
*Privacy and Information Disclosure: An
Economic Analysis of the
Gramm-Leach-Bliley Act*

by David Walrath

The Gramm-Leach-Bliley (GLB) Act is one of many laws passed in the United States and around the world that is designed to protect private information. One of the main directives in this law requires financial institutions to provide customers with a privacy notice that explains how they share their customers' private information with nonaffiliated third parties. This paper uses the GLB Act as a case study to analyze the arguments for and against a policy that requires firms to issue privacy notices to their customers. The arguments for this policy are based on theories and principles that are fundamental aspects of neoclassical and information economics—namely, complete information, unbounded rationality, and asymmetric information. The arguments against this policy are based on two central principles of behavioral economics—present bias and bounded rationality. This paper also presents an alternative policy and examines its shortcomings before recommending that Congress consider adopting the European Union's policy on privacy and information disclosure.

INTRODUCTION

Protecting private information is one of the most important concerns people have. Unfortunately, it is all too common for a person's financial information to be stolen and used for malicious purposes. It is also common for financial institutions to sell their customers' private information to nonaffiliated third parties (Freeman 2003). Government has become keenly aware of the public's concerns regarding the use and disclosure of private information, and numerous laws have been passed to better protect it. One such law is the Gramm-Leach-Bliley (GLB) Act, which, among other things, requires financial institutions to provide each customer with a privacy notice at the beginning of their relationship with the customer. This portion of the law, known as the Financial Privacy Rule, is designed to protect consumers, but it is uncertain how effectively it accomplishes this goal.

This paper uses the GLB Act as a case study to analyze the arguments for and against a policy that requires firms to issue privacy notices to their customers. The first section of this paper provides an overview of Title V of the GLB Act, which outlines the rules governing the protection of customers' private information by financial institutions. The second and third sections apply neoclassical, information, and behavioral economic theory to analyze this policy. Section four discusses an alternative to this policy, and section five offers and examines a policy recommendation for US lawmakers to consider.

OVERVIEW OF THE GLB ACT

On November 12, 1999, the GLB Act, also known as the Financial Services

Modernization Act of 1999, was signed into law (Cuaresma 2002). According to Cuaresma (2002, 497), this policy "was a revolutionary event in the world of financial services" because "it marked Congress' tentative attempt to ensure that private financial companies protect their customers' financial information." Title V of the GLB Act states that "each financial institution has an affirmative and continuing obligation to respect the privacy of its customers and to protect the security and confidentiality of those customers' nonpublic personal information" (Gramm-Leach-Bliley Act 1999, 1436). To this end, each financial institution "may not, directly or through any affiliate, disclose to a nonaffiliated third party any nonpublic personal information, unless such financial institution provides or has provided to the consumer a notice" that such information may be disclosed (1437). Additionally, as Freeman (2003, 5) states, "the consumer must...be given the opportunity to opt out of such a disclosure."

According to Title V, financial institutions must provide these privacy notices "at the time of establishing a customer relationship with a consumer and not less than annually during the continuation of such relationship." The notice must be "clear and conspicuous" and shall include what nonpublic personal information the firm collects about its customers, with whom it shares this information, and how it protects this information (Gramm-Leach-Bliley Act 1999, 1439). An example of nonpublic personal information would be a bank customer's banking records, which the bank could sell to a nonaffiliated third party, such as a telemarketing firm (Freeman 2003, 6). The notice must also

explain how a consumer can opt out of having this information shared with a nonaffiliated third party (Freeman 2003). If a consumer decides to opt out, he or she may not receive offers for certain products or services (Freeman 2003). Unless a consumer takes the initiative to opt out, a financial institution may freely disclose his or her nonpublic personal information (Freeman 2003). The notice must be given to the consumer “in writing or in electronic form.” (Gramm-Leach-Bliley Act 1999, 1439).

As a result of this policy, financial institutions mailed billions of written privacy notices to their customers (Freeman 2003). For example, as Freeman (2003, 5) notes, “By the end of 2001, Citigroup had already sent over 125 million notices.” According to Ballasy (2014), the Consumer Financial Protection Bureau decided in 2014 to allow “financial institutions that meet requirements to post their annual privacy notices online instead of through the mail” to cut costs, saving the financial services industry an estimated \$17 million a year (Matkins 2014). In 2015, Congress decided to eliminate the annual notice requirement altogether for financial institutions that satisfy certain conditions (Phipps et. al. 2016). For example, one such condition requires a financial institution’s disclosure practices not to have changed since its most recent privacy notice to consumers (Phipps et. al. 2016).

ECONOMIC ARGUMENTS FOR PRIVACY NOTICES

In neoclassical economic theory, as Goolsbee et. al. (2013, 606) states, it is “assumed that economic decision makers know everything relevant about the markets

in which they operate.” A market with complete information allows consumers to make efficient economic decisions. This fundamental concept of neoclassical economics helps explain why the GLB Act requires financial institutions to issue privacy notices to their customers. When a customer enters into a relationship with a financial institution, he or she must know how the financial institution will share his or her nonpublic personal information. According to Freeman (2003, 8), “The goal of the GLB Act is to allow customers to make informed decisions regarding how their personal data is utilized and transferred.” Knowing this information allows the consumer to make the best possible choice when selecting a financial institution. As Garrison et. al. (2012, 204) contends, “In an ideal marketplace, if complete information was available...to all participants, fully informed consumers would make decisions that are optimal for their financial situations and lifestyles.” If the privacy policies of financial institutions affect consumers’ economic decisions, then the GLB Act helps to create this ideal marketplace for consumers.

Another fundamental assumption of neoclassical economic theory is unbounded rationality. As Hutchison (1984) argues, if economic decision makers are capable of “virtually unbounded rationality,” then they are able to understand and process all of the information that is presented to them. Therefore, if the privacy notices mandated by the GLB Act are, in fact, “clear and conspicuous,” then consumers will be able to comprehend them and use them to inform their economic decisions. According to Acquisti and Grossklags (2005, 26), this assessment of consumers “as rational economic agents who go about

deciding how to protect or divulge their personal information” has permeated the policy debate. Policymakers believe that consumers are able to understand and process the information contained in privacy notices. Consequently, consumers should have access to this information because they will be able to use it to inform their economic decisions.

Lastly, information economics can help explain why consumers should have access to privacy notices. Akerlof (1970) developed the concept of asymmetric information, which can lead to market failure. Information asymmetry can arise in markets when sellers know more about their product than potential buyers. This asymmetry can cause these markets to fail when potential buyers decide not to participate because they cannot verify the quality of the product. However, as Loewenstein, Sunstein, and Golman (2014, 394) point out, privacy notices can correct information asymmetry by “providing information to the less informed buyer or advice recipient in order to level the informational playing field.” Therefore, privacy notices also rectify the market failure by eliminating the information asymmetry (392). Without privacy notices, there is no way for consumers, who are concerned about how their nonpublic personal information will be shared, to verify the disclosure practices of financial institutions. As a result, consumers may decide not to enter into relationships with financial institutions if they do not know how this information will be shared. By requiring financial institutions to issue privacy notices to their customers, the GLB Act aims to rectify this potential market failure.

ECONOMIC ARGUMENTS AGAINST PRIVACY NOTICES

According to behavioral economic theory, economic decision makers suffer from self-control problems. One of these self-control problems is a bias towards the present, which is particularly relevant in the discussion of privacy notices. For the most part, economic decision makers care about the protection of their nonpublic personal information and want to make sure this information is handled properly. When they enter into a relationship with a financial institution, for example, they may intend to verify that the financial institution will safeguard this information. Despite their plans to protect their privacy, economic decision makers often do not verify that their nonpublic personal information will be handled properly because something in the present distracts them from actually reading the privacy notices. This bias towards the present causes them to renege on their good intentions at the last minute (Laibson and List 2015).

As Bhargava and Loewenstein (2015, 399) argue, the information disclosure requirements favored by neoclassical and information economics “should, in theory, enable individuals to safely navigate the increasingly complex privacy landscape.” However, “biased assessments of probability lead most to simply ignore such disclosures” (399). Identity theft is a disastrous potential outcome of a financial institution’s disclosure of a customer’s nonpublic personal information. If a customer’s banking records, for example, were to fall into the hands of the wrong person and be used for malicious purposes, the customer would be severely harmed. People may care about preventing identity theft from happening to them, but they

simply do not think it will. Therefore, whatever distracts people in the present from following through on their good intentions receives more attention because, in their mind, the probability of a disastrous outcome is low.

Strong evidence indicates that present bias may have affected many of the consumers that received the privacy notices mandated by the GLB Act. A survey conducted by the American Bankers Association in 2001 found that only one out of every three consumers actually read their bank's privacy notice. The same survey found that 41 percent of banking consumers could not even recall receiving a notice (Janger and Schwartz 2002, 1230). Another survey from 2001 found that "only 0.5% of banking customers had exercised their opt-out rights" (1230). Clearly, present bias may have caused many consumers to simply ignore the privacy notices mandated by the GLB Act.

Biased assessments relating to privacy notices may lead to a more troubling phenomenon. After receiving one of these notices in the mail or seeing one posted on a website, Bhargava and Loewenstein (2015, 399) contend that consumers may "infer that the presence of privacy disclosures implies non-existent protections." If consumers know their financial institution has a privacy policy, but they do not read it, they may think their nonpublic personal information will not be shared with nonaffiliated third parties. Acquisti, Brandimarte, and Loewenstein (2015, 512) found that "62% of respondents to a survey believed (incorrectly) that the existence of a privacy policy implied that a [website] could not share their personal information without permission." According to Acquisti et. al. (2015, 512), this disturbing finding

"suggests that simply posting a policy that consumers do not read may lead to misplaced feelings of being protected."

Another behavioral concept relevant to the discussion of privacy notices is bounded rationality. In the context of privacy and information disclosure, Acquisti (2004, 23) states that bounded rationality "refers to the inability to process all the stochastic information related to risks and probabilities of events leading to privacy costs and benefits." Even if consumers do read privacy notices, they may lack the cognitive skills necessary to decipher all of the information presented to them. They may not be able to understand how a firm's disclosure practices would affect their privacy in the future. In contrast to the neoclassical concept of unbounded rationality, Acquisti and Grossklags (2005, 27) argue that consumers' innate bounded rationality "limits [their] ability to acquire, memorize, and process all relevant information" in situations relating to the protection of their privacy. Instead, as Acquisti and Grossklags (2005, 27) maintain, consumers "rely on simplified mental models, approximate strategies, and heuristics" when reading privacy notices.

Bounded rationality directly contradicts the neoclassical assumption that a market with complete information allows consumers to make efficient economic decisions. As Acquisti and Grossklags (2005) contend, even if individuals had access to complete information about their privacy risks and modes of protection, they may not be able to process all of this information and use it to optimize their choices within the market. Subsequently, the privacy notices mandated by the GLB Act may be insufficient because they

do not help consumers make the best possible choice when selecting a financial institution.

Clear evidence shows that many of the consumers that received these privacy notices may not have been able to process all of the information that they contained. Garrison et. al. (2012, 206) state that after the initial privacy notices were mailed to consumers, many noted that instead of being “clear and conspicuous,” they were “lengthy, confusing, written in a highly legalistic style, and generally incomprehensible.” Janger and Schwartz (2002, 1231) cite a readability study conducted by the Privacy Rights Clearinghouse which found that, “on average, the GLB Act privacy notices were written at a third or fourth year college reading level.” According to Janger and Schwartz (2002, 1231), “literary experts generally recommend that documents intended for the general public be written at a junior high school level.” As a result, many consumers may not have been able to use these privacy notices to optimize their choices within the market.

POLICY ALTERNATIVE

The privacy notices mandated by the GLB Act could be simplified and standardized to address the issues raised by behavioral economics. As Loewenstein, Sunstein, and Golman (2014, 405) point out, “given the limits of human attention, perhaps the most obvious way to improve the effectiveness of disclosures is to simplify them.” According to Bhargava and Loewenstein (2015, 399), this alternative equates to an “informational nudge” approach, which would present each financial institution’s privacy policy “in a simple, vivid, and standardized fashion to

heighten attention and understanding.” Eight federal regulatory agencies actually adopted this alternative policy in December 2009 (FTC 2009). In response to the public’s frustration with the initial privacy notices, Garrison et. al. (2012, 206) states that these agencies “decided to explore ways to make these notices more easily understandable and usable for consumers.” Consequently, they developed and released a standardized privacy form that financial institutions could use for their privacy notices. According to the US Federal Trade Commission (FTC 2009, 1), this model form simplified the information presented in the privacy notices and allowed “consumers to easily compare the privacy practices of different financial institutions.” Because the privacy notices mandated by the GLB Act are now standardized, it should be easier for consumers to make the best possible choice when selecting a financial institution.

On the other hand, a simplified and standardized notice does not solve all of the problems related to privacy and information disclosure. According to Bhargava and Loewenstein (2015, 399), “Given that even simplified information may be ignored or misinterpreted, simplified disclosures are unlikely to be sufficient.” Due to present bias and people’s innate bounded rationality, consumers may not read or be able to interpret even simplified privacy notices. Additionally, if consumers do read and can interpret the privacy notices of different financial institutions and decide that they dislike the disclosure practices of each of these firms, they will still likely sign up for the services of one of these firms. When consumers are deciding which bank to join, for example, they know that participation in this market

is essential in the modern, interconnected world. The disclosure practices of different banks are likely irrelevant to most consumers because they know that they must join a bank, even if they dislike how the banking industry handles their private information. Therefore, information disclosure policies probably do not affect consumers when they are attempting to optimize their choice of a financial institution.

POLICY RECOMMENDATION

Instead of passing a law that requires firms to issue privacy notices to their customers, US policymakers could adopt the European Union's policy on privacy and information disclosure. As Bhargava and Loewenstein (2015, 399) state, the European Union's data protection laws "explicitly restrict firm use of information to purposes judged to be in the consumer's interest and consistent with reasonable expectations." A consumer's personal data may be lawfully disclosed to a nonaffiliated third party if, for example, the disclosure is based on the consent of the consumer or the vital interests of the consumer require the disclosure of his or her personal data (EU FRA 2014). In addition, the purpose of the information disclosure must be visibly defined before the disclosure can be initiated (EU FRA 2014). The EU system provides far greater protection for consumers because it places severe restrictions on the disclosure of their nonpublic personal information. Rather than focusing on an attempt to inform consumers about how their private information may be shared, these laws focus on making it more difficult for firms to share consumers' private information at all. As a result, the European Union's policy on privacy and information disclosure

is designed to protect consumers with asymmetric interests (Bhargava and Loewenstein 2015). Since the behavioral concepts of present bias and bounded rationality strongly influence consumers, they may need the increased protection of their nonpublic personal information the EU system provides.

This paper recommends that US policymakers consider adopting the European Union's policy on privacy and information disclosure. Because many consumers simply do not read privacy notices, or may not be able to interpret them, they may need to be protected from themselves. The EU system provides far greater protection for consumers than the US system, but more analysis would be needed before Congress could make an informed decision on whether to adopt this law. For example, if a cost-benefit analysis of the European Union's policy found it to be worthwhile, then this result would lend weight to its adoption in the United States.

Additionally, US policymakers should know there would be drawbacks if the European Union's data protection laws were passed in the United States. As Williamson (2010) argued with his "remediableness" criterion, every government intervention will have transaction costs, which are costs associated with making an economic exchange. According to Williamson (2010, 683), "The remediableness criterion serves as a reality check on the practice among public policy analysts of assuming that transaction costs in the public sector are zero." One of the most obvious transaction costs resulting from the adoption of the EU system is the requirement for a new set of US laws governing data protection. According to Cuaresma (2002, 508), "Currently, no single comprehensive privacy law exists"

in the United States. “Instead, general privacy rights stem from disparate sources,” such as the Constitution, state constitutions, federal and state statutes, and common law (508). Adopting the EU system would mean that Congress would have to pass a comprehensive privacy law. US policymakers would also have to create a new agency to supervise financial institutions and ensure their compliance with the stringent requirements of the EU system. The agency within the European Union that accomplishes this task is the European Data Protection Supervisor. The new US agency would need to have significant regulatory power to ensure that consumers’ nonpublic personal information is shared responsibly.

SUMMARY

The GLB Act requires financial institutions to issue privacy notices to their customers. The arguments for this policy are based on neoclassical and information economics. Access to complete information allows the consumer to make the best possible choice when selecting a financial institution. Consumers are also able to comprehend the information contained in privacy notices and use it to inform their economic decisions. Lastly, privacy notices rectify a potential market failure by eliminating information asymmetry.

The arguments against this policy are based on behavioral economics. Present bias causes consumers to renege on their

good intentions to protect their private information at the last minute. Privacy notices may also lead to misplaced feelings of being protected. Lastly, consumers’ innate bounded rationality hinders their ability to process all of the information contained in privacy notices.

An alternative to this policy would be to simplify and standardize the privacy notices mandated by the GLB Act. However, this policy alternative is still insufficient mainly because information disclosure policies likely do not affect consumers when they are attempting to optimize their choice of a financial institution. Instead, this paper recommends that Congress consider adopting a policy that makes it more difficult for firms to share their customers’ private information, even though this policy would entail transaction costs.

Government has a responsibility to develop and implement policies that protect the private information of its citizens. However, policies that require firms to issue privacy notices to their customers fall short of actually protecting consumers. When the burden is on consumers to learn how their private information may be shared and, therefore, to protect their own privacy, it is far too easy for them to either ignore or misinterpret the notices designed to help them. Instead, the burden could be placed on government to ensure that the private market handles consumers’ nonpublic personal information in a responsible way.

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