percent of Personal Disposable Income in 2000 was 106 percent in the United States, compared to an average of about 68 percent across the European Union and Japan (see Figure 1).[11] The greater availability of credit in the United States is no coincidence. Economists have found that the volume of consumer and mortgage lending rises as a direct result of greater information sharing within a country's credit reporting system, and the United States has the most complete, timely, and reliable credit histories of any country.[12]

In 2001, 75 percent of U.S. households participated in the consumer and mortgage credit markets and held some type of debt. Sixty-eight percent of U.S. households owned their own homes, and nearly two-thirds of these homeowners had some type of mortgage loan.[13] Those mortgages made it possible for U.S. consumers to purchase 516,000 single-family homes *every month*, on average during 2001. According to the National Association of Home Builders, the construction of housing and the value of housing services produced by the housing stock accounts for about 14 percent of U.S. GDP. Moreover, in the first twelve months after purchasing a newly built home, the new owners spend an additional $8,905 on furnishings and improvements, more than twice the amount spent in a year by non-moving homeowners.[14] These additional expenditures, most of which are financed via some type of consumer credit, help to fuel economic growth.

About 73 percent of all households owned at least one general purpose credit card (e.g., Visa, MasterCard, Discover, American Express) in

[10] Federal Reserve Board <www.federalreserve.gov>.

[11] "Global Growth, Local Challenge," Morgan Stanley Research, Mar. 21, 2001.

[12] Tullio Jappelli and Marco Pagano, "Information Sharing, Lending and Defaults: Cross-Country Evidence," *Journal of Banking and Finance*, Vol. 26, 2002, pp 2017-2045.

[13] Federal Reserve Board, 2001 Survey of Consumer Finances.

[14] National Association of Home Builders <www.nahb.com>.

2001.[15] Consumer credit also financed the purchase or lease of 1.4 million cars, SUVs and light trucks in the average month during 2001. Nearly a third of all households had automobile loans or leases. Across 200 million individual credit reports on file with the major U.S. repositories, the average U.S. consumer-borrower had eleven open accounts (seven credit cards, four installment or real-estate-secured loans).[16] *Credit market participation is remarkably wide and deep.*

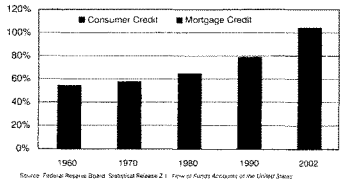
Figure 2 illustrates the striking growth in household credit in the United States as a percent of Personal Disposable Income over the past 40 years. The key point is that the *role of household credit in the U.S. economy, especially mortgage credit, has grown dramatically since passage of the FCRA.* To be sure, population demographics (e.g., the coming of age of the baby boomers) and other economic factors have much to do with credit growing faster than Personal Disposable Income since 1980. Nevertheless, the credit reporting system provided the essential ingredients for an innovative marketplace to respond to a burgeoning demand for credit.

Consumer Credit and the U.S. Economy

For many years, growth in consumer indebtedness has been viewed negatively by both the business press and Wall Street analysts.[17] Rising debt loads are treated as warning signals of impending slowdown in consumer spending. However, academic research in the 1990s has begun to turn this viewpoint on its head. In a recent article that reviews this research, Federal Reserve Board economist Dean Maki concluded: "In stark contrast to the view that growth in consumer indebtedness is a negative force threatening future spending, a consensus seems to be emerging from recent research that consumer credit growth is positively related to consumption in future periods."[18]

Simply put, credit growth is an expression of optimistic consumer expectations regarding future income. When consumers feel good about their personal financial outlook, and credit markets do not impose liquidity constraints, consumer borrowing and spending rises. Credit markets help translate optimism into real economic activity. In this way, *smoothly functioning credit markets facilitate and extend economic expansion.*

Figure 2
U.S. Consumer and Mortgage Credit as a Percentage of Disposable Income (1960-2002)



Source: Federal Reserve Board Statistical Release Z.1 Flow of Funds Accounts of the United States

[15] Ana M. Aizcorbe, Arthur B. Kennickell and Kevin B. Moore, "Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances," *Federal Reserve Bulletin*, Jan. 2003, pp 1-32.

[16] Consumer Data Industry Association <www.cdiaonline.org>.

[17] An interesting analysis of journalistic reporting on the impact of consumer debt trends on the macro-economy finds that it has been consistently (and inappropriately) skewed toward the negative for the past 50 years. See Thomas A. Durkin and Zachariah Jonasson, "An Empirical Evaluation of the Content and Cycle of Financial Reporting: The Case of Consumer Credit," Credit Research Center Working Paper No. 64, McDonough School of Business, Georgetown University, Apr. 2002.

[18] Dean M. Maki, "The Growth of Consumer Credit and the Household Debt Service Burden," in *The Impact of Public Policy on Consumer Credit*, eds. Thomas A. Durkin and Michael E. Staten, Kluwer Academic Publishers, 2002, pp 43-63.

Consumer credit allows households to transfer consumption from periods where household income is high to periods where income is low. This is particularly important for householders early in the life-cycle (ranging in age from the early 20s though their 40s) when the demand for housing, durable goods and education is relatively high, and incomes are relatively low but expected to rise over time. U.S. credit markets are the most efficient in the world at allowing households to smooth their consumption patterns over time, rather than postpone major purchases until incomes and asset holdings build to sufficient levels.

Because credit reports have allowed creditors to extend loans and establish lines of credit for a much wider segment of the population, as we discuss in greater detail below, tens of millions of households have access to a credit "bridge" that can sustain them through temporary disruptions and declines in incomes. Research has shown that *credit markets that make loans accessible to large segments of the population provide a cushion that neutralizes the macroeconomic drag associated with temporary declines in income, lowering the risk of outright recession and reducing the magnitude of downturns when they do occur.*[19]

Evidence from overseas markets supports the conclusion that *the United States enjoys a macroeconomic growth advantage as a consequence of its well-developed consumer credit markets.* Cross-country studies have found that credit availability and consumption fluctuations are linked. Specifically, consumer spending is more sensitive to changes in income in countries with less-developed consumer credit markets, especially during periods of tighter credit constraints.[20] In contrast, during the past two decades since financial deregulation significantly altered U.S. credit markets, credit constraints have become less of a factor in explaining shifts in household spending, because markets are making credit available to a wider range of borrowers and doing it more consistently through the business cycle.

The growing importance of consumer credit markets to the strength and resiliency of the U.S. economy is a direct consequence of the credit reporting system that provides the foundation for millions of loan decisions annually. A recent study of 43 countries found that total bank lending to the private sector (scaled by country GNP) is larger in countries where information sharing is more solidly established and intense, even after controlling for factors such as country size, growth rates and the legal environment.[21] Consequently, *the macroeconomic benefits from smoothly functioning consumer credit markets can be linked back to the establishment of a comprehensive system for sharing consumer borrowing and payment histories.*

Impact of Credit Reporting on Traditionally Underserved Americans

One of the more remarkable achievements attributable to the development of comprehensive credit reporting is the increased access to credit down the household income spectrum in the U.S. over the past three decades. Recall that

[19] Dirk Kreuger and Fabrizio Perri, "Does Income Inequality Lead to Consumption Inequality? Evidence and Theory," National Bureau of Economic Research Working Paper No. W9202, Sep. 2002.

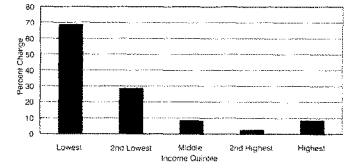
[20] Tulio Japelli and Marco Pagano, "Consumption and Capital Market Imperfections: An International Comparison," *American Economic Review*, Dec. 1989; Phillipe Bacchetta and Stefan Gerlach, "Consumption and Credit Constraints: International Evidence," *Journal of Monetary Economics*, Oct. 1997.

[21] Japelli and Pagano, id.

the FCRA was implemented in 1971. Figure 3 below displays the change in the percentage of U.S. households that had access to and used non-mortgage credit (i.e., closed-end automobile, education and other personal installment loans, plus open-end credit card accounts and lines of credit) between 1970 and 2001. The largest gains were in the lower end of the income spectrum. The proportion of households in the lowest fifth of the income distribution who had access to consumer credit jumped by nearly 70 percent over the period. Participation by households in the second lowest income quintile rose by 29 percent. By contrast, growth in the highest and second highest income quintiles averaged less than 5 percent.

Figure 3 illustrates that the growth in the national credit reporting system under the guidance of the FCRA has facilitated an increase in the number of Americans who now qualify for credit. The intuition behind this is straightforward. Detailed and reliable information on past payment behavior gives creditors confidence in assessing the creditworthiness of new borrowers. It allows them to design products to meet the credit needs of previously underserved populations. Credit reports allow businesses from hundreds of miles away to provide credit to people they have never met

Figure 3
Change in the Proportion of U.S. Households Using Non-Mortgage Credit (1970 vs. 2001)



Source: Federal Reserve Board, Survey of Consumer Finances

who are located in small towns and rural areas and who otherwise have limited access to those opportunities.

Put simply, accessible credit information "democratizes" financial opportunity: because of the underlying credit reporting network, U.S. consumers can get credit, insurance and a host of other financial services based on their individual records, not their family name or how long they have known their banker. In addition, they can rent apartments, purchase cell phones and cable television services, and rent automobiles without either large deposits or an established relationship with the service provider, all because their reputation for paying as agreed is documented through their credit reports.

The U.S. credit reporting system benefits traditionally underserved segments of the population in other ways as well. Research on U.S. income inequality has found a stubborn pass-through of low economic status from generation to generation. Studies underway at the Federal Reserve Bank of Chicago are finding that "[a]lthough the underlying factors that cause substantial (income) immobility in the United States remain poorly understood, some preliminary work suggests that borrowing constraints among families with low net worth may play a role in perpetuating income inequality." For example, the author suggests that families facing credit constraints may have neither the assets nor the ability to borrow against future income to invest properly in their children's education.[22]

Because the credit-reporting infrastructure helps to support broader access to credit it can enhance asset and wealth accumulation. This

[22] See Bhash Mazumder, "Analyzing Income Mobility Over Generations," *Chicago Fed Letter*, Number 181, Sep. 2002.

Table 1. Home Ownership Rates Among Younger Borrowers

Country	% Home Ownership Among Population Aged 26-35	Average % Downpayment, 1991-1995
United States	49.3	11
United Kingdom	63.8	5
Spain	40.0	20
France	35.0	20
Italy	23.2	40
Germany	18.5	20

Source: Chiuri and Jappelli, 2002.

effect is most pronounced for younger households. As mentioned earlier, young households generally face tighter credit constraints. Younger borrowers have incomes that are relatively low but expected to rise, and high demand for the big-ticket purchases associated with family formation (housing, automobiles, education). Economists studying household survey data in the United States from the early-1980s found at that time that young households faced liquidity constraints (restricted access to credit) that left them with as much as 75 percent less credit than they would otherwise demand and use if credit were more widely available.[23] Two decades of expanded access to credit since then has narrowed that gap, to the benefit of young and otherwise marginal borrowers on the fringe of the market.

Home ownership is one of the most important steps in the accumulation of wealth. Economists have found that home ownership rates among younger households vary substantially across developed countries, and the reason is linked to differences in credit reporting. A study of home ownership rates in 14 countries (including eleven EU countries, Canada, the United States, and Australia) found that the cross-country variance in the required downpayment for a mortgage loan is a key determinant of differences in the timing of home purchase. The authors concluded that factors that foster the increased availability of mortgage loans and increased competition among mortgage lenders would lead to earlier home purchase behavior. In particular, the authors cited the extent of credit reporting (amount of information available in consumer credit report files) as a key factor, noting substantial variance in file content across the sampled countries. Lenders in the United States, Canada, and the United Kingdom can require less collateral (i.e., a lower down payment) as a hedge against the likelihood of default because borrower credit histories are more complete. These countries are among the leaders in terms of home ownership among younger households. In contrast, in countries where the exchange of credit history data is far more limited (e.g., France, Italy and Spain) down payments are higher and the degree of

[23] Donald Cox and Tullio Japelli, "The Effect of Borrowing Constraints on Consumer Liabilities," *Journal of Money, Credit and Banking*, Vol. 25, No. 2, May 1993, pp 197-213.

home ownership among younger households is significantly lower.[24]

There is no question that the comprehensive borrowing and payment histories contained in U.S. credit reports have facilitated a boom in mortgage lending to "subprime" borrowers, opening the door to wealth-building through home ownership. Subprime mortgage customers are households for whom the cost of mortgage credit would be significantly higher than the prevailing "prime" rate in the conventional mortgage market. Borrowers may be deemed subprime for a variety of economic reasons, including: credit problems in the past; too much existing debt relative to income; short, thin or non-existent credit histories; self-employment income that is irregular or otherwise difficult to document; low downpayment and few liquid assets. Subprime mortgage borrowers are often younger, lower-income or minority households. These borrowers were either on the fringe or entirely outside of the U.S. mortgage market just a decade ago.

Subprime mortgage lending experienced rapid growth during the boom years of the 1990s. New lending by subprime mortgage specialists rose from less than $30 billion in 1993 to over $213 billion in 2002.[25] Subprime originations accounted for about 9 percent of all residential mortgage originations in the United States in 2002.

Why did such rapid growth occur in a previously underserved segment of the market? To a large degree it was a combination of (a) the availability of detailed credit report data, (b) the legal ability to implement risk-based pricing, and (c) the adoption of statistical risk scoring technology by the mortgage industry which allowed risk to be rapidly and consistently measured. In an analysis of home ownership trends since the late 1980s, Federal Reserve Board economists Rafael Bostic and Brian Surrette concluded that "something dramatic has taken place in the home ownership process faced by lower-income families."[26] Eight million more U.S. households became homeowners by the end of the 1990s than was the case at the start of the decade. Home ownership rates rose more sharply for African Americans, Hispanics, and lower-income families than for other groups between 1989 and 1998, but only a small part of these gains were attributable to improvements in their incomes or economic circumstances. Bostic and Surette found that a substantial share of the improvement was due to changes in the ways that mortgage markets function, and cited significant innovation among mortgage lenders in terms of risk measurement and the ability to develop and tailor new products for specific population segments.

The ability of lenders to develop products to (profitably) serve new borrowers and a wider segment of the population is critically dependent on the presence of accurate and timely credit report data. It is to this critical role of credit report data to support accurate decision-making that we now turn.

[24] Maria Concetta Chiuri and Tullio Jappelli, "Financial Market Imperfections and Home Ownership: A Comparative Study," manuscript, Department of Economics, Universita di Salerno, 2002.

[25] *Inside B&C Lending*, Vol. 8, Issue 3, Feb. 3, 2002.

[26] Raphael W. Bostic and Brian J. Surette, "Have the Doors Opened Wider? Trends in Homeownership Rates by Race and Income," Federal Reserve Board Working Paper, Apr. 2000.

More Accurate Decision-Making

Piercing the "Fog of Uncertainty"

It is no exaggeration to say that credit bureau data has become the cornerstone of the $7 trillion consumer lending industry in the United States. With access to the deepest, most comprehensive consumer payment histories in the world, U.S. creditors now apply statistical scoring models to estimate an individual's repayment risk on virtually every type of consumer loan transaction, including home mortgages. Creditors use scoring to set and adjust virtually every dimension of the loan relationship, including the initial application decision, pricing, collateral requirements on secured loans, size of credit line on unsecured credit cards, authorization of purchases at the point of sale, decisions to cross-sell other financial products, and the appropriate steps to collect the debt if the account becomes delinquent, or even looks like it might become delinquent.[27]

The credit report helps lenders pierce the "fog of uncertainty" that characterizes the risk assessment for a potential new borrower. Lending markets almost always display what economists call an "information asymmetry" between borrowers and lenders. Borrowers typically have more accurate information than lenders about their likelihood of repaying a loan. Lenders have an obvious incentive to evaluate the borrower's creditworthiness, and the outcome will affect whether to approve the loan as well as its price. Borrowers have an incentive to signal their true risk (if it is low) or disguise it (if it is high). Given the amount of the loan principal at stake, both parties have incentives to incur costs (often large ones) to reduce the information asymmetry, and these actions have significant consequences for the operation of credit markets. The emergence of the third-party credit bureau to compile borrower credit histories and distribute them to lenders significantly lowers the cost to all parties of measuring borrower risk.[28]

Credit reports in the United States contain factual information about consumers' current and past credit experience that is compiled over time, from a wide range of sources, and updated daily. Rather than relying on data from a single source or a snapshot of a borrower at a single moment in time, creditors (as well as insurers, employers and other businesses with a permissible purpose) can see a far more complete picture of present *and* past credit behavior. In the words of Federal Trade Commission (FTC) Chairman Timothy Muris: The extraordinary amount and variety of consumer credit available in the United States is made possible "because, without anybody's consent, very sensitive information about a person's credit history is given to the credit reporting agencies."[29] Such a complete credit report helps lenders pierce the "fog of uncertainty" surrounding new applicants. The result is a better match of borrowers to loans.

More efficient matching of loans and borrowers produces significant benefits for both consumers and the economy. Economists John Barron and Michael Staten conducted a study

[27] Paul Demery, "How Technology Boosted Plastic," *Credit Card Management 10th Anniversary Edition*, May 1998, pp 42-45.

[28] For the seminal article on the role of credit bureaus in making credit markets more efficient see Marco Pagano and Tullio Japelli, "Information Sharing in Credit Markets," *Journal of Finance*, Dec. 1993, pp 1693-1718.

[29] Timothy J. Muris, *Protecting Consumers' Privacy: 2002 and Beyond*, Privacy 2001 Conference, Oct. 4, 2001.

that simulated the effect in the United States of imposing restricted credit reporting rules such as those in Australia (which allows the reporting of negative, or default, information only) and various Latin American countries (which developed fragmented, industry-specific reporting systems).[30] An example illustrates the general conclusions. To achieve the same default rate experienced with loans made in the U.S. reporting environment, creditors that were constrained to using the sharply limited credit bureau data present under Australian rules would extend new credit to 11,000 fewer customers for every 100,000 applicants than would be the case if they were allowed to use the more complete data available under U.S. law. The reason is intuitive: when risk assessment tools have less information available to them, creditors are less effective at matching loans to creditworthy borrowers. More loans go to borrowers who will default. More borrowers are rejected who would have repaid. The negative impact on worthy borrowers is greatest for those who are young, have short time on the job or at their residence, have lower incomes, and are generally more financially vulnerable. These are precisely the borrowers for whom the ability to see successful handling of credit on the credit report is most important, to offset attributes that otherwise make them appear to be higher risk.

A statistically valid credit scoring model based on credit bureau data has become the most powerful tool for predicting and managing risk appropriately. Credit bureau data in the United States have been shown to be dramatically more predictive than application information alone, including borrower income.[31] The reason is straightforward. Past payment behavior signals both ability *and* willingness to repay. Creditworthiness can be inferred from the degree to which past and existing lines have been utilized and whether those payments were on time or late. By definition, consumers with "good" credit histories have taken the credit available to them and, subject to their available incomes and economic circumstances, found a way to meet and pay their accounts as agreed. Risk assessment based on credit bureau data rewards those consumers who find a way to make their payments. Consequently, as detailed credit reports enable lenders to do a better job of assessing and pricing borrower risk, they also have an important side effect: they reinforce borrower incentives to manage credit wisely and avoid delinquencies and defaults. In this way, credit reporting improves the performance of the entire market and lowers the costs of making credit available.[32] *All of this further lowers the cost of credit to consumers.*

Credit scoring based on a borrower's own past payment history replaces face-to-face attempts to evaluate character and capacity (common a generation ago) with a less invasive, more accurate assessment based on documented prior behavior. Lending decisions are faster and more equitable. There is less opportunity

[30] John M. Barron and Michael E. Staten, "The Value of Comprehensive Credit Reports: Lessons from the U.S. Experience," in Margaret Miller, ed., *Credit Reporting Systems and the International Economy*, MIT Press, 2003.

[31] Gary G. Chandler and Lee Parker, "Predictive Value of Credit Reports," *Journal of Retail Banking*, Vol. XI, no. 4, Win. 1989; Gary G. Chandler and Robert W. Johnson, "The Benefit to Consumers from Generic Scoring Models Based on Credit Reports," *IMA Journal of Mathematics Applied in Business and Industry*, Vol. 4, No. 1, Oxford University Press, 1992, pp 61-72; R.B. Avery, R.W. Bostic, P.S. Calem and G.B. Canner, "Credit Risk, Credit Scoring and the Performance of Home Mortgages," *Federal Reserve Bulletin*, Jul. 1996, pp 621-648.

[32] A. Jorge Padilla and Marco Pagano, "Sharing Default Information as a Borrower Discipline Device," *European Economic Review*, Vol. 44 2000, pp 1951-1980.

for the loan decision to be influenced by factors other than how the borrower has handled credit in the past, and standardized credit report data make it easier for regulators to verify compliance with antidiscrimination and other lending laws. Moreover, validation of statistical scoring models built with credit bureau data prove that these inferences are more accurate and consistent, as well. Federal Reserve Board Chairman Alan Greenspan has noted that access to personal credit history data makes individual financial institutions *"more creditworthy and efficient,"* and the U.S. financial services sector *"more transparent and stronger in general."*[33]

Preventing Delinquencies and Defaults

Furthermore, an under-appreciated aspect of today's risk management technology is that it allows lenders to be proactive in *preventing* debt problems, not only in the application phase but even for existing accountholders. Credit scoring that takes into account the full breadth of a borrower's obligations (and past payment history) allows creditors to prevent overextension. Scoring is being used to determine appropriate intervention for borrowers headed for trouble, including possible recommendations for credit counseling assistance.[34] The comprehensive credit reports that have developed under FCRA give U.S. lenders a much broader base of knowledge about a borrower's financial circumstances, and more tools to serve their customers. The broader the lender participation in the voluntary reporting system, the better the information in the credit reports, to the benefit of all lenders and borrowers alike.

Consequently, U.S. delinquency rates are low, remarkably so in the face of such high penetration of credit products across all income segments of the population. In the fourth quarter of 2002 only 3.9 percent of all mortgage borrowers in the United States were delinquent 30 days or more.[35] Only 4.6 percent of all credit card borrowers were delinquent 30 days or more on their accounts.[36] Indeed, a scan of 200 million credit reports revealed that 60 percent of U.S. borrowers had never had a payment delinquent 30 days or more in the previous seven years.[37]

Despite remarkably low average delinquency rates across all U.S. households, some observers have worried that previously underserved groups may have taken on more new credit than they could handle. If this actually occurred, it follows that we should expect to see evidence of growing household budgetary stress throughout the 1990s, the decade of most rapid gains in credit accessibility and growth in debt relative to income. This would be especially apparent among lower income households, those revealed in Figures 2 and 3 to have experienced the greatest percentage growth in participation in credit markets. However, Figures 4 and 5 provide little support for such an argument. Both figures display data from the Federal Reserve's Surveys of Consumer Finances. Figure 4 displays, by income

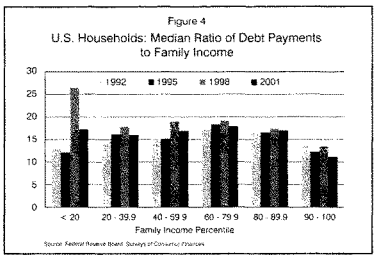
[33] Remarks by Alan Greenspan at the Conference on Bank Structure and Competition of the Federal Reserve Bank of Chicago, Chicago, IL (May 6, 1999) (emphasis added).

[34] For examples see: Paul Demery, "Why Risk Managers Expect More," *Credit Card Management, 10th Anniversary Issue*, May, 1998, pp 34-35; Jane Adler, "Two Faces of the Card Market," *Collections and Credit Risk*, Vol. 7, No. 10, Oct., 2002, pp 48-54; Peter Lucas, "Score Updates," *Collections and Credit Risk*, Vol. 7, No. 10; Oct. 2002, pp 22-25.

[35] Source: authors' calculations utilizing TrenData, an aggregated credit report database product of Trans Union, LLC.

[36] Id.

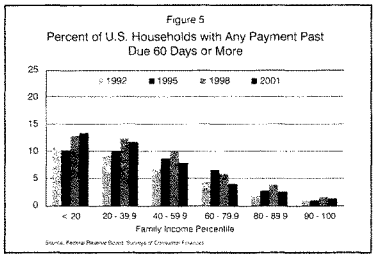
[37] Consumer Data Industry Association <www.cdiaonline.org>.



grouping, the median ratio of households' debt payments relative to their income. With the exception of one observation (1998 for households in the lowest fifth of the income distribution), the share of household income devoted to debt service is remarkably similar across all income groups, suggesting strong self-regulating behavior on the part of both borrowers and creditors.

This is not to deny that some households do find themselves with unmanageable debt loads. But, as a group, households in the lower two-fifths of the income distribution do not carry greater debt burdens (payments as a percent of monthly income) than higher income households, and their burden has not significantly increased over the past decade.

Figure 5 displays the percent of households who were delinquent on any debt payment 60 days or more during the previous year. Not surprisingly, the percentage of lower income households that experience payment difficulties is higher than the delinquency rate for higher income households. Relative to higher income households, those households in the lower part of the income distribution often have incomes that are more vulnerable to interruption and generally have fewer assets to function as a cushion when budgets are tight. Notice that all income groups experienced some rise in delinquencies over the course of the past decade. However, as in the previous figure, there is little evidence that households in the lowest two-fifths of the income distribution experienced any greater increase in delinquency (in percentage terms) than households in the other groupings. All of this suggests net positive benefits to wider credit access across the income spectrum.



To summarize, in the United States, comprehensive credit reports have improved the efficiency of credit markets, led to powerful improvements in risk-management technology (like credit scoring), and brought consumers more product choices, lower prices, and more equitable treatment. Robust, national credit reporting has made it possible for more people to have access to more credit without increased defaults.

Enhanced Competition

Because it dramatically reduces the cost of assessing the risk of new borrowers, credit report information encourages entry by new lenders and greater competition. A significant

obstacle to new entry into an established loan market is the prospect that the only customers interested in the new lender's product are the ones who have been rejected by other lenders because of their higher risk. This problem that economists call "adverse selection" can sharply limit the number of competitors in a market, especially if information on a borrower's past credit experience is costly to obtain.[38] Credit report information lowers those costs. It follows that the more detailed the credit history available to new entrants, the more competitive will be the market for new loans.

The credit card industry provides a prime example of the pro-competitive effects of nationwide credit reporting in the United States. Through the late 1970s, most credit cardholders acquired their cards through their local financial institutions, often by picking up applications at a branch. Choice was limited to the number of issuers in the local area who happened to offer a card product. Customers in smaller towns had fewer choices than residents of large cities. Local institutions faced little threat of entry into the market by financial institutions outside the state or region, a fact that was reflected in higher prices and little variance in card features.[39]

All of this began to change in the early 1980s. A key legal decision in 1978 gave national banks the ability to launch national credit card marketing programs at far lower cost than before.[40] The ability under the FCRA to acquire information about potential cardholder prospects, irrespective of location, made it possible for companies—both new and established—to enter new geographic markets, often with astounding speed.[41] In particular, the use of prescreening to target applicants provided the jet fuel for the acceleration in card offerings and competition. New entrants used credit reports and other externally acquired information to identify and target low-risk borrowers for their low-rate cards throughout the United States. Retailers and manufacturers introduced their own "co-branded" bank credit cards as unique alternatives to the traditional Visa and MasterCard products being offered by banks. Companies with established products and brands outside the financial services market (General Motors, General Electric, AT&T, Sears) combined data about existing customers of their corporate affiliates with information from credit reports and other external sources to identify and reach likely prospects. Many of these new products came without an annual fee and gave consumers an opportunity to earn cash rebates or free products and services each year depending upon their charge volume. Thanks to the success of those new market entrants, cards offering frequent traveler miles, rebates, and other consumer benefits have become commonplace.

The wave of new entrants to the bankcard market put great downward pressure on the finance charge rate and annual fees charged by

[38] Giovanni Dell'Ariccia, Ezra Friedman and Robert Marquez, "Adverse Selection as a Barrier to Entry in the Banking Industry," *RAND Journal of Economics*, Vol. 30, No. 3, Aut. 1999, pp 515-534.

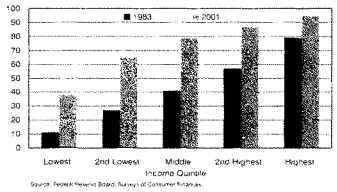
[39] For further discussion of competitive conditions in credit card markets see Christopher R. Knittel and Victor Stango, "Price Ceilings as Focal Points for Tacit Collusion: Evidence from Credit Cards," mimeograph, Federal Reserve Bank of Chicago, Nov. 10, 2001.

[40] Marquette National Bank of Minneapolis v. First of Omaha Service Corp., 439 U.S. 299 (1978).

[41] Following its introduction in 1992, the General Motors MasterCard established 2 million accounts and more than $500 million of balances in its first 60 days, making it the most successful credit card launch in U.S. history. See Martin Dickson, "Record Take-Up for GM Card," *Financial Times*, Nov. 17, 1992, p 26.

existing issuers. Incumbent issuers were forced to make a choice: either leave their rate unchanged and risk defection of their best customers to the new, low-rate entrants or cut finance charge rates and fees. As a result, between 1991 and 1992 the proportion of all revolving bankcard balances in the United States being charged an APR greater than 18.0 percent plummeted from 70 percent to 44 percent in just twelve months.[42]

Figure 6
U.S. Bankcard Ownership by Household Income



Source: Federal Reserve Board, Survey of Consumer Finances

The ability of new entrants to use credit report data to establish and cultivate relationships with customers thousands of miles away has transformed the competitive landscape in the United States, injecting price and service competition into the credit card market which had not been known for either. Economists Richard Schmalensee and David Evans reinforce this point: "The industry has expanded robustly in the past 20 years. Output measured by the number of cards issued, the amount charged on cards, and the amount of charges that are financed, has risen dramatically. Prices, as measured by the average revenue issuers receive after adjusting for charge-offs, have fallen. The expansion of the industry has taken place through both the continuous entry of new issuers and the growth of existing ones."[43]

Tiered, risk-based pricing based on credit report data made it possible for any given issuer to serve a broader range of customers. In 2001 a Federal Reserve Board study noted that "Many card issuers that in the past offered programs with a single interest rate now offer a broad range of card plans with differing rates depending on credit risk and consumer usage patterns."[44]

Not surprisingly, one consequence of the explosion in credit card competition and adoption of risk-based pricing has been a dramatic increase in the percentage of U.S. households owning at least one general-purpose bank credit card, from 43 percent in 1983 to 73 percent by 2001. Figure 6 reveals substantial gains in ownership in every income group, but the gains were much larger among lower income households. Overall, 30 million more U.S. households had a bankcard in 2001 than was the case in 1983.

The availability of credit report data transformed the competitive landscape of the credit card industry in the United States,

[42] RAM Research Corp., *Card Trak*, no. 28, April, 1993. To be sure, market interest rates (including the prime rate) fell by approximately 400 basis points between 1990 and 1994, but they also fell by over 200 basis points during the mid 1980s, with no comparable decline in credit card interest rates. Competitive pressures were much greater by the early 1990s, forcing issuers to develop innovative pricing strategies to prevent defection of their best customers. It is no coincidence that this was the period during which variable rate cards (with interest rates tied to the prime rate or some similar index) gained substantial market share.

[43] David Evans and Richard Schmalensee, *Paying with Plastic: The Digital Revolution in Buying and Borrowing*, MIT Press, 2000, p 246.

[44] *The Profitability of Credit Card Operations of Depository Institutions*, Board of Governors of the Federal Reserve System, Jun. 2001.

intensifying price and service competition.[45] In contrast, laws that would inhibit the assembly of comprehensive credit reports act as a barrier to competition by giving the dominant incumbent lender a monopoly over the information it possesses about its customers, and denying new market entrants the information needed to provide and market competitive services. Such laws, Robert Litan, vice president and director of the Economic Studies Program and Cabot Family Chair in Economics at the Brookings Institution, has written, "raise barriers to entry by smaller, and often more innovative, firms and organizations."[46]

Ownership rates for unsecured credit cards puts the difference in access to credit across countries in sharpest perspective. Table 2 compares the number of cards owned per thousand people in the United States verses eight EU countries. Ownership rates are vastly higher in the United States. Indeed, the rankings in card ownership strongly resemble the rankings of countries by the amount of detail in credit bureau reports. This is all the more significant because unsecured, revolving lines of credit are considered to be much higher risk than secured loans because of the lack of collateral and the lender's exposure in the untapped line. Literally, the borrower's reputation (past and future) is the lender's assurance that the loan will be repaid. For this product, comprehensive credit reports are the most valuable.

Although cultural differences across country borders surely explain some of the variance in card ownership in Table 2, it is hard to avoid the conclusion that the presence of more detailed credit histories in the United States is responsible to a large extent for the much higher rate of credit card ownership. Indeed, an Industry Report on the global credit card industry prepared by Morgan Stanley Dean Witter confirms this conclusion regarding the impact of the credit reporting environment as a boon or impediment to new entrants. Of the United Kingdom, the Morgan Stanley report had this to say: "Barriers to entry are low and new companies are still entering. U.K. credit bureaus have access to almost as much data as do those in the United States, allowing companies to launch targeted direct mail campaigns."

Their assessment of competitive conditions and entry prospects in other European countries contrasts sharply. For example, "France is a difficult market to crack." In addition to a cartel-like organization that controls the nation's merchant terminal structure, "[l]ack of a central credit bureau in the country is another hindrance, since the credit information made available through the Banque de France is limited to negative or so-called black data. This information is held for only one year." The report's authors write that while "Italy is an open market," "[t]he biggest obstacle to new entrants is the lack of a centralized credit bureau." They note that "[n]ew entrants in Spain's revolving credit market face some challenges. The lack of availability of credit information on consumers is one problem, as the country does not have

[45] One card industry executive remarked in 1998, "Ten years ago, credit cards were an under-marketed business. Issuers are now more sophisticated in their approach to underwriting, pricing and targeting offers at consumers. The entry of a lot of powerful marketers like AT&T and General Motors woke people up and made them realize they were not as aggressive as they could be." See Peter Lucas, "Marketing's Long and Winding Road," *Credit Card Management 10th Anniversary Edition,* May 1998, pp 26-30.

[46] Robert E. Litan, *Balancing Costs and Benefits of New Privacy Mandates*, AEI-Brookings Joint Center for Regulatory Studies Working Paper 99-3, p 11 (1999).

centralized credit bureaus to collect and exchange credit information."[47]

Other evidence from Europe provides additional confirmation of the relationship between robust credit reporting and competition. New service providers in financial services markets require access to credit data to thrive and the presence of comprehensive, accurate, and up-to-date credit reports facilitates new competition. Restrictive or inefficient credit reporting laws act as a barrier to competition by giving the dominant incumbent a monopoly over the information it possesses about its customers and denying new market entrants the information needed to provide and market financial services. In Europe, where comprehensive credit reports are not readily available, financial services are provided by far fewer institutions—*one-tenth* the number that serve U.S. customers—despite the fact that the pan-European market has almost one and one-half times as many households.[48] This means that European consumers have fewer choices of companies and services, fewer locations at which they can obtain financial services, and fewer ATMs—one-third the number in the United States—at which they can obtain and deposit funds.[49]

In France, for example, the EU country with some of the strictest financial privacy laws, seven banks control more than 96 percent of banking assets.[50] Laws that restrict the availability of complete, reliable credit histories help facilitate this type of concentration. The seven dominant French banks, each with assets over $100 billion,

[47] Kenneth A. Posner, Athina Meehan and Geula Daniel, *Industry Report: Global Credit Cards*, Morgan Stanley Dean Witter Equity Research, Mar. 21, 2001, pp 75, 78-79, 81, 83.

[48] Walter F. Kitchenman, *The European Union Directive on Privacy as a Barrier to Trade* 6 (The Tower Group, 2000).

[49] Id.

[50] In particular, France does not allow "positive" credit reporting, i.e., delinquent accounts may be reported, but lenders may not share information about accounts in good standing. Consequently, unless a borrower has had past payment difficulties, he has no credit history at all.

Table 2. Credit Card Ownership, 1997 (per 1000 people in population)

Country	Superpremium + Premium	Corporate	Standard	Total
United States	650.4	20.9	945.0	1616.3
United Kingdom	91.3	22.5	546.7	660.5
Belgium	53.0	6.9	197.4	257.3
Netherlands	38.3	9.4	195.9	243.5
Spain	26.5	4.3	212.0	242.8
Sweden	44.2	46.4	85.8	176.4
Germany	39.7	4.6	127.8	172.0
Italy	18.2	9.7	109.1	137.0
France	25.1	3.1	68.3	96.6

Source: Lyn C. Thomas, David B. Edelman, and Jonathan N. Crook, Credit Scoring and its Applications, Society for Industrial and Applied Mathematics, Philadelphia, 2002, p 212.

already own extensive databases; they have no need to share information about their customers with anyone. In fact, they don't want to share information about their customers. The fact that this system restrains innovation, hurts customer choice, and increases price is not a great concern to those banks because the same system also restrains competition and makes it easier to hold customers and capital captive.

Speed and Convenience

The depth of information in U.S. credit reports enhances the speed of credit, insurance, and other financial service decisions. Even very significant decisions about financing a college education or a new home or writing automobile or homeowners insurance are often made in a matter of hours or minutes, instead of days and weeks as is the case in most other countries, because credit history data is readily accessible. A survey of auto lenders in the United States revealed that in 2001, 84 percent of automobile loan applicants received a decision within an hour; 23 percent of applicants received a decision in less than 10 minutes.[51] Many retailers open new charge accounts for customers at the point of sale in less than two minutes. According to FTC Chairman Muris:

> Many fail to appreciate that the average American today enjoys access to credit and financial services, shopping choices, and educational resources that earlier Americans could never have imagined. Today, we can check our credit card and bank balances over the phone 24 hours a day, we can order books, clothes, or gifts online while we are having our first cup of coffee in the morning, or we can review our finances in a convenient consolidated statement whenever we like. What I personally find most astounding is what occurs all over America at auto dealers every day. If consumers have good credit, they can borrow $10,000 or more from a complete stranger, and actually drive away in a new car in an hour or less. I call this the "miracle of instant credit."[52]

The variety and speed of such services are unheard of in most other countries where restrictive laws often prevent credit bureaus from storing sufficient information on consumer borrowing and payment behavior to support rapid and accurate decision-making. "When you think about it," Muris concluded, "this event is extraordinary. This 'miracle' is only possible because of our credit reporting system."[53]

Catalyst to Productivity Growth

The availability of comprehensive and timely credit report data contributes to the mobility of both labor and capital in the U.S. economy. As a result, credit reporting is arguably one of the key elements of the U.S. infrastructure that underpins the remarkable productivity growth of the past decade.

[51] Consumer Bankers Association, 2002 Automobile Financing Survey.

[52] Muris, supra.

[53] Id.

A number of economic studies have now concluded that the proliferation of computer and information technology was largely responsible for the productivity surge in the United States. However, what was remarkable about this development was that the same factors were available worldwide, but for the most part we did not witness similar productivity growth elsewhere. Economists who study productivity growth are increasingly conceding that the secret to the flexibility and resiliency of the U.S. economy lies in the underlying institutions that promote efficiency in capital and labor markets. These institutions allow both capital and labor to reallocate to their highest valued uses.[54]

A good example of such an institution is the U.S. regulatory framework that facilitates the transfer of personal credit history data for permissible purposes. Portable credit "reputations" give consumers greater mobility, and make us more open to change. From a labor market perspective, the credit reporting system under FCRA has increased our mobility as a society, so that structural shifts within the economy can cause temporary disruptions but without crippling long-term effects. There is less risk associated with severing old relationships and starting new ones, because objective information is available that helps us to establish and build trust in new locations more quickly.

In contrast, more restrictive, and inconsistent, credit reporting laws in Europe prevent European consumers from taking full advantage of their complete credit histories. The fact that credit *information* is not mobile restricts the mobility of *consumers*, because of the resulting difficulty of obtaining credit from new institutions. As a result, economist Walter Kitchenman writes that consumer lending in Europe "where it exists, is concentrated among a few major banks in each country, each of which has its own large databases."[55] In fact, European consumers, although they outnumber their U.S. counterparts, have access to *one-third* less credit as a percentage of Gross Domestic Product.

A developed credit reporting system makes capital more mobile as well. There is growing, cross-country empirical evidence that the increased efficiency of capital markets is a powerful determinant of growth. Improved risk sharing—by spreading risks over a larger pool of capital and a larger number of investors—lowers the cost of capital, and leads to greater investment.[56] This is why Walter Kitchenman has described the "almost universal reporting" of personal information about consumers as not only the "foundation" of consumer credit in the United States," but also as the "secret ingredient of the U.S. economy's resilience."[57]

Investment in financing small business startups is a prime example. Small business formation in the United States has benefited directly over the past decade from the underlying credit reporting system. According to the National Federation of Independent Businesses,

[54] For example, see Christopher Gust and Jaime Marquez, "International Comparisons of Productivity Growth: The Role of Information Technology and Regulatory Practices," International Finance Discussion Papers, No. 727, Board of Governors of the Federal Reserve System, May 2002.

[55] Kitchenman, *European Union Directive*, supra, at 3; Geert Bekaert, Campbell Harvey and Christian Lundlbad, "Does Financial Liberalization Spur Growth?" National Bureau of Economic Research Working Paper No. 8245, Apr. 2001.

[56] Geert Bekaert, Campbell Harvey and Christian Lundlbad, "Does Financial Liberalization Spur Growth?" National Bureau of Economic Research Working Paper No. 8245, National Bureau of Economic Research, Apr. 2001.

[57] Walter F. Kitchenman, *U.S. Credit Reporting: Perceived Benefits Outweigh Privacy Concerns* (The Tower Group 1999).

seven out of ten small-business owners start their businesses with less than $20,000.[58] By the early 1990s, credit analysts had determined that personal credit reports for small business owners and partners were highly predictive of the success of the business. Commercial scorecards for evaluating small business loans were introduced to the market in 1995. Since then, research has shown that small business credit scoring is associated with "a net increase in lending to relatively risky marginal borrowers, that would otherwise not receive credit."[59] Other research has shown that, much like the case in consumer credit markets, small businesses are increasingly dealing with banks and other lenders located far away. The authors conclude that "greater, and more timely, availability of borrower credit records, as well as the greater ease of processing these may explain the increased lending at a distance. Consistent with such an explanation, distant firms no longer have to be observably the highest quality credits, suggesting that a wider cross-section of firms can now obtain funding from a particular lender."[60] These findings have great significance for economic growth in the United States. Small businesses represent over 99 percent of all employers in the United States, create 80 percent of all new jobs, and account for about 38 percent of Gross Domestic Product.[61]

As we have seen, credit reporting allows lenders to cut through the "fog of uncertainty" to better evaluate potential borrowers. The transparency of risk in single loans enables creditors to document that risk, and subsequently pool loans of similar risk and sell them to investors. This ability to securitize and resell consumer and mortgage loans in secondary markets brings huge amounts of loanable funds into consumer credit and mortgage markets, making credit cheaper and more readily available.

The enormous growth and new entry into the U.S. credit card market was fueled in part by the influx of loanable funds during the 1990s made possible through securitization. At the end of 1990, there were $1 billion of securitized credit card balances in the United States, less than 1 percent of all outstanding card balances. By the end of 1996, securitized card balances totaled $178 billion, about 45 percent of total outstanding card balances. As of the end of 2002, securitized receivables comprised nearly 56 percent of over $700 billion in revolving credit outstanding. According to Richard C. Drason, associate director at ratings agency Fitch IBCA, securitization "played a major role for smaller players, for players just getting into the business, and for regional players trying to grow nationally. It gave them access to cheaper funds that they might not have been able to obtain."[62] Securitization has been especially helpful to non-depository credit card companies that did not have access to consumer deposits to use to make card loans. The transparency of risk in the accounts that underpin credit card-backed securities gives even distant investors

[58] National Federation of Independent Business <www.nfib.com>.

[59] Allen N. Berger, W. Scott Frame and Nathan H. Miller, "Credit Scoring and the Availability, Price and Risk of Small Business Credit," Federal Reserve Board Working Paper, April 2002.

[60] Mitchell A. Petersen and Raghuram G. Rajan, "Does Distance Still Matter? The Information Revolution in Small Business Lending," National Bureau of Economic Research Working Paper 7685, May 2000.

[61] National Federation of Independent Business <www.nfib.com>.

[62] Linda Punch, "The Legacy of Card Bonds," *Credit Card Management 10th Anniversary Issue*, May 1998, pp 36-38.

such confidence that MBNA's chief financial officer remarked "Our (card-backed) securities are well-received in all corners of the globe, from England to the Far East to Australia. Many times the deals are oversubscribed."[63]

Again, the European Union provides a contrast. Cross-border competition has benefited the corporate lending market over the past decade, but consumer loan markets remain fragmented. Conversion to a common currency within the European Union has not been enough to remove persistent cross-border differences in consumer loan interest rates. Adjustments to changing market interest rates conditions are faster in some countries but lag far behind in other countries. Economists have concluded that to lower the cost of consumer loans it will be necessary to encourage cross-border penetration by retail lenders to bring loan rates into closer alignment across countries.[64] Of course, as was noted above, one of the impediments to cross-border consumer lending to some countries is the lack of information about borrowers, a direct result of lack of harmonization of credit reporting rules across EU countries.

Public Safety and Security

Credit reports have long played an important role in protecting public safety. For example, one of the "permissible purposes" for which the FCRA permits credit reports to be used is to screen applicants for employment. Because credit reports include public record data, past addresses, and prior names, they have proved a useful and convenient way to check for past criminal convictions when employing school bus drivers, child care workers, security guards, and people to fill other sensitive positions.

Credit reports are an important tool in preventing financial fraud, because they provide a comprehensive picture of an individual's financial dealings. They are also becoming an increasingly potent weapon in the fight against identity theft, because they provide a reliable source of dynamic information that can be used to identify applicants for credit and other financial services. Rather than rely on an easily forged document like a driver's license or static information like mother's maiden name, businesses can verify the identity of customers or employees against an array of often-changing data points, such as outstanding mortgage balance or open credit lines.

The federal government has recognized the unique resource that credit reports provide for identity verification and has begun exploring using them as an efficient, cost-effective tool for identifying passengers boarding airplanes, visitors entering government buildings, and in other settings where positive identification is necessary to protect public safety. Moreover, the Transportation Security Administration is exploring an expanded use of credit reports to identify potential terrorists and security threats by analyzing credit report data. To be certain, credit reports are only one of many tools for responding to terrorist threats, and some of these proposed uses pose important policy and

[63] Id., p 38.

[64] Friedrich Heinemann and Martin Schuler, "Integration Benefits on EU Retail Credit Markets-Evidence from Interest Rate Pass-through," manuscript, Zentrum fur Europaische Wirtschanftsforschung. Mannheim, Germany, Nov. 2001, available at www.ecri.be; Kleimer and Sander, "Consumer Credit Rates in the Eurozone: Evidence on the Emergence of a Single Retail Banking Market," European Credit Research Institute Research Report No. 2, Jan. 2002.

legal issues, but these proposals highlight the importance to individual safety and public security of accessible credit reports as sources of comprehensive, nationwide, accurate, and up-to-date information.

Reduced Costs

In the United States, comprehensive credit reports have improved the competitiveness and efficiency of credit markets, led to powerful improvements in risk-management technology (like credit scoring), and brought consumers more product choices, lower prices and more equitable treatment. To the extent credit reports enable lenders to do a better job of assessing and pricing borrower risk, they reinforce borrower incentives to manage credit wisely and avoid delinquencies and defaults. *All of this ultimately lowers the cost of credit to consumers.*

Reliable, centralized, and standardized consumer credit information also makes it possible to pool consumer loans and then sell them to investors. Securitization, as already noted, makes more capital available to consumers and greatly reduces the cost of credit. A Tower Group consulting study concluded that U.S. mortgage rates are two full percentage points lower than in Europe because it is possible to securitize and sell mortgage loans.[65] *Consequently, American consumers save as much as $120 billion a year on nearly $6 trillion of outstanding mortgages because of the efficiency and liquidity that credit report data make possible.*[66]

Robust credit reporting contributes to saving consumers money in other ways as well. For example, by making refinancing easy and fast, credit reports allowed eleven million U.S. homeowners to refinance their home mortgages to take advantage of lower interest rates during just a 15-month period in 2001 and early 2002. Doing so allowed them to collectively save an estimated $3.2 billion *annually* in mortgage payments.[67] U.S. lenders are also increasingly taking advantage of accessible credit reports to allow consumers to refinance auto loans. We have also already seen how improved risk sharing—by spreading risks over a larger pool of capital and a larger number of investors—lowers the cost of capital, thereby making credit available to consumers more affordably.

Summary

The U.S. credit reporting system has benefited all consumers by facilitating access to more credit and financial services, especially for traditionally underserved populations. It has improved the accuracy of financial decision-making, generating substantial benefits for individual consumers as well as the entire economy. Ubiquitous credit information has significantly enhanced competition and lowered prices by making it possible for existing financial institutions to compete for customers

[65] Kitchenman, *U.S. Credit Reporting*.

[66] If mortgage interest rates are 2 percent lower as a result of securitization, 2 percent of $6 trillion in outstanding mortgages equals a $120 billion savings in interest each year.

[67] Glenn Canner, Karen Dynan and Wayne Passmore, "Mortgage Refinancing in 2001 and Early 2002," *Federal Reserve Bulletin*, Dec. 2002, pp 469-481.

nationally, by enabling businesses other than financial institutions to begin offering competitive products and services, and by leveling the playing field so that new entrants could overcome the advantage of established lenders in assessing new customers. The credit reporting system has significantly reduced costs for mortgages, credit card, and other financial services, saving U.S. consumers hundreds of billions of dollars each year. Accessible credit information has dramatically improved consumer convenience, making possible the "miracle" of instant credit; consumers can even apply for a mortgage or auto loan by phone or via the Internet and get a decision within seconds. The U.S. system of credit reporting greatly enhances consumer mobility and choice, as well as public safety and security.

The Threat of New Restrictions on Credit Reporting

Proposals to abandon uniform national standards by eliminating federal preemption for the eight core areas currently protected under FCRA threaten the diverse array of benefits that flow from the current credit reporting system under the FCRA. While most aspects of credit reporting are vulnerable to the high costs of state or local regulation, some are especially at risk. This explains why Congress first preempted state-level regulation in these areas in 1996. There are many examples, but the following three illustrate the risk.

Voluntary Reporting

Because no one is *required* to provide information to credit bureaus, if furnishers of information faced significant compliance burdens or liability, as would be the case if complying with separate and even inconsistent state laws, they would be more likely to stop contributing the information. Recognizing the special vulnerability of the entire credit reporting system, in 1996 Congress excluded the states from regulating the responsibilities of furnishers of credit information.

Voluntary reporting has already proved fragile as some financial institutions have reportedly withheld information about their best customers out of concern that it might be used by competitors to try to attract those customers. Some credit grantors, for example, choose to report derogatory information only (e.g., delinquencies, charge-offs), but not accounts in good standing. Some choose not to report at all. The industry and regulators have long fought this practice, because even the absence of a small amount of relevant information from credit reports could dramatically reduce their usefulness and lead to less accurate credit decisions and less access to credit for people who need it most.[68]

Imposing liability for errors or significant additional burdens on the furnishers of consumer data to credit bureaus would encourage some (perhaps many) firms to curtail or cease reporting. In particular, liability for errors could discourage the reporting of negative events regarding a consumer's account

[68] "It's Essential That Lenders Report Credit Data," *The Commercial Appeal* (Memphis, TN), Jan. 23, 2000, p C2.

(e.g., delinquency). They would no longer enhance the quality and depth of the bureau information by contributing their portfolio experience. The predictive accuracy of scoring models would quickly deteriorate if non-participation became commonplace. Increased or disparate standards of furnisher liability would be inconsistent with current regulatory initiatives to encourage robust reporting, and could easily undermine the value of credit reporting.

Obsolescence Determinations

The 1996 amendments also precluded states from regulating when adverse data would be considered "obsolete" and therefore could not be included in credit reports. Currently, information on delinquencies, accounts placed with collection agencies, tax liens and similar events must be excluded from credit reports after seven years (with the exception of a notice of bankruptcy, which may remain for ten years). Proponents of accelerated deletion argue that the old information is "stale" and therefore may no longer be relevant to determining an individual's creditworthiness.

The available evidence, however, suggests that these arguments are wrong. Derogatory information continues to distinguish levels of credit risk "even as the information ages."[69] The results of one 1990 study are particularly interesting. The study found that "significantly more people who declare bankruptcy have older public record derogatory information but none in recent years, than do all people. As a result, if creditors are not allowed to know of public record derogatory information that is four years old or older, they may lose an important predictor of future bankruptcy."[70]

Since storage of old information entails positive costs, simple economics suggests that bureaus will retain data only so long as its value (enhanced prediction of risk) exceeds the storage cost. If creditors find old derogatory information is useful, then they will pay more for files that have it (or purchase reports more frequently). Laws that prohibit the use of such information degrade the reporting system's value for predicting risk.

Opt-In Consent

The 1996 amendments to the FCRA explicitly authorized the sharing of personally identifiable information among affiliated companies and with anyone for the purpose of marketing credit or insurance opportunities to consumers, provided that consumers are given an opportunity to opt out of that sharing.[71] Congress thought these activities too important to subject them to divergent state regulation. Some privacy advocates propose allowing states to alter the balance struck in 1996 by shifting to an opt-in regime for using credit report data to market credit products to their residents. Some of these opt-in proposals would require companies to obtain explicit

[69] Fair, Isaac Companies, *The Associated Credit Bureaus, Inc. Study on Adverse Information Obsolescence Phase 1*, Sep. 1990, p 3.

[70] Fran Lyons and Lee Allen, "Importance of Aged Public Record Derogatory Information," *Dialogue*, MDS Group, Fall 1990, p 6.

[71] 15 U.S.C. §§ 1681a(d)(2)(A)(iii), 1681b(c)(5).

consumer consent prior to using personally identifiable information for prescreening or before sharing such information among affiliates.

An opt-in system for giving consumers choice over information usage is always more expensive than opt-out because it requires each company that wishes to use personal information to target its marketing efforts and gain explicit consent from each consumer prior to making any offers. In contrast, opt-out is less costly because it infers permission if consumers don't explicitly object. Based on the studies and company experience-to-date, it appears that conditioning the use of information on opt-in consent is tantamount to banning the use outright.[72]

This makes an opt-in system for permissible use an especially great impediment to new and smaller credit market entrants, who lack extensive customer lists of their own or the resources to engage in mass marketing to reach consumers likely to be interested in their products or services. If information for targeting offers is unavailable because the cost of soliciting opt-in consent is too great or because too few customers have received and responded to opt-in requests, new competitors may be unable to market their products and services at all. A proliferation of opt-in requirements across multiple states would balkanize credit marketing. Credit availability would be uneven across the country, but independent of either the creditworthiness of borrowers or underlying economic conditions. Such a trend would erode the consumer benefits from national competition that were highlighted in the previous sections.

National Credit Reporting

Credit reporting in the United States today is inherently national. The value of the entire system depends upon data being collected about borrowers who travel and use credit nationwide, and collected from creditors who are located throughout the country and deal with customers nationwide. This is why credit bureaus have undergone such consolidation and integration during the past half-century. Indeed, credit reporting has contributed to consumer mobility by breaking down entry barriers and opening up markets to national and global competition.

Virtually all of the benefits to individuals and the economy from the current U.S. reporting system result from its national character. National credit reporting has made possible national competition in the market for credit and other financial services. That competition depends on the ability of banks and other card issuers to enter distant markets and provide customer service across state lines. Capturing credit data on a state-by-state basis provides

[72] For a more detailed discussion and results from case studies see Michael E. Staten and Fred Cate, "The Impact of Opt-In Privacy Rules on Retail Credit Markets: A Case Study of MBNA," 52 *Duke Law Journal* (forthcoming 2003).

[73] A simple example illustrates the point. Not a single one of the ten largest bank card issuers is located in Texas, the second-most populous state in the U.S. Those top ten issuers held 83 percent of all bank card receivables at the end of 2001. Consequently, it is quite likely that 80 percent or more of Texans with bank cards are borrowing from and making payments to one or more out-of-state financial institutions. This is the rule rather than the exception, and reflects the national character of U.S. credit markets. *Card Industry Directory*, 2003 Edition, Thomson Media, New York, 2002, p 17.

little value because the vast majority of consumers deal with creditors from out of state.[73]

Consumers in the U.S. are remarkably mobile, thanks in part to the ubiquitous availability of credit reports. Forty-two million Americans—approximately 16 percent of the U.S. population—move each year. As of 1998, there were 6 million vacation or second homes in the United States, often in states different than the owners' primary homes.[74] A growing number of consumers live in one state and work in another. This is especially true in major urban centers, such as New York, New Jersey, and Connecticut, or Virginia, Maryland, and the District of Columbia, where population is most concentrated.

Compartmentalizing credit histories state-by-state would ill serve consumers as they move, commute, and travel across state lines. It would leave holes (potentially large ones) in a consumer's credit file. Moreover, even if it did not in the case of a particular borrower, the fact that it *could* would greatly reduce the reliability of credit reports. How is a lender to know whether the picture of the consumer that the report presents is complete or not?

The cost of determining which state law or laws applied, and of complying with those laws, could easily undermine the credit reporting system. That system deals in huge volumes of data—over 2 billion trade line updates, 2 million public record items, an average of 1.2 million household address changes a month, and over 200 million individual credit files. Its viability depends on achieving exceptional efficiency in matching and processing updates so that files can be maintained at low marginal cost. In turn, this keeps the cost of providing credit reports low. In the face of greater centralization and unification of markets, and the increased mobility of both consumers and the goods that they desire, crafting, implementing, complying with, and enforcing 51 separate laws governing credit reporting will always be more expensive than is the case with a single law.[75] If state and local laws are inconsistent, compliance costs are greatly exacerbated.

Worse still, it may be impossible for a business to comply with the conflicting provisions of state credit reporting laws in all of the states in which it operates. This is especially true online. The Internet crosses state boundaries and has facilitated truly national (in many cases, global) markets. Yet the technologies of the Internet make it impossible to identify automatically in which state users are located. Even offline, however, businesses face a significant compliance challenge when faced with inconsistent state requirements.[76]

Historically, privacy advocates have argued

[74] *Use and Misuse of Social Security Numbers*, Hearings before the Subcomm. on Social Security of the House Comm. on Ways and Means, May 11, 2000 (statement of Stuart K. Pratt).

[75] That number could go far higher: already Daly City, Contra Costa County, San Mateo County, and San Francisco have adopted their own ordinances regulating the sharing of financial information with affiliates and third parties-four separate laws, in addition to applicable federal and state laws, within one 20-mile area. Daly City Ordinance No. 1295 (Sep. 9, 2002), as amended by Ordinance No. 1297 (Nov. 12, 2002); Contra Costa County Ordinance No. 2002-30 (Sep. 24, 2002), as amended by Ordinance No. 2002-44 (Nov. 5, 2002); San Mateo County Ordinance No. 4126 (Aug. 6, 2002), as amended by Ordinance No, 4144 (Nov. 5, 2002); San Francisco City Ordinance No. 237-02 (Dec. 20, 2002).

[76] An ironic example comes from the recent experience of gourmet ice cream manufacturer Ben & Jerry's with food labeling. Although a vocal opponent of genetically altered milk, and one of the first U.S. companies to voluntarily label its products as containing only milk from untreated herds, the company had to abandon this practice—even though it and its customers desired it—"because of the difficulty of complying with multiple state labeling requirements." Dan L. Burk, "The Milk Free Zone: Federal and Local Interests in Regulating Recombinant bST," 22 *Columbia Journal of Environmental Law* 227, 299 (1997).

for the need to replace state and local laws with a single, uniform privacy standard. A national standard offers better and more consistent privacy protection. In regard to the privacy of medical records, Helena Gail Rubenstein, from the Massachusetts Group Insurance Commission, has written that "normatively, privacy advocates and data users agree that any health information system that must operate within the confines of fifty different sets of ground rules cannot operate efficiently."[77]

The absence of preemption, Professor Larry Gostin has written, "is self-defeating. It simply pushes the privacy battle into state legislatures and redirects the resources of the provider and research communities to costly lobbying efforts in the fifty state capitals. What will result is a patchwork of rules, as each state makes its own peace with the various interest groups." The absence of preemption, he concluded, in a world in which "data needs do not recognize state boundaries" and businesses "operate in multiple states," is to "increase the cost" to everyone who pays for goods and services in the modern economy.[78]

It is not clear why credit reporting should be different—why consumer privacy would be enhanced by "a patchwork of rules," rather than a uniform national law. How are consumers served, for example, by receiving different notices of their rights under the FCRA or by waiting different amounts of time for reinvestigations of disputed data to be completed, depending upon the state or county or city in which they are located?

The need for a single standard in the core areas of credit reporting is so great that if Congress fails to maintain one through federal legislation, it will likely emerge from the states. When the costs and complexity of complying with state-by-state legislation are high, then in the face of multiple legal standards, the most restrictive tends to dictate business practices. By complying with the most restrictive law, a business hopes to comply with the less restrictive ones as well.

In the case of credit information, states that adopt the most restrictive laws (and that are too populous or important for a business to simply cease to operate in), will set the de facto privacy standard for all other states. In the absence of express federal preemption, the most restrictive state privacy regime will ultimately effectively preempt both the privacy laws of other states and the federal standard as well. This is the irony of the current preemption debate. The question isn't whether there will be de facto preemption, but rather from what source it will come: Congress or one state legislature imposing its laws on the entire country.

Howard Beales, head of the FTC Bureau of Consumer Protection, noted this point when he was a professor at George Washington University. Addressing the specific subject of product advertising, which is similar to credit reporting in terms of its national reach and high cost of entry, Beales wrote that "[t]he high costs of developing advertising and the lack of any marketing reason to distinguish between consumers based on their state of residence mean that, as a practical matter, actions by individual states will determine the content of advertising for consumers nationwide." As with credit reporting, "it is the most restrictive

[77] Helena Gail Rubenstein, "If I am Only for Myself, What Am I? A Communitarian Look at the Privacy Stalemate," 25 *American Journal of Law and Medicine* 203 (1999).

[78] Lawrence O. Gostin, "Health Information Privacy," 80 *Cornell Law Review* 451 (1995).

judgment, rather than the most accurate, that will effectively govern," Beales noted. "If the most restrictive judgment" prevails, Beales concluded, "consumers are the likely losers. . . . Indeed, it is hard to imagine a system that is more likely to encourage advertisers"—or credit bureaus, he might have added—"to avoid altogether the kinds of objective product information that are most valuable to consumers."[79]

Conclusion

In 1996 Congress amended the FCRA to ensure that individuals would have the same substantive rights regarding collection and use of their credit histories irrespective of the state in which they live. Congress also guaranteed that the content of credit reports would be consistent across the country and the fundamental unfairness to both consumers and creditors of relevant information being reported under one state's laws but withheld under another's would be avoided. The 1996 amendments guarded against driving furnishers of credit information from the voluntary reporting system by overly burdensome compliance requirements or the threat of liability from separate or even inconsistent state laws. They also ensured that affiliated companies—whether or not dealing with credit information—would be able to share information freely, pursuant to federal law, without having to contend with regulatory barriers erected by state and local governments.

By limiting the term of preemption to seven years, Congress provided a specific opportunity for policymakers to determine how well uniform national reporting standards have served the public. The consistent, overwhelming answer to this question provided, based on all of the available evidence we have examined, is that the national credit reporting system operating under the amended FCRA has generated extraordinary benefits for individual consumers and for the nation as a whole. Proposals to alter the 1996 framework by allowing the states to intervene in the protected core areas threaten to erode the benefits of robust, national credit reporting that consumers enjoy today.

The economic scope of that threat is impossible to measure in advance, because it depends on the type and severity of adjustments to the existing reporting system and because the benefits of the U.S. credit reporting system are felt so broadly and are intertwined with so many areas of commerce. Nevertheless, a few examples make it clear that the magnitude of the threat posed by new restrictions on credit reporting could easily be in the hundreds of billions of dollars annually.

For example, recall that a Tower Group consulting study calculated that U.S. mortgage rates are two full percentage points lower than in Europe because standardized credit information facilitate the sale and securitization of mortgage loans.[80] That amounts to a $120 billion savings every year on nearly $6 trillion of outstanding mortgages outstanding at the end of 2002. New regulations that would raise the cost and consequently inhibit voluntary reporting by creditors would move the U.S.

[79] J. Howard Beales, III, "What State Regulators Should Learn From FTC Experience in Regulating Advertising," *Journal of Public Policy & Marketing*, Vol. 10, No. 1, Spr. 1991, p 101.

[80] Kitchenman, *U.S. Credit Reporting*.

system closer to the restricted files common in many EU countries, impairing the portfolio risk assessment that is at the heart of securitization. This would lead to higher costs for investors, a reduced supply of loanable funds available in the mortgage markets, and higher mortgage interest rates.

We have also discussed how less comprehensive credit reports would raise the cost of entry into new markets by all lenders. Recall that competitive pressures in the credit card market in the late 1980s and early 1990s led to a dramatic decline in credit card interest rates. Less competition for new customers would begin to ease the downward pressure on credit card pricing. With over $700 billion in revolving credit outstanding in the U.S. at the end of 2002, every percentage point rise in average credit card interest rates would cost consumers an additional $7 billion annually. Extending this example, since comprehensive credit reports and prescreening enhance competition across all types of consumer credit, every percentage point rise in average consumer loan rates would cost consumers $17 billion in additional finance charges annually.[81]

The economic impact of declining access to credit is difficult to estimate. Certainly, some portion of the 516,000 homes that Americans purchased every month during 2001 would not have been sold had mortgage credit been more expensive and the underwriting standards for loan acceptance been higher. The same is true for some fraction of the 1.4 million cars, SUVs, and light trucks purchased in the average month, the majority of which were financed with loans or leases. Clearly, a reduction in consumer spending on housing and durable goods resulting from tighter credit markets would impose a drag on U.S. economic activity.

All quantitative estimates of the costs of moving to a less comprehensive reporting system are necessarily speculative because they anticipate changes to the U.S. credit reporting system that we have fortunately never endured. Regardless of the magnitude of such dollar cost estimates, the threat of unraveling the gains to individual consumers should give policymakers the greatest pause. Compared to most other developed countries, the U.S. national credit reporting system has helped make it possible for a higher proportion of Americans to live in their own homes, drive their own cars, and afford college educations. It has greatly increased the number of Americans who now qualify for credit, insurance, and other financial services, and increased the confidence of providers in meeting the needs of previously underserved populations. The credit reporting system, undergirded by the FCRA, has helped to break down geographic and economic barriers, so that virtually all Americans can choose from services provided by competing businesses without regard for location. Credit reporting has had a literally transforming effect on the lives of less well-off individuals, young adults, and those located in small towns and rural areas. "Democratization" describes a broad and beneficial social effect, but the greatest measure of the impact of robust, national credit reporting is measured in the millions of individual lives improved.

In sum, it appears that all of the available evidence—economic and otherwise—suggests that the national reporting system that has evolved under FCRA has helped make the United States the world leader in the development of competitive consumer and mortgage credit markets.

[81] Based on $1.72 trillion in outstanding (non-mortgage) consumer credit, as was the case at the end of 2002.

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