

Privacy Peril: Illinois Requires Borrowers to Ask Permission to Obtain Mortgage

By: Laurence E. Platt

BNA's Banking Report, August 8, 2005





BANKING REPORT



Reproduced with permission from BNA's Banking Report, Vol. 85, No. 6, 8/08/2005. Copyright © 2005 by The Bureau of National Affairs, Inc. (800-372-1033) <http://www.bna.com>

Privacy Peril: Illinois Requires Borrowers to Ask Permission to Obtain Mortgage

By LAURENCE E. PLATT, ESQ.

Years ago, I challenged a state regulator's after-the-fact claim that a debt consolidation loan was not in the borrower's interest because in her view it never made sense to convert unsecured credit card debt into a secured, home equity loan. A perfectly rational economic choice, I thought, but her view was neither the law nor a public policy previously articulated by the state.

In a somewhat sarcastic tone, I suggested that the state establish a toll free number, 1-800-CALL PAM, so mortgage lenders could determine in advance whether the state thought it was prudent to make a loan. Missing the sarcasm, she explained that the state had insufficient resources to fund such a worthy initiative.

I am reminded by this story as I read the new Illinois law that requires a lender to furnish a state regulator with the confidential, personal financial information of any loan applicant living in a certain geographic area within Chicago so the state can assess whether the applicant needs credit counseling prior to consummating the loan transaction. The Illinois legislature chose not to articulate any specific standards by which this judgment should be made; it instead delegated this duty to a state agency without any legislative direction.

Nor did the legislature explain what should happen if the borrower chose not to follow the advice of the credit counselor. Rather, the legislature merely mandated the

disclosure to the state of confidential, personal financial information, without an applicant's advance consent; the state would review the information against these undisclosed standards and determine whether the borrower perhaps had made a mistake.

Major Shift. However laudable the public policy purpose may be to protect consumers against bad choices, the new law marks a major shift in thinking about the proper role of government in protecting its citizenry. For years, both the federal government and many state governments thought it was essential to protect the privacy rights of individuals against the unwarranted intrusion of the government snooping around their personal lives.

Certainly, the government always retained the right to pursue its law enforcement responsibilities, subject to certain procedural protections. If the activity were not otherwise illegal, however, the government would not inject itself into the middle of the consumer's decision making process. The purpose of this article is to demonstrate how the new Illinois law is at odds with the longstanding public policy of promoting the privacy rights of individuals.

Background:

The Illinois General Assembly passed H.B. 4050 on May 31, 2005, and Governor Rod Blagojevich signed it into law on July 21, 2005. This law, which goes into effect in January 2006, establishes a predatory lending database program for a probationary period of four years within a "pilot program area." Within this pilot area, brokers, originators, credit counselors, title companies and closing agents will be required to disclose personal information of every loan applicant to the

Laurence E. Platt, Esq. is a partner at Kirkpatrick & Lockhart Nicholson Graham LLP. Sarah Markwood, a summer associate, helped prepare this article.

State Department of Financial and Professional Regulation (the "Department"), without the advance consent of the loan applicant.

The Department then will determine whether the broker or lender is required to refer the applicant to mandatory credit counseling to be funded by the broker or lender. The law is silent on whether a lender can proceed to make a loan on the originally proposed terms if the borrower elects to reject the advice of the credit counselor.

It is interesting to analyze this new law against the backdrop of other laws that prohibit the government from accessing the personal financial records of individuals outside of a law enforcement context. Other than the new terrorism initiatives, such as the Patriot Act, the federal Right to Financial Privacy Act ("RFPA"), enacted by Congress in 1978, is the principal law limiting the ability of the federal government to require financial institutions to furnish confidential, personal financial information about its customers without the customer's consent. Illinois has a law on the books for 50 years that achieves a similar result.

Right to Financial Privacy Act

In an attempt to protect consumer's privacy, Congress passed the RFPA in 1978 to create a statutory protection for bank records and guard the confidentiality of personal financial records of individuals. The RFPA was a response to the United States Supreme Court's ruling in *United States v. Miller*, 425 U.S. 435 (1976). In *Miller*, the Court held that a financial institution has property rights in its customers' financial records and a customer does not have a constitutional privacy interest in those records. Under this ruling, a bank customer had no standing to object to the disclosure of his or her records to the government. After this ruling, Congress sought to provide some protection for the privacy of customers' financial records and created the RFPA.

The basic provision of the RFPA states that "no Government authority may have access to or obtain copies of, or the information contained in the financial records of any customer from a financial institution unless the financial records are reasonably described" and

- the customer authorizes access;
- there is an administrative subpoena or summons that meets the necessary requirements of the RFPA;
- there is a search warrant that meets the necessary requirements of the RFPA;
- there is a judicial subpoena that meets the necessary requirements of the RFPA; or
- there is a formal written request that meets the necessary requirements of the RFPA.

Under RFPA, customers must be provided with advance notice of the requested disclosure to enable the customer to challenge the government's access to the records. It is notable that law enforcement is the only permitted purpose under RFPA for the government to obtain the confidential, personal information of a bank's customers.

Neither the explicit provisions of RFPA nor the debates surrounding its enactment give the government a right to force a financial institution to disclose its customers confidential information based on the government's claim that it desires to help the customer.

¹ 1 H.R. REP. NO. 95-1383, at 34 (1978).

² 2 See 12 U.S.C. § 3401 (1978).

The intent of Congress in enacting the RFPA demonstrates the importance of protecting individuals from required disclosures of personal, financial information. Through the reports, hearings and debates surrounding the enactment of the RFPA, members of Congress and experts expressed concern for protecting individuals against this invasion of privacy.

Report on Financial Institutions Regulatory Act of 1978.

The House Committee on Banking, Finance and Urban Affairs submitted a report on the Financial Institutions Regulatory Act of 1978 to discuss both the history of the Act and the need for the legislation. The purpose of RFPA, Title XI of the Financial Institutions Regulatory Act, was "to protect the customers of financial institutions from unwarranted intrusion into their records while at the same time permitting legitimate law enforcement activity."³

The RFPA sought to create a balance so that law enforcement officials could still gather the information necessary in their investigations. Under the report's analysis, if the information was necessary for these investigations, the RFPA permitted disclosure following the required procedural steps. The RFPA's purpose of maintaining a cooperative atmosphere for "legitimate law enforcement purpose" was constant throughout the legislation.⁴ Instead of inhibiting these inquiries, the goal was to restrict the intrusions that had no proper investigative purpose and were an invasion of a person's privacy.

The interest in protecting the customers' privacy rights was so great that over 100 privacy bills were introduced during the 95th Congress. Many of these bills were based on the Privacy Protection Study Commission's determination that there was a need for an overhaul of national privacy laws.⁵ The Commission further concluded that the "flow of information within government was relatively unrestricted" and "individuals have little, if any, power to protect themselves from improper use of disclosure within Government."⁶ Id.

Federal agencies can obtain with ease an individual's personal information from other agencies that it would not be able to obtain directly from an individual. While the commission recognized that law enforcement officers need to be able to acquire certain information in an informal manner, the commission also sought to limit the ease with which some agencies collect personal information.

Senate Financial Institutions Subcommittee Hearings.

The hearings during June 16-17, 1976, before the Senate Subcommittee on Financial Institutions of the Committee on Banking, Housing and Urban Affairs, permitted other individuals and organizations to voice their concerns about individuals' privacy interests. Hope Eastman, associate director of the National Office of the American Civil Liberties Union, spoke on behalf of bank customers about the expectation for information disclosed to banks to remain private from the government.

³ 3 H.R. REP. NO. 95-1383, at 33 (1978).

⁴ 4 *Id.* at 51.

⁵ 5 *Id.* at 244-45.

⁶ 6 *Id.* at 245.

⁷ 7 See Right to Financial Privacy Act: Hearing on S. 1343 Before the Senate Comm. on Banking, Housing and Urban Affairs, 94th Cong. 163 (1976) (statement of Hope Eastman).

Eastman detailed the grave concern consumers have about personal information held by the bank being obtained by the government. In showcasing the ACLU's support of the RFPA, Eastman stated that there is an "urgent need" to create a safeguard so personal information remains private and protected. Eastman believed that legislative action, and not a judicial decision, was the proper method of ensuring this consumer privacy. Another argument included in Eastman's statement was the need to protect each person's privacy as the reliance on financial institutions grew to become a common occurrence in the modern era.

A.A. Milligan, President-Elect of American Bankers Association, also discussed the need for protecting his customers' rights.⁹ Milligan argued that the enactment of the Bank Secrecy Act of 1970 resulted in a loss of privacy rights, and this loss must now be corrected through the RFPA. He stated, "Looking back, we might wish we had argued more vocally and effectively for our customers' rights." *Id.* Milligan also quoted Rex Morthland, a man who represented the ABA at an Aug. 14, 1972, hearing on the possible amendment of the Bank Secrecy Act:

"The right of privacy in connection with one's financial transactions is an essential part of our American system of values and is protected by our Constitution and laws. . . . We are convinced the respect for privacy and assurance of confidentiality are essential to the reputation of any bank with its customers."¹⁰

A statement by the U.S. League of Savings Associations and the California Savings and Loan League also stressed the importance of maintaining privacy of the customers' records by acknowledging that customers expect their records to be treated with confidentiality.¹¹ The leagues asserted that the "greatest threat to the privacy of customer records is . . . posed by . . . the many statutory requirements and mandates of government agencies with investigatory authority who dictate that associations maintain and provide such records and information."¹²

Harold W. Greenwood, Jr., representing the National Savings and Loan League, provided another testimony on the importance of confidentiality between loaners and customers.¹³ His statement claimed that the savings and loan industry, one that is built on trust and reliability, is unduly pressured by the government to provide customer records and violate that trust.¹⁴ After the ruling in *Miller*, Greenwood maintained that there needs to be proper control measures in place to prevent an abuse of individuals' privacy rights and to limit the large expenses incurred by the savings and loan industry.

House Floor Debate of the Enactment of the RFPA. The actual discussion and debate of the RFPA, as detailed in the Congressional Record, described the RFPA's purpose of providing the customers of financial institutions

a legitimate expectation of privacy.¹⁶ Congress viewed the act as a "major step forward in the protection of citizens' rights to privacy."¹⁷ Furthermore, both the original authors of the act and the congressmen supporting amendments to the act agreed that individual bank records must have certain, fundamental privacy rights.¹⁸

Representative Pattison also expressed the greater need for protection of these privacy rights as a result of individuals keeping personal records at banks and other financial institutions instead of at home where they had possession of the records.¹⁹ The safeguard of actual possession no longer existed. He then discussed how the Miller decision contributed to the need for individuals to have protection and remedies available to them.²⁰

After the Miller ruling that customers have no standing to prevent disclosure of their financial records held by a financial institution, customers needed a remedy against the government's acquirement of their records. As Representative Rousselot stated, "The [RFPA] gives us hope. It promises to reverse the processes that threaten so fundamental a value. It will restore confidence in the American people that the Government is there to help them, not to monitor them."²¹

With this analysis of the fundamental policies behind the RFPA, Congress' concern for the privacy of customers of financial institutions is evident.

Illinois Banking Act

RFPA is a federal law, and its prohibitions only apply to the federal government. The Illinois legislature created the Illinois Banking Act ("Act") in 1955 to restrict the personal information financial institutions may disclose about its customers.²² The Act provides similar protections as found in the RFPA to Illinois citizens in state actions. The Act does not permit a bank to disclose any financial records or financial information obtained from financial records of a customer of the bank unless:

- the customer authorized the disclosure;
- the records are disclosed pursuant to a lawful subpoena, summons, warrant or court order that meets the necessary requirements of the Act; or
- the bank is seeking to collect an obligation and is complying with fraud provisions of the Consumer Fraud and Deceptive Business Practices Act.

The Act does include exceptions to this general provision that permit the disclosure of documents in certain situations. The only exception permitting disclosure to the government, other than the exceptions to facilitate the government's law enforcement functions, is the exception to allow the government to perform its general supervision and audit of the bank.

There is no exception that requires a bank to furnish the government with confidential, personal financial information without the customer consent so that the government is able to determine the wisdom of certain

⁸ 8 *Id.*

⁹ 9 See Right to Financial Privacy Act, 94th Cong. 47 (statement of A.A. Milligan, president-elect, American Bankers Association).

¹⁰ 10 *Id.*

¹¹ 11 Right to Financial Privacy Act, 94th Cong. 58.

¹² 12 *Id.* at 59.

¹³ 13 Right to Financial Privacy Act, 94th Cong. 100.

¹⁴ 14 *Id.*

¹⁵ 15 *Id.*

¹⁶ 16 124 CONG. REC. H11418 (daily ed. Oct. 3, 1978) (statement of Rep. Rousselot).

¹⁷ 17 *Id.* at H11417 (statement of Rep. Whalen).

¹⁸ 18 124 CONG. REC. H11730 (daily ed. Oct. 5, 1978) (statement of Rep. Pattison).

¹⁹ 19 *Id.*

²⁰ 20 *Id.* at H11731.

²¹ 21 *Id.*

²² 22 See 205 Ill. Comp. Stat. Ann. 5/48.1 (West 2005).

transactions.²³ While it would appear that the new Illinois law on credit counseling would supersede the provisions of the Act, the legislature did not explicitly amend the Act and its terms would appear to prohibit the disclosures required under the new law.

Even though the Illinois Banking Act existed before the RFPA was enacted in 1978, like RFPA, it addresses the need for protecting individuals from unnecessary disclosures of personal information. Based on a review of its provisions, the underlying policies of the Illinois Banking Act appear to be the same as those of RFPA.

Conclusion

The enactment of the new credit counseling law marks a material departure from the way both Congress and the Illinois legislature have addressed the protection of a consumer's confidential, personal financial information. Existing law sharply limits the purpose for which the government can access the information provided to a financial institution for a private transaction. Other than for law enforcement purposes or national security, the government has had no right to force private parties to turn over information about

their customers without the prior approval of the customers.

The interest of the government to protect the health and safety of its citizenry is no greater today than the time of the enactment of the RFPA and the Illinois Banking Act. It would have been easy at that time to provide a generalized exception permitting the government to obtain a consumer's confidential, personal financial information without the consumer's advance consent in order to protect the consumer. On the contrary, both Congress and the Illinois legislature were more concerned about unwarranted intrusion by the government when it acted without the consumer's consent and there was no allegation of a legal violation.

Protecting an individual by invading his or her privacy is a scary proposition. If replicated by others, the new Illinois law portends a 1984-type environment where the government will not tell you in advance which rules apply, but will feel free to access your confidential, personal financial records to determine after the fact if you lacked the capacity to make what it then perceives to be wise choices. Like the state official with whom I tussled several years ago, perhaps Illinois should initiate a new toll free number, 1-800-CALL ROD, to enable borrowers to ask permission to obtain a home loan. Remember to say "pretty please."

²³ 23 See 205 Ill. Comp. Stat. Ann. 5/48.1(b). [See 205 Ill. Comp. Stat. Ann. 5/48.1(b).

MORTGAGE BANKING/CONSUMER FINANCE PRACTICE

Kirkpatrick & Lockhart Nicholson Graham LLP has approximately 1,000 lawyers who practice in offices located in Boston, Dallas, Harrisburg, London, Los Angeles, Miami, Newark, New York, Palo Alto, Pittsburgh, San Francisco, and Washington. K&LNG represents entrepreneurs, growth and middle market companies, capital markets participants, and leading FORTUNE 100 and FTSE 100 global corporations, nationally and internationally.

For more information, please visit our website at www.klng.com or contact one of the lawyers listed below.

ATTORNEYS

Laurence E. Platt	202.778.9034	lplatt@klng.com
Phillip L. Schulman	202.778.9027	pschulman@klng.com
Costas A. Avrakotos	202.778.9075	cavrakotos@klng.com
Melanie Hibbs Brody	202.778.9203	mbrody@klng.com
Steven M. Kaplan	202.778.9204	skaplan@klng.com
Jonathan Jaffe	415.249.1023	jjaffe@klng.com
H. John Steele	202.778.9489	jsteele@klng.com
R. Bruce Allensworth	617.261.3119	ballensworth@klng.com
Daniel J. Tobin	202.778.9074	dtobin@klng.com
Nanci L. Weissgold	202.778.9314	nweissgold@klng.com
Phillip John Kardis II	202.778.9401	pkardis@klng.com
Stephen E. Moore	617.951.9191	smoore@klng.com
Stanley V. Ragalevsky	617.951.9203	sragalevsky@klng.com
David L. Beam	202.778.9026	dbeam@klng.com
Emily J. Booth	202.778.9112	ebooth@klng.com
Krista Cooley	202.778.9257	kcooley@klng.com
Eric J. Edwardson	202.778.9387	eedwardson@klng.com
Suzanne F. Garwood	202.778.9892	sgarwood@klng.com
Anthony C. Green	202.778.9893	agreen@klng.com
Laura A. Johnson	202.778.9249	laura.johnson@klng.com
Kris D. Kully	202.778.9301	kkully@klng.com
Drew A. Malakoff	202.778.9086	dmalakoff@klng.com
Christopher G. Morrison	202.778.9245	chris.morrison@klng.com
Erin Murphy	415.249.1038	emurphy@klng.com
Lorna M. Neill	202.778.9216	lneill@klng.com
Stephanie C. Robinson	202.778.9856	srobinson@klng.com
Holly M. Spencer	202.778.9853	hspencer@klng.com

DIRECTOR OF LICENSING

Stacey L. Riggan	202.778.9202	sriggan@klng.com
------------------	--------------	--

REGULATORY COMPLIANCE ANALYSTS

Dana L. Lopez	202.778.9383	dlopez@klng.com
Nancy J. Butler	202.778.9374	nbutler@klng.com
Joelle Myers	202.778.9093	jmyers@klng.com
Marguerite T. Frampton	202.778.9253	mframpton@klng.com
Jeffrey Prost	202.778.9364	jprost@klng.com
Allison A. Rosenthal	202.778.9894	arosenthal@klng.com
Jonathon P. Schuster	202.778.9883	jschuster@klng.com
Brenda R. Kittrell	202.778.9049	bkittrell@klng.com
Joann Kim	202.778.9421	jkim@klng.com
Teresa Diaz	202.778.9852	tdiaz@klng.com
Robin L. Dinneen	202.778.9481	rdinneen@klng.com
Danielle M. Taylor	202.778.9058	dtaylor@klng.com

Kirkpatrick & Lockhart Nicholson Graham (K&LNG) has approximately 1,000 lawyers and represents entrepreneurs, growth and middle market companies, capital market participants, and leading FORTUNE 100 and FTSE 100 global corporations in every major industry, nationally and internationally.

K&LNG is a combination of two limited liability partnerships, each named Kirkpatrick & Lockhart Nicholson Graham LLP, one qualified in Delaware, U.S.A. and practicing from offices in Boston, Dallas, Harrisburg, Los Angeles, Miami, Newark, New York, Palo Alto, Pittsburgh, San Francisco and Washington and one incorporated in England practicing from the London office.

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

Data Protection Act 1998— We may contact you from time to time with information on Kirkpatrick & Lockhart Nicholson Graham LLP seminars and with our regular newsletters, which may be of interest to you. We will not provide your details to any third parties. Please e-mail egregory@klng.com if you would prefer not to receive this information.

© 2005 KIRKPATRICK & LOCKHART NICHOLSON GRAHAM LLP. ALL RIGHTS RESERVED.



www.klng.com

BOSTON • DALLAS • HARRISBURG • LONDON • LOS ANGELES • MIAMI • NEWARK • NEW YORK • PALO ALTO • PITTSBURGH • SAN FRANCISCO • WASHINGTON

