NATIONAL RETAIL FEDERATION

The National Retail Federation's
Protecting Privacy in the New Millennium Series

PUTTING PEOPLE FIRST: CONSUMER BENEFITS OF INFORMATION-SHARING

Fred H. Cate
Michael E. Staten

EXECUTIVE SUMMARY

Information is the lifeblood of our 21st century economy; the flow of information is essential to providing the services, products, convenience, safety, accessibility, recognition, and low costs that consumers expect and demand. Information-sharing is essential to:

1. Identify and Meet Individual Needs—According to Federal Reserve Board Governor Edward Gramlich, "Information about individuals' needs and preferences is the cornerstone of any system that allocates goods and services within an economy." The more such information is available, he continued, "the more accurately and efficiently will the economy meet those needs and preferences."[1]

2. Increase Efficiency and Lower Prices—Information-sharing plays a significant role in reducing the prices that consumers pay for goods and services and in expanding the range and affordability of methods of paying for them.

3. Enhance Customer Convenience—Widespread information-sharing provides consumers with unprecedented convenience, and greatly enhances the speed with which decisions can be made and services provided. Thanks to the routine collection and use of information about transactions and accounts, customers:

- can now return merchandise at many retailers without a receipt because of the retailer's ability to look up the original sale in its own records;
- who forget their store credit card can, with proper identification from the customers, now access that information at the point of sale;

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[1]Financial Privacy, Hearings Before the Subcomm. on Financial Institutions and Consumer Credit of the House Comm. on Banking and Financial Services, 106th Cong. (1999) (statement of Edward M. Gramlich).

- can also order supplies and replacement parts without knowing an exact model number; the retailer can simply look up the past transaction and obtain the needed information;
- receive discounts and even free merchandise because the retailer tracks their purchases and rewards frequent shoppers;
- enjoy the recognition and other benefits of customer loyalty programs even when shopping in different stores or even different retail chains;
- never have to be asked for the same information—mailing address, clothing size, or credit card number—twice; and
- can obtain information about past purchases for insurance claims when fire or other disasters destroy or damage those goods.

4. Inform Customers of New Opportunities—Information-sharing allows consumers to be informed rapidly and at low cost of those opportunities in which we are most likely to be interested. Less information means more marketing solicitations, greater inconvenience, higher prices, and less choice.

5. Expand Access to Services and Products—Accessible personal information gives U.S. consumers unprecedented access to goods, services, and the means to pay for them. It has increased the number of Americans who now qualify for credit and other services, and spurred competition in the market to service those consumers. In our highly mobile and increasingly global society, information-sharing facilitates consumer mobility and creates a democratization of opportunity.

6. Detect and Prevent Fraud and Other Crimes—Personal information is one of the most effective tools for stemming losses due to fraud and identity theft. Many consumers report that the first warning they receive about credit card fraud comes not from law enforcement authorities, but from a retailer or other business that detected an odd pattern of charging activity. Personal information is also essential to preventing, detecting, and solving other crimes and improving the public welfare, for example, by locating and contacting missing family members, heirs to estates, pension fund beneficiaries, witnesses in criminal and civil matters, tax evaders, and parents who are delinquent in child support payments.

To provide all of these and other benefits, access to data is essential. Laws restricting that access make the provision of many valuable services, and the convenience and benefits they provide, untenable. In the words of Alabama Attorney General Bill Pryor, it is consumers who ultimately pay the price for new privacy laws "in terms of either higher prices for what they buy, or in terms of a restricted set of choices offered them in the marketplace."[2]

Personal information constitutes a critical part of this nation's "essential infrastructure," and, like other parts of our national infrastructure, we tend to take the information infrastructure for granted, until we are faced with the daunting prospect of learning to live without the many

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[2]Bill Pryor, Protecting Privacy: Some First Principles, Remarks at the American Council of Life Insurers Privacy Symposium, July 11, 2000, Washington, DC, at 4.

benefits that flow from it. Given the extraordinary range and value of those benefits—the service, convenience, access, recognition, affordable prices, and opportunities that we have come to expect—we should hesitate before we restrict it even for the most apparently worthwhile purpose.

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PUTTING PEOPLE FIRST: CONSUMER BENEFITS OF INFORMATION-SHARING

Fred H. Cate[1]
Michael E. Staten[2]

Proponents of greater government privacy protection often characterize the privacy debate in terms of consumers versus businesses. They argue that information flows harm consumers and so should be stopped by new legislation and regulation. This is not merely inaccurate, it misses the point entirely about the role of information and privacy in our modern economy. Information is the lifeblood of our 21st century economy; the flow of information is essential to providing the services, products, convenience, safety, accessibility, recognition, and low costs that consumers expect and demand.

Restricting information flows to protect privacy always, inevitably interferes with those consumer benefits and imposes demonstrable costs, to be sure, on businesses and the economy as a whole, but primarily on individual consumers and citizens. The real tension in the current privacy debate isn't between consumers and businesses, but rather between consumers' desire for greater privacy and our desire for the many benefits that flow from readily accessible personal information, benefits which new government privacy protections inherently interfere.

This paper examines the range of benefits that flow from the responsible use of information, and the interference with those benefits and other costs imposed by laws that restrict the flow of information in an effort to protect privacy.

1. Identify and Meet Individual Needs

Information is used to identify and meet customer needs. Businesses do not automatically know which products and services consumers want; frankly, often neither do consumers.

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[1]Professor of Law, Harry T. Ice Faculty Fellow, and Director of the Information Law and Commerce Institute, Indiana University School of Law—Bloomington. This paper is published by the National Retail Federation as part of its Protecting Privacy in the New Millennium series. For additional information or to order additional copies, contact the National Retail Federation, Attn: Privacy Project, 325 7th Street, N.W., Suite 1100, Washington, DC 20004, tel. (202) 783-7971, fax (202) 737-2849, privacy@nrf.com.

[2]Distinguished Professor and Director of the Credit Research Center, The Robert Emmett McDonough School of Business, Georgetown University.

Because information about the purchases that consumers *actually* make and services that we *actually* use is routinely collected and analyzed, consumers are offered products and services that respond to our demonstrated needs and desires. This greatly reduces the cost of developing those products and services and the risk that they will not respond to consumer demand, thereby greatly reducing the price that consumers pay for them, and virtually eliminating the inconvenience and delay associated with stopping consumers to ask about likely preferences.

Federal Reserve Board Governor Edward Gramlich put it this way in testimony before Congress in July 1999: "Information about individuals' needs and preferences is the cornerstone of any system that allocates goods and services within an economy." The more such information is available, he continued, "the more accurately and efficiently will the economy meet those needs and preferences."[3] Thanks to widespread, responsible information-sharing, businesses create and stock the right goods at the right time in the right place.

2. Increase Efficiency and Lower Prices

Information-sharing plays a significant role in reducing the prices that consumers pay for goods and services. For example, because widely available consumer information allows manufacturers, wholesalers, and retailers to know what to make, what to stock, and when, it reduces the costs of excess inventory and outdated stock. As Federal Reserve Board Chairman Alan Greenspan has noted: "[T]he recent years' remarkable surge in the availability of real-time information has enabled business management to remove large swaths of inventory safety stocks and worker redundancies, and has armed workers with detailed data to fine tune product specifications to most individual customer needs."[4]

In addition, the sharing of reliable, centralized, and standardized consumer information also makes it possible to reduce the cost of providing a variety of means by which consumers can pay for the products and services they want. Such information is the very foundation of consumer credit from banks and retailers, instant credit at point of sale, and many deferred payment programs. Because that information is collected routinely and automatically (under the rules of the Fair Credit Reporting Act)—the average adult American's credit bureau file is updated *five times a day*—it creates a ready reliable source of information on which the consumer can draw when he or she applies for credit or a loan or mortgage. Because readily accessible, reliable information allows for more accurate assessment of risk, it contributes to lower priced credit and fewer defaults by borrowers.

In addition, because the risk can be quickly identified at relatively small cost it is possible to bundle together large pools of consumer loans and then sell them to investors. This process—known as securitization—has brought hundreds of billions of dollars in new capital into lending markets and ultimately into the hands of consumers. The influx of new capital

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[3]Financial Privacy, Hearings Before the Subcomm. on Financial Institutions and Consumer Credit of the House Comm. on Banking and Financial Services, 106th Cong. (1999) (statement of Edward M. Gramlich).

[4]Remarks by Alan Greenspan at the Conference on Bank Structure and Competition of the Federal Reserve Bank of Chicago, Chicago, IL (May 6, 1999).

greatly reduced the cost of credit to consumers and made broader access more affordable. Today, more than 30 percent of all consumer loans are securitized. As a result, American consumers save as much as *$80 billion a year* on mortgage loans because of the liquidity that credit bureau information makes possible.[5] Moreover, shared personal information also reduces the cost of products and services by reducing the risks of accepting checks and other non-cash payments.

Information-sharing also allows consumers to benefit from the economic efficiency of organizations outsourcing many basic business operations to third parties. Many businesses outsource marketing, account management, customer satisfaction surveying, and other activities to third parties that specialize in these activities and maintain the infrastructure necessary to perform them efficiently and accurately. These relationships are not always obvious. For example, many retailers provide specialty services and products, such as fine jewelry, photographic studios, vision services, or hair care, through independent companies that license the retailer's name, but are not the retailer's affiliates. By taking advantage of the efficiency that comes with specialization, retailers offer consumers the specialized services and products we want, but at a far lower cost than would otherwise be possible.

3. Enhance Customer Convenience

Widespread information-sharing provides consumers with unprecedented convenience. In the specialty service context, open information-sharing means that independent companies provide services to customers under the retailer's name, accept the retailer's credit card, include information and coupons in the retailer's mailings and advertisements, participate in the retailer's loyalty programs, and, from a customer perspective, are simply another department of the retailer's operations.

Information-sharing greatly enhances the speed with which decisions can be made. This is particularly important in retail settings, where credit products of many forms make it possible for consumers to purchase the goods and services we need when we need them. In 1997, 82 percent of automobile loan applicants received a decision within an hour; 48 percent of applicants received a decision within 30 minutes.[6] Many retailers open new charge accounts for customers at the point of sale in less than two minutes, provided that the customer shows appropriate identification. While instant credit and the flexibility it provides are critical services provided by many retailers in the United States, they are unheard of outside of the United States. In other countries, restrictive laws often prevent credit bureaus and other businesses from routinely collecting information from many sources on myriad aspects of consumer activities to maintain the accurate, up-to-date files necessary to support rapid and accurate decision making.

The sharing of personal information is essential to the convenience of one-stop-shopping and service. Among the most common customer requests is the demand for consolidated, simplified access to information about our accounts. Consumers want to call a single telephone

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[5]Walter F. Kitchenman, *U.S. Credit Reporting: Perceived Benefits Outweigh Privacy Concerns* 7 (The Tower Group 1999).

[6]*1998 Automobile Finance Study,* Consumer Bankers Association, Arlington, VA, at 19.

number and receive a single monthly statement updating them about all of our dealings—whether relating to credit, loyalty programs, warranties, or other services—provided by a retailer or other business. We want to update information (for example, mailing address) across companies with a single call or letter. To respond to this persistent demand requires that the diverse affiliates through which a single company offers services be able to communicate customer information with each other. It also requires information-sharing across companies, for example, when a customer wishes to use a store charge card at a jewelry counter or other specialty service provider that is housed, but not owned, by the store issuing the card. Because of that information-sharing, customers today enjoy the convenience of being able to arrange for the purchase, delivery, installation, and maintenance of a product with a single visit or call, and of being able to pay for all four services with one credit card or check.

Thanks to the widespread, routine collection and storage of information about transactions and accounts, customers:

- can now return merchandise at many retailers without a receipt because of the retailer's ability to look up the original sale in its own records;
- who forget their store credit card can, with proper identification from the customers, now access that information at the point of sale;
- can also order supplies and replacement parts without knowing an exact model number; the retailer can simply look up the past transaction and obtain the needed information;
- receive discounts and even free merchandise because the retailer tracks their purchases and rewards frequent shoppers;
- enjoy the recognition and other benefits of customer loyalty programs even when shopping in different stores or even different retail chains;
- never have to be asked for the same information—mailing address, clothing size, or credit card number—twice; and
- can obtain information about past purchases for insurance claims when fire or other disasters destroy or damage those goods.

All of these benefits depend upon the routine collection and sharing of information, because the required data may have been collected in another location, or by an affiliate, or by a third-party altogether. Moreover, in each of these practical, everyday examples, the customer would not likely have anticipated in advance that he or she would need the information from the retailer. Few of us anticipate needing past purchase information in case a fire destroys our home or we need to someday buy a battery or replacement part. Yet we are exceptionally grateful when we learn that the information is accessible to us when the need arises.

4. Inform Customers of New Opportunities

Information-sharing allows consumers to be informed rapidly and at low cost of those opportunities in which we are most likely to be interested. A customer who buys a television can receive information on VCRs. A customer who wears a certain brand of clothes can be notified when a new shipment arrives. Customers who only shop when goods are on sale can be given advance notice of a sales event. Frequent shoppers in one store today even receive discounts and advance notice of sales and other opportunities and recognition from other companies because of widespread information-sharing.

We often forget that once a business has developed a new product or service, it must inform potential customers. The ready availability of basic, personal information about consumers' demonstrated interests means that people most likely to be interested can receive the news; other people don't have to be troubled with mail or calls informing them of information that isn't relevant to them; and we all benefit from the lower costs and diminished environment impact that "target marketing" makes possible.

In a nation with over 100 million households, target marketing reduces the prices that consumers pay for products because it dramatically reduces the cost of soliciting customers by raising the likelihood that the consumer receiving the message will actually be interested in the service or product. Consumers need information about products and services and businesses must advertise, whether or not they have information about who is likely to be a customer. Targeted marketing reduces those advertising costs relative to mass marketing. Target marketing also reduces the volume and cost of so-called junk mail and enhances consumer satisfaction by increasing the chance that the mail and calls we receive are actually of interest. And it increases choice in the market, because the cost of alerting consumers about a new product or opportunity can be a major obstacle to the launch of new businesses and prevent innovative products from ever reaching the marketplace.

Less information-sharing means less informed consumers, more marketing solicitations, greater inconvenience, higher prices, and less choice.

5. Expand Access to Services and Products

Comptroller of the Currency John Hawke, Jr. testified before Congress in 1999 that information exchanges serve a "useful and critical market function" that benefits consumers and businesses alike."[7] Consumer credit markets provide a case in point. The current U.S. economic boom has significantly raised the standard of living for U.S. citizens through the availability of over $5 trillion in outstanding mortgages and other consumer loans. Consumer credit finances homes and cars, funds college educations, and provides the credit cards that consumers use everyday to purchase goods and services. The "almost universal reporting" of personal credit histories (under the rules of the Fair Credit Reporting Act) is, in the words of economist Walter Kitchenman, the "foundation" of consumer credit in the United States and a "secret ingredient of the U.S. economy's resilience."[8]

Studies have shown that the comprehensive credit reporting environment in this country has given U.S. consumers access to more credit, from a greater variety of sources, more quickly, and at lower cost than consumers anywhere else in the world.

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[7]Financial Privacy Hearings, supra (statement of John D. Hawke, Jr.).

[8]Kitchenman, supra at 1.

Computerized credit histories have made it possible to store and instantaneously retrieve many years of payment history for over 200 million adult residents in the U.S. Over 2 million credit reports are delivered by the three major national credit reporting agencies each day to facilitate the consumer-initiated transactions. The availability of complete, reliable credit histories and the national sharing of personal information have greatly increased both the range and sources of services to which each consumer has access. As a result, the typical U.S. household has more than twelve retail banking products scattered across more than six different financial institutions.

More complete, reliable, and widely available personal information also has increased the number of Americans who now qualify for credit and other services, and increased the confidence of service providers in meeting the needs of this previously underserved population. Thanks to readily available credit information, over the past two generations, millions of Americans have gained access to credit to enable them to purchase homes and raise their standard of living. In 1956 about 24 percent of U.S. households (13 million) had mortgage loans. By 1998 over 43 percent of households (44 million) had home mortgage loans, and the percent of the U.S. population owning their own homes reached an all-time high. The same story has unfolded for credit card products, but in a shorter time period. Between 1983 and 1998 every household income grouping enjoyed substantially improved access to the versatile "bank card" product. Over 25 million more households owned a bank card in 1998 than was the case just 15 years earlier. In our highly mobile and increasingly global society, information-sharing facilitates consumer mobility and creates a democratization of opportunity.

Responsible information-sharing expands consumer access to products and services in another important way. It allows new market entrants, which cannot afford mass market advertising and lack the customer lists of their well-established competitors, the ability to offer reach those people most likely to be interested. Just look at the marketing practices of companies like America Online, which achieved its current status as an Internet powerhouse because, as a start-up company, it mailed free copies of its software to people likely to be interested in Internet access. Prohibiting the sharing of basic information or requiring affirmative consumer consent before the software could have been sent would have denied consumers information about an opportunity that many of them obviously value, while *increasing* the volume of marketing material that AOL would have been required to distribute. All to avoid what—an unsolicited piece of mail?

Equally important, information sharing makes it possible for businesses—new or established—to enter new markets often with dramatically beneficial results for consumers. The credit card industry provides some of the most spectacular examples of the benefits to consumers made possible because information-sharing allowed new entry into the market. Beginning in 1985, existing retailers and manufacturers began introducing their own bank credit cards, many of 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—something Visa and MasterCard had never offered. Thanks to the success of those new market entrants, no-annual-fee cards and cards offering consumers rebates, frequent traveler miles, and many other benefits are commonplace.

What made these cards successful and allowed them to offer the public not only new choices, but also a range of new benefits, was the availability of information about consumers. The companies offering these cards drew on information about their existing customers and credit bureau data under the rules established by the Fair Credit Reporting Act to identify creditworthy consumers. Tens of millions of consumers were delighted to be offered new lower-cost, greater-benefit cards and opened accounts. Those consumers who chose not to open accounts simply discarded the offer. More significantly, hundreds of millions of consumers benefited by these new cards' transforming effect on the market. Such a rapid and dramatic impact on the marketplace would not have been possible without the ability to share information across affiliated companies. Open information flows allowed these new cards to fundamentally alter the competitive landscape and pricing in a market that had been dominated for decades by established commercial banks.

6. Detect and Prevent Fraud and Other Crimes

One final example of a key use of personal information is to prevent and detect fraud. More than 1.2 million worthless checks are cashed at retailers, banks, and other U.S. businesses every day, accounting for $12.6 billion in losses. Treasury Department officials estimate credit card fraud losses to be between $2 billion and $3 billion in 2000. The insurance industry paid $20 billion in 1999 for fraudulent property and casualty claims. Across the economy, business losses due to all forms of document fraud and counterfeiting exceed $400 billion—6 percent of annual revenue of American businesses—per year. Although businesses covered virtually all of these losses, these losses ultimately affect consumers through higher prices, inconvenience, and lost time and productivity.

Personal information is one of the most effective tools for stemming these losses. Such information is used every day to identify consumers cashing checks and seeking access to accounts. Not only does that information help identify the perpetrators of financial fraud, it also gives retailers and check-cashing services the ability and confidence to accept checks, especially from out-of-state accounts. Close monitoring of account activity also allows credit providers and other businesses to recognize unusual behavior that may indicate that a credit card or debit card has been stolen or is otherwise being used without authorization. Many consumers report that the first warning they receive about credit card fraud comes not from law enforcement authorities, but from a retailer or other business that detected an odd pattern of charging activity.

Consumers also benefit as citizens from accessible personal information. Personal information—often drawn from public records and aggregated by commercial service providers—is essential to preventing, detecting, and solving crimes. In 1998 the FBI alone made more than 53,000 inquiries to commercial online databases to obtain a wide variety of personal information. According to Director Louis Freeh, "Information from these inquiries assisted in the arrests of 393 fugitives wanted by the FBI, the identification of more than $37 million in seizable assets, the locating of 1,966 individuals wanted by law enforcement, and the locating of 3,209 witnesses wanted for questioning."[9]

Personal information is also used to improve public welfare. Personally identifiable information is used to locate and contact missing family members, heirs to estates, pension fund beneficiaries, witnesses in criminal and civil matters, tax evaders, and parents who are delinquent in child support payments. The Association for Children for Enforcement of Support reports that public record information provided through commercial vendors helped locate over 75 percent of the "deadbeat parents" they sought.[10] Accessible personal information also helps identify victims of fraud or environmental hazards, and saves lives by locating owners of recalled automobiles and blood, organ, and bone marrow donors.

Conclusion

These six categories of benefits that consumers enjoy because of routine information-sharing are illustrative, not exhaustive. The key point is that to provide all of these and other benefits, access to data is essential. Laws restricting that access make the provision of many valuable services, and the convenience and benefits they provide, untenable. In the words of Alabama Attorney General Bill Pryor, it is consumers who ultimately pay the price for new privacy laws "in terms of either higher prices for what they buy, or in terms of a restricted set of choices offered them in the marketplace."[11]

Personal information constitutes a critical part of this nation's "essential infrastructure," and is essential to providing consumers with the service, convenience, access, recognition, affordable prices, and opportunities that we have come to expect. Like other parts of our national infrastructure, such as roads and telephone systems, we tend to take the information infrastructure for granted, until we are faced with the daunting prospect of learning to live without the many benefits that flow from it.

This does not mean that privacy is unimportant or unprotected, but rather that it must be balanced—as consumers do in our choices every day—with the benefits that we enjoy because of the responsible use of personal information. Given the extraordinary value that information-sharing contributes to each of us, we should hesitate before we restrict it even for the most apparently worthwhile purpose.

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[9]Fiscal Year 2000 Budget Requests for the Federal Bureau of Investigation and the Drug Enforcement Administration, Hearings before the Subcomm. on Commerce, Justice, State, and Judiciary of the Comm. on Appropriations, Senate, 106th Cong., 1st Sess. (Mar. 24, 1999) (statement of Louis J. Freeh).

[10]Information Privacy Act, Hearings before the Comm. on Banking and Financial Services, House of Representatives, 105th Cong., 2d Sess. (July 28, 1998) (statement of Robert Glass).

[11]Bill Pryor, Protecting Privacy: Some First Principles, Remarks at the American Council of Life Insurers Privacy Symposium, July 11, 2000, Washington, DC, at 4.