

MEMO# 19224

October 6, 2005

FEDERAL DISTRICT COURT STRIKES DOWN PROVISIONS OF CALIFORNIA'S PRIVACY LAW GOVERNING THE SHARING OF INFORMATION WITH AFFILIATES

©2005 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [19224] October 6, 2005 TO: CHIEF COMPLIANCE OFFICER COMMITTEE No. 62-05 COMPLIANCE ADVISORY COMMITTEE No. 53-05 PRIMARY CONTACTS - MEMBER COMPLEX No. 42-05 PRIVACY ISSUES WORKING GROUP No. 5-05 SMALL FUNDS MEMBERS No. 84-05 TECHNOLOGY ADVISORY COMMITTEE No. 21-05 OPERATIONS MEMBERS No. 15-05 RE: FEDERAL DISTRICT COURT STRIKES DOWN PROVISIONS OF CALIFORNIA'S PRIVACY LAW GOVERNING THE SHARING OF INFORMATION WITH AFFILIATES We are pleased to report that the U.S. District Court for the Eastern District of California ("District Court") has struck down the affiliate-sharing provisions of California's privacy law and permanently enjoined the State from enforcing those provisions. The background of this case and the District Court's decision are briefly described below. A copy of the District Court's decision is attached. As you may recall, in 2003, California enacted a privacy law that, among other things, required financial institutions to provide a notice and opt-out to a customer prior to sharing non-public personal information about the customer with an affiliate. Shortly thereafter, the affiliate-sharing provisions of the law were challenged in the District Court on the basis that the federal Fair Credit Report Act preempted states from regulating the sharing of information among affiliates. When the District Court upheld California's law, this decision was appealed to the U.S. Circuit Court for the Ninth Circuit ("Circuit Court"). The Institute filed an amicus brief with the Circuit Court expressing our view that California's authority to regulate the sharing of information among affiliates had been preempted by Congress. 1 1 See Institute Memorandum to Compliance Advisory Committee No. 78-04, Operations Members No. 29-04, Primary Contacts - Member Complex No. 77-04, Privacy Issues Working Group No. 4-04, SEC Rules Members No. 112-04, Small Funds Members No. 85-04, and Technology Advisory Committee No. 23-04 [No. 17894], dated August 13, 2004. Joining the Institute on the brief were the Securities Industry Association, the Investment Counsel Association of America, the American Counsel of Life Insurers, the American Insurance Association, and the National Business Coalition on E-Commerce and Privacy. 2 In June of this year, the Circuit Court held that the sharing of certain information among affiliates is, in fact, preempted by federal law. 2 In particular, the Circuit Court held that the California law: . . . is preempted to the extent that it applies to information shared between affiliates concerning consumers' credit worthiness, credit standing, credit capacity, character,

general reputation, personal characteristics, or mode of living that is used, expected to be used, or collected for the purpose of establishing eligibility for credit or insurance, employment, or other authorized purpose. The Circuit Court remanded the case back to the District Court to determine whether it was possible to sever the preempted affiliate-sharing provisions from the California law consistent with the above holding. On remand, the Circuit Court determined the law cannot be severed and enjoined the State from enforcing its affiliate-sharing provisions. In determining that no portion of the law's affiliate-sharing provisions could be enforced, the District Court expressed concern with the "cloud of uncertainty" that would arise if certain of the law's affiliate-sharing provisions were preserved while others, due to the federal preemption, were unenforceable. According to the District Court, this cloud of uncertainty might result in financial institutions that share information with affiliates being in the untenable situation of either risking violation of the California law or complying with the law when not required to do so. Tamara K. Salmon Senior Associate Counsel Attachment (in .pdf format) Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (<http://members.ici.org>) and search for memo 19224, or call the ICI Library at (202) 326-8304 and request the attachment for memo 19224. 2 See Institute Memorandum to Chief Compliance Officer Committee No. 49-05, Compliance Advisory Committee No. 44-05, Primary Contacts – Member Complex No. 27-05, Privacy Issues Working Group No. 3-05, Small Funds Members No. 59-05, and Technology Advisory Committee No. 13-05 [No. 18968], dated June 22, 2005.

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