

**THE IMPACT OF OPT-IN PRIVACY RULES
ON RETAIL CREDIT MARKETS:
A CASE STUDY OF MBNA**

WORKING PAPER #62

March 2002



By

Michael E. Staten, Ph.D.
Distinguished Professor and Director, Credit Research Center
Georgetown University

Fred H. Cate
Indiana University School of Law - Bloomington

March 13, 2002

**THE IMPACT OF OPT-IN PRIVACY RULES ON RETAIL CREDIT
MARKETS:
A CASE STUDY OF MBNA***

Michael E. Staten
Georgetown University

Fred H. Cate
Indiana University School of Law - Bloomington

ABSTRACT

Advances in information technology have created a public-policy dilemma. Rapid access to personally identifiable information is becoming increasingly important to U.S. economic productivity, especially in the financial services industry. At the same time, consumers express a growing demand for “privacy,” as that term refers to the ability to “control or conceal the use of information about oneself.” Broad-based, “opt-in” laws have been proposed that would condition the collection, transfer or use of personal information on obtaining explicit consumer consent.

This case study of a large U.S. financial services company shows how opt-in laws could threaten the viability of key services and products. MBNA Corporation has harnessed information technology as the engine for establishing and building customer relationships without every physically meeting its customers. We examine the implications of opt-in rules that would restrict the flow of personal information into the company from external sources, and within the company through artificial barriers to sharing across affiliates. We illustrate how opt-in laws neutralize some of the productivity gains generated by advances in information technology. Although the examples are cast specifically in terms of MBNA’s products and services, most are also typical of the operations of the top ten credit card issuers in the U.S. Consequently, the lessons can be generalized across the credit card and financial services industries as firms increasingly rely on personally identifiable information instead of physical contact (through brick-and mortar outlets) when developing a customer base.

Revised: March 13, 2002

* Please address all correspondence as follows:

Prof. Michael Staten
Credit Research Center
3240 Prospect St., NW (top floor)
Washington, DC 20007
Tel: 202.625.0103
FAX: 202.625.0104
Email: statenm@msb.edu

The Impact of Opt-in Rules on Retail Credit Markets: A Case Study of MBNA

Executive Summary

Laws that require explicit consumer consent for the collection, transfer or use of personal information (opt-in laws) impose significant costs on both businesses and consumers. This case study of MBNA Corporation demonstrates how opt-in requirements mandated uniformly across the U.S. economy could threaten the viability of key services and products offered by U.S. financial services companies, to the detriment of consumers. Although the examples are cast specifically in terms of MBNA's products and services, most are also typical of the operations of the top ten credit card issuers who collectively held over 80 percent of the \$554 billion in bank credit card receivables outstanding in the United States as of the end of 2000. Consequently, the lessons can be generalized across the credit card and financial services industries as firms increasingly rely on personally identifiable information instead of physical contact (through brick-and mortar outlets) when developing a customer base.

Founded only two decades ago with an initial base of 600,000 accounts and \$209 million in receivables, MBNA had become the second largest credit card issuer in the United States by the end of 2000. The company provides credit cards and other loan products to 51 million consumers, has \$89 billion of loans outstanding, and services 15 percent of all outstanding U.S. Visa/MasterCard credit card balances—all without any brick-and-mortar branches. It achieved this exceptional growth by intensively using personal information to identify potential customers, provide them with credit products and services appropriate to their specific situations, and offer them individualized, tailored service. Indicative of its success in finding the right customer for its card products, MBNA's customers carry balances 52 percent higher than the industry average and have an average transaction size 30 percent higher than the industry average, but they default or become delinquent at rates well below the credit card industry average.

MBNA does not derive revenue streams from selling information about its customers to third parties. Rather, it purchases information from third parties, gathers information from its own affiliates, and makes extensive use of that data to identify those consumers to whom offers of credit cards and other products should be made. Consequently, opt-in rules applied broadly throughout the U.S. economy (as well as those that apply just to financial services firms, as is the case with the Gramm-Leach-Bliley Financial Services Modernization Act) impact MBNA *by restricting its ability to gather information and use it to deliver products and services to customers and prospects.*

The information-intensive marketing employed by MBNA and other financial services providers has transformed the entire credit card industry—stimulating national competition, the entry of new competitors, and the development of new and innovative credit products. The percent of credit card balances being charged an interest rate of 18.0 percent or more plummeted from 70

percent to 44 percent in just 12 months during 1991-1992. Intense competition for new customers has democratized the bank credit card market by expanding access for consumers across the income spectrum. Nearly 30 million more U.S households owned a bank credit card in 1998 than was the case in 1983. Competition has also created more equitable pricing that rewards borrowers who keep their accounts current and imposes higher costs on borrowers who are slow to pay.

Opt-in laws threaten these benefits by effectively neutralizing some of the productivity gains made possible by advances in information technology. Opt-in laws make targeted marketing to existing and potential new customers more costly, thereby discouraging entry into new markets. This case study illustrates these effects through a series of specific examples. The examples do not catalogue all of the effects of various opt-in laws, but have been selected to illustrate the broad and often subtle impact that a rule as seemingly innocuous as requiring affirmative consent can have on businesses and consumers alike.

An in-depth analysis of mandatory opt-in requirements on MBNA's business practices and strategies reveals that mandatory opt-in requirements would:

1. **Hobble MBNA's Affinity Group Business Model:** A rule requiring opt-in consent before MBNA could use information from third parties would hobble MBNA's central business model—the affinity marketing strategy. Access to member lists for organizations such as professional associations and alumni groups allows MBNA to identify likely cardholder prospects and tailor a product for them that builds on their affinity for the organization. This strategy implodes with loss of access to member records. In addition, loss of the affinity marketing partnership would mean that the affinity organizations (many of which are non-profit) would lose a significant source of revenue used to support their operations.
2. **Raise account acquisition costs and lower revenue streams:** A rule requiring opt-in consent before MBNA could use information from third parties or its own affiliates would dramatically limit the company's ability to determine which of the 800 million customer "leads" it receives annually are appropriate candidates to receive card offers. Losing access to the internal and external information necessary to cull prospect lists would *raise the costs of acquiring new accounts via direct mail by 22 percent per account booked*. Moreover, the new accounts booked would have lower revenues and higher losses relative to the more precisely targeted group, yielding an *8 percent reduction in net income* over the first five years of account experience.
3. **Generate more offers to uninterested/unqualified consumers and more missed opportunities to qualified customers:** Because offers would be less well targeted, more consumers would receive offers in which they were not interested and for which they are not qualified, resulting in a higher incidence of unwanted mail and higher rejection rates on card applications. In addition, because direct marketing messages would be less-well targeted, millions of other consumers would never receive information and offers for products and services in which they were likely to be interested and for which they were fully qualified.

4. **Impair efforts to prevent fraud and identity theft:** New opt-in laws would pose a significant risk to the antifraud efforts of MBNA and all credit card companies, even if written to exempt the specific use of personal information to prevent and detect fraud. Much of the external information on which MBNA and other companies rely may no longer be available under broadly applied opt-in rules. Use of such information for a variety of commercial purposes makes it economically feasible to create the databases that are later tapped in conjunction with antifraud efforts. MBNA and all of its customers would be harmed if opt-in rules led to shrinkage of those databases, and subsequent dilution of MBNA's effectiveness at preventing fraud.

More broadly, by raising the costs of entering new markets, opt-in rules would reduce the supply of products across the credit card industry. Diminished competition would begin to reverse the gains to consumers from lower pricing and wider choice of products.

- **Reduced supply, higher credit card interest rates and fees:** Since opt-in restrictions would impact all credit card issuers (not just MBNA), the reduction in supply would inevitably impact all cardholding consumers through higher prices, limits on card features or reduced access to credit cards. If the adoption of opt-in restrictions limited competition and new entry such that average credit card rates rose even 1 percentage point (100 basis points), it would cost consumers approximately \$5 billion in additional finance charges annually. To put this in perspective, the Federal Reserve Board has reported that the average credit card interest rate fell between 1991 and 1994 by nearly 2.5 percentage points as a consequence of competitive pressures from new entrants.
- **Retreat back to stereotypical, "lifestyle" marketing:** Legislation may impose practical limits on business access to personal information, but it does not change the underlying value of that information. Opt-in laws that restrict the availability or use of information about individuals inevitably require companies to search for less-accurate substitutes, e.g., aggregated information, neighborhood census data, inferred information. The resulting marketing decisions are certainly less accurate, and possibly less equitable. Individuals would receive offers based less on their own preferences and experiences and more on the average characteristics of their age group, neighborhood, or other easily observable attributes.

The irony of these costs and burdens is that MBNA already offers its customers opportunities to limit the company's use of their personal information. Currently 130,000 customers have opted out of having their credit report information transferred across MBNA affiliates. Over one million customers have opted out of receiving any type of direct mail marketing offers. Since these customers have their preferences respected under the current privacy rules, it suggests that an opt-in regime to accomplish the same purpose is unnecessary, as well as expensive and burdensome to all customers regardless of their privacy preferences.

Revised: March 13, 2002

THE IMPACT OF OPT-IN PRIVACY RULES ON RETAIL CREDIT MARKETS: A CASE STUDY OF MBNA*

Michael E. Staten
Georgetown University

Fred H. Cate
Indiana University School of Law - Bloomington

1. INTRODUCTION

Free-flowing information has become a defining characteristic of the “New Economy” in the United States. Economists have long recognized that the costs of acquiring information and arranging transactions are like sand in the gears of commerce. Markets function more efficiently when it is less costly to identify and design the right product for the right consumer and deliver it at the right time. Many of the factors underlying the remarkable growth in productivity during the 1990s (e.g., just-in-time delivery, total quality management, electronic commerce) are a consequence of advances in information technology that support the rapid acquisition and transfer of information. This is particularly true in the financial services sector with respect to the use of personally identifiable information. As Comptroller of the Currency John Hawke, Jr. testified before Congress in 1999, our financial services market is an “information-driven industry. . . Information exchanges serve a useful and critical market function that benefits consumers and financial institutions alike in facilitating credit, investment, insurance and other financial transactions.”¹

Much of that essential information relates to individuals and their specific transactions. Notwithstanding the resulting benefits, surveys over the past decade document that consumers have become increasingly sensitive about the collection and commercial use of personal information (financial and otherwise) by businesses.² In a 1999 IBM/Harris survey, 94 percent of Americans said they were worried about “possible misuse” of their personal information, and 80 percent thought that “consumers have lost all control over how personal information about

* We thank MBNA America for its participation in this case study and all of the MBNA employees who shared their time and expertise throughout the project. In addition, we received helpful comments and suggestions on earlier versions of this article from Martin Abrams, Dan Jaffe, David Klaus, Mark MacCarthy, Harriet Pearson, and Michael Turner. This project was supported by a grant to Georgetown University from the Privacy Leadership Initiative.

¹ Financial Privacy, Hearings before the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Banking and Financial Services, House of Representatives, 106th Congress, 1st Sess. (July 21, 1999), statement of John D. Hawke, Jr.

² Westin, Alan and Louis Harris and Associates, annual surveys from 1990-1996, sponsored by and available from Atlanta-based Equifax, Inc. See also Louis Harris & Associates and Alan F. Westin, *Privacy Concerns and Consumer Choice*, sponsored by Ameritech and Privacy and American Business, Hackensack, NJ, December, 1998.

them is collected and used by companies.”³ Consumer surveys suggest a growing demand for “privacy,” as that term refers to the ability to “control or conceal the use of information about oneself,” at least in certain circumstances.⁴

The explicit assignment of property rights to the use of personal information in the U.S. has lagged far behind the development of technology to capture and transfer such information, but is beginning to catch up.⁵ With a few exceptions, up until the late 1990s firms were legally able to use and exchange most customer and transaction data, with the primary constraint being the threat of alienating privacy-sensitive customers. Judging from consumer privacy surveys, market discipline in the form of potential customer attrition over privacy issues has grown steadily throughout the past decade, making that constraint more binding. Nevertheless, over the past five years the concept that consumers should have the *legal right* to exercise some degree of choice over commercial use of personal information has become an accepted principle underpinning public policy toward privacy in the U.S. But, the form in which that choice must be offered is far from settled.

One approach to giving consumers control over how data about them is used is an “opt-out” system, under which consent to a specified use of information may be *inferred* from the fact that the consumer was given notice of usage of specific data and the opportunity to restrict usage, *but did not object*. In those industries in the U.S. where laws currently mandate that consumers be given a choice, opt-out is the consent system most commonly used.⁶ However, legislation being proposed with increasing frequency at both the federal and state levels would require that firms obtain *explicit* consent from individuals before collecting, using or exchanging information about them.⁷ Such “opt-in” rules have already been incorporated into many European data protection laws.

In a world with costless transacting the debate over whether to adopt opt-in vs. opt-out rules would be irrelevant. A Coasian view of bargaining over the rights to use personally identifiable information concludes that if negotiating and contracting is costless, the usage rights will accrue to the party with the greatest value, regardless of the initial assignment.⁸ If the consumer places

³ Westin, Alan F. “Intrusions: Privacy Tradeoffs in a Free Society,” *Public Perspective*, November/December 2000, p 10.

⁴ The concept of privacy utilized throughout this paper follows the definition first posed by Alan Westin in his seminal work *Privacy and Freedom* (1967): informational privacy is “the claim of individuals, groups, or institutions to determine for themselves when, how and to what extent information about them is communicated to others.” Subsequently, George Stigler examined the economics of “concealment of information” that may have value in sorting individuals and matching of preferences and opportunities. See George J. Stigler, “An Introduction to Privacy in Economics and Politics,” *Journal of Legal Studies*, Vol. 9, December 1980, pp 623-644.

⁵ In keeping with recent U.S. privacy legislation, we use the term “personal information” to refer to *any* data relating to a specific individual, unless those data are routinely available from public sources, such as telephone directories.

⁶ For examples, see the the Gramm-Leach-Bliley Financial Modernization Act (1999); Fair Credit Reporting Act provisions that address pre-screening (1996); various federal and state telemarketing laws pertaining to “do not call” listings. In contrast, individually identifiable health information is increasingly subjected to opt-in rules, like those found in the federal Health Insurance Portability and Accountability Act (HIPAA).

⁷ For examples of federal opt-in legislation introduced during 2001 see H.R. 2720, “Consumer’s Right to Financial Privacy Act,” and S. 1055, “Privacy Act of 2001.”

⁸ For a development of a Coasian framework for examining the allocation of privacy rights, see Charles M. Kahn, James McAndrews and William Roberds, “A Theory of Transaction Privacy,” Federal Reserve Bank of Atlanta, Working Paper 2000-22, November 2000.

a sufficiently high value on privacy, she can pay the company a sum sufficient to block the transfer of the information to a third party (or, possibly, to discourage the reuse of the information by the company itself in preparing subsequent marketing messages). This payment could come in the form of foregone discounts that were available to consumers who consent to subsequent usage.

If contracting for usage rights imposes positive costs, then the initial assignment of rights and rules governing usage may have economic consequences. In this paper we demonstrate that although the opt-in vs. opt-out approaches sound similar, they differ dramatically in their practical impact. The following case study assesses the impact of requiring a large U.S.-based financial services provider to obtain explicit consent from consumers before using personal information about them. We conclude that opt-in requirements mandated uniformly across the U.S. economy could threaten the viability of key services and products offered by U.S. financial services companies.

To illustrate the costs of moving to an opt-in system, we examine MBNA Corporation, a financial institution that offers consumers in the United States, Canada, the United Kingdom and Ireland a variety of loan and insurance products (primarily credit cards), takes deposits, but operates entirely without a branch network. Incorporated in 1981, and publicly traded since 1991, the company has compiled a stunning growth record in just two decades. As of the end of 2000, the company provided credit cards and other loan products to 51 million consumers, had \$89 billion of loans outstanding and serviced 15 percent of all Visa/MasterCard credit card balances outstanding in the United States.

MBNA's ability to access and use information about potential and existing customers is largely responsible for it becoming the second largest credit card issuer in the United States in less than 20 years. To appreciate the critical role that the sharing of information has played in MBNA's remarkable history, one need only reflect on the challenge of acquiring 51 million customers with no brick-and-mortar stores or branches. Like firms in a variety of businesses, but especially financial services, MBNA harnessed information technology as the engine for establishing and building customer relationships without ever physically meeting its customers. By using direct mail, telephone and, most recently, Internet contacts, the company has reached out to new prospects throughout the population, regardless of where they live, with offers tailored to their individual interests.

The following sections discuss how MBNA currently uses personal information to bring products and services to existing customers and new prospects. Against this backdrop we then examine the implications of opt-in rules that would restrict the flow of personal information into the company from external sources, and within the company through artificial barriers to sharing across affiliates. *Through a series of specific examples we illustrate how opt-in laws neutralize many of the productivity gains generated by advances in information technology.* These examples are cast specifically in terms of MBNA's products, services and customers, but most are also typical of the operations of the top ten credit card issuers who collectively held over 80 percent of the \$554 billion in bank credit card receivables outstanding in the United States as of the end of 2000. Consequently, the lessons can be generalized across the credit card and financial

services industries, and, more generally, to any business that substitutes information for physical contact in developing a customer base.

2. THE MBNA EXPERIENCE

a. Free-Flowing Information Triggered Competitive Entry into the Credit Card Industry

To fully understand the impact that companies like MBNA have had on the credit card business one must begin with some historical perspective. 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.⁹

All of this changed beginning in the early 1980s. Both the established full-service banks with credit card programs (e.g. Citibank, Bank of America, First Chicago, Chase) and upstart, branchless, “monoline” entrants (e.g., MBNA, Provident, First USA, and later Capital One) began national marketing campaigns. By the mid-1980s, retailers and manufacturers (e.g., Sears/Discover card, General Motors, AT&T, General Electric) also began introducing their own “co-branded” bank credit cards as unique alternatives to the traditional Visa and MasterCard products being offered by banks.

*The ability to acquire information about potential cardholder prospects made it possible for companies—both new and established—to enter new geographic markets, often with astounding speed.*¹⁰ New entrants used externally acquired demographic information, credit bureau data (as authorized by the Fair Credit Reporting Act), and data about the existing customers of their corporate affiliates to identify and target low-risk borrowers for their low-rate cards throughout the United States. The availability of information about prospects sparked innovation in the card products offered, as issuers were able to anticipate and develop card features tailored to individual preferences. 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. Other new versions of the bank credit card product, including those offered by MBNA, allowed consumers to demonstrate and display loyalty to an alma mater or professional organization by using cards embossed with the institution’s image and logo. Thanks

⁹ 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, November 10, 2001.

¹⁰ 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. The GM card roll-out eclipsed the record set previously by the AT&T MasterCard which had opened 1 million accounts 78 days after its launch in 1990. As further evidence that the GM card reached its targeted audience, the company reported that its cardholders were using the GM card 12 times a month, vs. an industry average of 3.5 times monthly, and the average purchase was \$112, vs. an industry average of \$58. See, Martin Dickson, “Record Take-up for GM Card,” *The Financial Times*, Nov. 17, 1992, p 26.

to the success of those new market entrants, cards offering frequent traveler miles, rebates and other consumer benefits have become commonplace.

The competition for customers sparked by these new entrants also put increasing downward pressure on credit card pricing. Perhaps the most dramatic evidence of the impact of entry on credit card interest rates occurred between 1990 and 1993. The wave of new entrants to the bankcard market that began in the late 1980s expanded the availability of credit to new cardholders, but also put new cards in the hands of the customers of existing issuers. Incumbent issuers saw attrition escalate, particularly among their lowest risk customers who were being offered low-rate cards by the new entrants. Competitors knew no borders and reached customer mailboxes from thousands of miles away.

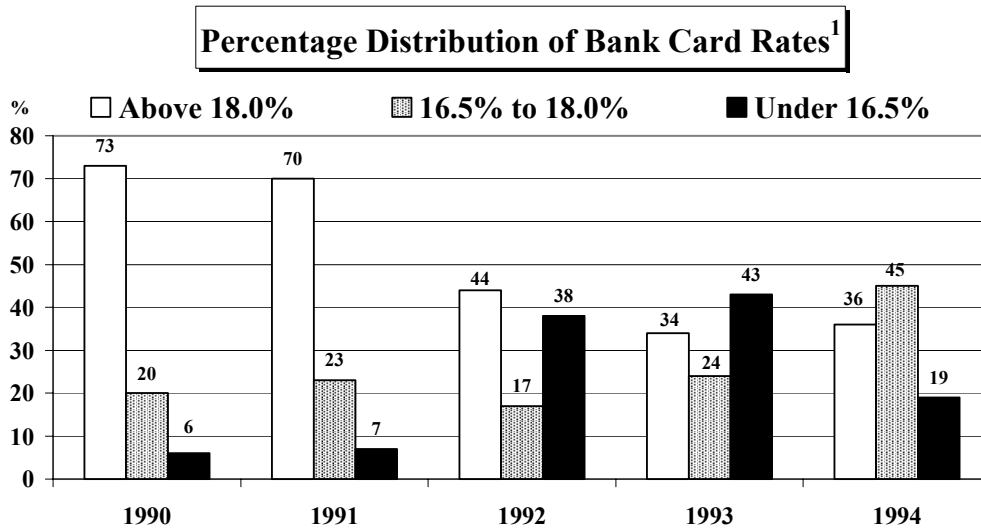
The flood of targeted card offers forced incumbent issuers to make a choice: either leave their rates unchanged and risk defection of their best customers to the new, low-rate entrants or cut finance charge rates and fees as a defensive measure. In late 1991 American Express became the first major issuer to unveil a tiered pricing structure for its Optima product to slow customer defections. The company's best cardholders (e.g., cardholders with high charge volume and no delinquency in the previous 12 months) received a low 12.5 percent rate on their revolving balances, well below the average 18-20 percent rates typically charged. Shortly thereafter, Citibank announced a similar pricing structure for its Classic cardholders, who had been paying 19.8 percent. Citibank officials estimated that by the end of 1992, nearly ten million Citibank Classic cardholders had benefited from the new tiered-rate structure.

The proportion of revolving credit card balances in the United States being charged an APR greater than 18.0 percent plummeted from 70 percent to 44 percent in just 12 months (see Figure 1).¹¹ All of this was possible because *information that allowed new competitors to identify promising cardholder prospects negated some of the advantages of the incumbent issuers.*¹² ***Information about existing and potential customers therefore facilitated the entry of new issuers, intensified competition among existing card issuers, and spurred the development of new card products.***

¹¹ Card Trak, RAM Research Corp., Issue #50, March, 1995. For description of rate cuts by major issuers in response to the wave of new entrants see Sullivan, *Credit Card Management*, October, 1990; Hilder and Pae, *The Wall Street Journal*, May 3, 1991; Spiro, *Business Week*, December 16, 1991; Pae, *The Wall Street Journal*, February 4, 1992; "Citibank Leads an Exodus from Higher Interest Rates," *Credit Card News*, May 1, 1992.

¹² For a detailed discussion of the impact on competition and pricing associated with the entry of AT&T and General Motors into the credit card business see D.W. Carlton and A. Frankel, "Antitrust and Payment Technologies," *Federal Reserve Bank of St. Louis Review*, Vol 77, 1995, pp 41-54; D.W. Carlton and A. Frankel, "The Antitrust Economics of Credit Card Networks," *Antitrust Law Journal*, Vol 63, 1995, pp 643-668.

Figure 1



¹ Proportion of outstanding bank card balances.
 Data derived from survey of 100 top issuers representing 93% of U.S. bank card receivables.
 Source: *CardTrak*, RAM Research.

The ability of new entrants to use personal information to establish and cultivate relationships with customers thousands of miles away has transformed the competitive landscape in the United States, injecting intense price and service competition into the credit card market which had not been historically noted for either.¹³ 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, 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.”¹⁴

Regarding the choices now available to consumers as a result of national marketing campaigns, Schmalensee and Evans further observe

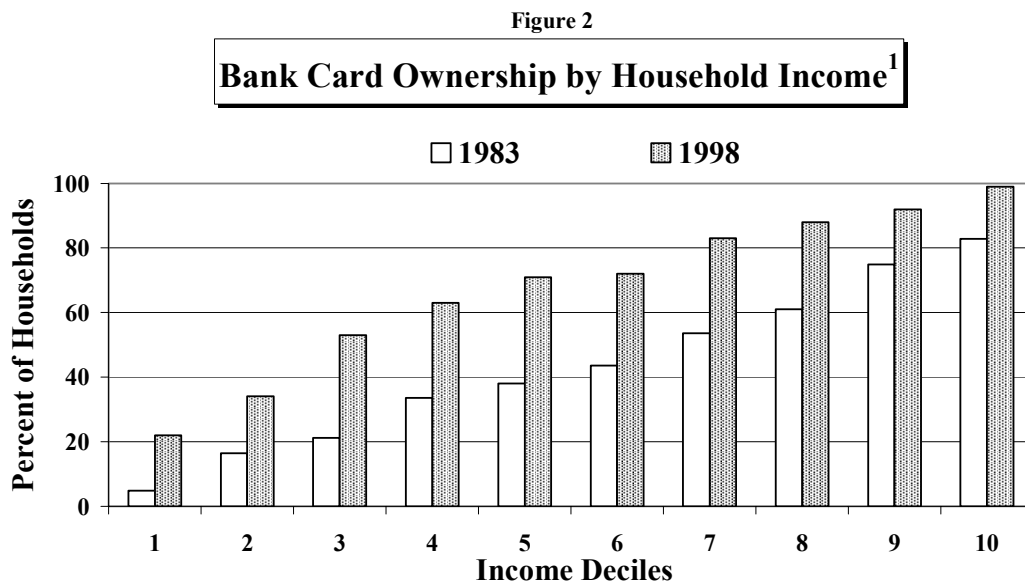
“a 1998 Federal Reserve System survey of 148 of the largest credit card issuers in the United States found that 72 issuers distribute their cards nationally. . . . Consumers in

¹³ “Once again, perhaps the most profound development has been the rapid growth of computer and telecommunications technology. The advent of such technology has lowered the cost and broadened the scope of financial services. These developments have made it increasingly possible for borrowers and lenders to transact directly and for a variety of financial products to be tailored for very specific purposes. As a result, competitive pressures in the financial services industry are probably greater than ever before.” Remarks by Federal Reserve Board Chairman Alan Greenspan at the Charlotte Chamber of Commerce, Charlotte, NC, July 10, 1998.

¹⁴ David Evans and Richard Schmalensee, *Paying With Plastic: The Digital Revolution in Buying and Borrowing*, MIT Press, 2000, p 246.

Chicago, for instance, can obtain cards from more than 70 national issuers in addition to many more local and regional issuers. Consumers have more choice in their credit card issuer than they have for many other services. For example, in Chicago a typical consumer can choose among 15 grocery store chains, 27 health maintenance organizations, and 82 national or regional newspapers.”¹⁵

Tiered, risk-based pricing according to portfolio segment has made it possible for any given credit card issuer to serve a broad range of customers. “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.”¹⁶ Consequently, the competition sparked by new entrants not only triggered a dramatic reduction in credit card pricing to lower-risk customers, but also substantially broadened access to the bank credit card product to millions of higher-risk households. Figure 2 illustrates the dramatic increase in the percent of U.S. households owning at least one bankcard between 1983 and 1998. The largest increases in card ownership occurred in the lower income segments of the population. Overall, nearly 30 million more households owned a bank credit card in 1998 than was the case in 1983.



¹ Percent of households with at least one bank card.
Source: Federal Reserve Board.

¹⁵ Evans and Schmalensee, 2000, p 225.

¹⁶ “The Profitability of Credit Card Operations of Depository Institutions,” an Annual report by the Board of Governors of the Federal Reserve System, submitted to the Congress pursuant to Section 8 of the Fair Credit and Charge Card Disclosure Act of 1988, June 2001. The report also notes (page 6) that “credit card interest rates fell sharply from mid-1991 through early 1994 after being relatively stable for most of the previous twenty years.” The decline in the average “most common interest rate” on issuer credit card plans between 1991 and 1994 was 244 basis points. “Since early 1994, credit card interest rates have fluctuated in a narrow range between 14.32 and 16.25 percent. For 2000, credit card interest rates averaged 14.91 percent, the second consecutive year such rates have averaged below 15 percent.” P. 6.

b. Personal Information as the Cornerstone of the MBNA Strategy

As one of the most successful of the new entrants into the card industry, MBNA's experience illustrates why the availability of personal information was a necessary ingredient for the heightened competition that broadened credit card availability, lowered prices and expanded card features. This section reviews MBNA's overall strategy for using information to target new customers, and presents a variety of measures of its success. In later sections we discuss in greater detail how the company uses personal information to enter new markets.

MBNA was incorporated in Delaware in 1981 as the credit card subsidiary of Maryland National Bank with an initial base of 600,000 accounts and \$209 million in receivables. The company grew to 7 million accounts during its first decade. Following its IPO in 1991, the customer base grew from 7 million to 51 million during its second decade, with \$89 billion of receivables at the end of 2000. Millions of MBNA cardholders gained access to a versatile credit card product. More importantly, the threat of losing business to companies like MBNA put competitive pressure on the incumbent card issuers in the industry to lower their prices and broaden their product selection, benefiting all cardholding consumers.

The slogan on the cover of MBNA's 2000 Annual Report summarizes the company's strategic plan: "Success is getting the right customers and keeping them." Like most major credit card issuers today, MBNA identifies prospects, establishes relationships, anticipates customer needs, and provides personalized service, but does all this without meeting its customers in person. How does it find new prospects and service existing customers without branches or stores?

At the core of its marketing and targeting strategies is the proposition that consumers who share a common institutional bond or experience will have an affinity for using a card that lets them demonstrate their affiliation each time they use it to pay for a purchase. The affinity for the institution raises the probability that a prospect will be converted to a customer. Equally important, the institution or organization usually maintains a list of members on which MBNA can focus its marketing efforts. Following this "affinity group" marketing strategy MBNA designs a card product tailored to members of a particular group (e.g., Penn State University or the National Education Association), negotiates a financial arrangement with the organization for the exclusive rights to market an affinity card to its members, and uses the member list as a source of potential names to contact via direct mail or telemarketing.

Over 4,700 affinity organizations endorse MBNA products to their members in exchange for financial benefits from the company that in many cases total millions of dollars over the life of the marketing contract. These revenues are a substantial component of the funding base for most of these organizations, many of which are non-profit member associations. A sample of affinity MBNA's affinity organizations follows.

- The Professional Organization sector of the card portfolio includes 1,400 professional organizations. The company estimates that MBNA affinity credit cards are carried in the United States by 66 percent of all physicians, 46 percent of all lawyers, 67 percent of all

dentists, 46 percent of nurses, 27 percent of teachers, 45 percent of engineers and 27 percent of all architects.

- Over 3.5 million alumni and students of over 600 colleges and universities use MBNA products endorsed by their alumni associations or schools.
- 4.3 million people carry MBNA credit cards featuring their favorite sports teams, racecar drivers or other sports-related activities.
- Hundreds of affinity programs have been created for people with a common interest but no formal organization (e.g., “Don’t Mess with Texas” card; Irish-American heritage card).
- Design of new affinity cards is an ongoing process. In 2000 alone, MBNA acquired the endorsements of 459 new groups, including the United States Tennis Association, Grambling State University, the Atlanta Braves, National Audubon Society, Barnes and Noble.com, and the Thurgood Marshall Scholarship Fund.
- Although MBNA has no branches of its own, its products are marketed in more than 12,000 bank offices around the United States and United Kingdom through the endorsement of several hundred financial institutions for whom it was more economical to contract out the credit card product rather than offer it themselves. The financial institution sector of the portfolio includes several million customers.

Although targeting prospects through affinity groups has proven to be a clever strategy, not every group member is offered a card product. The key to the company’s profitability and earnings growth (especially given the rapid growth in the size of the customer base) has been in screening the prospects from each affinity group to identify those likely to be quality customers. Given that MBNA’s fundamental business is lending money via an unsecured credit card with a revolving line of credit attached, the company wants to put the card in the hands of customers who will use it but who will not default on their balances. Consequently, MBNA uses information to screen prospects both before it makes card offers (the targeting process) and after it receives applications (the underwriting process).

The combination of affinity marketing and stringent underwriting means that consumers are more likely to be offered products that are appropriate for them—and that fewer consumers are bothered with offers that are inappropriate for them. Across the entire portfolio MBNA customers carry balances about 52 percent higher than the industry average (\$3,519 for MBNA vs. \$2,311 industry-wide) and have an average transaction size 30 percent higher than the industry average (\$129 per card use for MBNA vs. \$99 industry-wide).¹⁷ At the same time, the portfolio delinquency rate was 4.49 percent, and net credit losses at the end of 2000 were 4.39 percent of average managed receivables, both well below the credit card industry average delinquency rate of 4.84 percent and charge-off rate of 5.62 percent.¹⁸

By the end of 2000 MBNA had experienced 40 consecutive quarters of growth in earnings per share. Standard and Poor reported that MBNA had the best five-year annualized return of any bank in the S&P500. *CIO* magazine named MBNA one of the top 100 companies in the United States for excellence in management and strategic use of technology. For the year 2000, *Business*

¹⁷ Source: MBNA.

¹⁸ Source: MBNA and Moody’s Investors Services, Credit Card Credit Index for December, 2000 based on its rating of \$335 billion of securitized credit card receivables.

Week gave MBNA its fourth consecutive best-in-industry rank and inclusion in the Business Week 50, an annual ranking of America’s best performing companies. However, the ultimate testament to the viability of the MBNA business model for delivering value to consumers is that the number of customers using the company’s products and services has grown from several hundred thousand to over 50 million in just 18 years.

3. DIMENSIONS OF THE OPT-IN VS. OPT-OUT DEBATE

a. Opt-In Regimes

Before examining how opt-in rules might impact an information-intensive business like MBNA, some background on the regulatory debate is in order. A common theme that implicitly runs through both federal and state laws in the U.S. is that governmental privacy protections are only permitted when they target specific types of information and providers where a balancing test can be reasonably construed to warrant government intervention. The Supreme Court has struck down many ordinances that would require affirmative consent before receiving door-to-door solicitations,¹⁹ before receiving Communist literature,²⁰ even before receiving “patently offensive” cable programming.²¹ The words of the Court in the first case—involving a local ordinance that banned door-to-door solicitations without affirmative householder consent—are particularly apt:

Whether such visiting shall be permitted has in general been deemed to depend upon the will of the individual master of each household, and not upon the determination of the community. In the instant case, the City of Struthers, Ohio, has attempted to make this decision for all its inhabitants.²²

The U.S. Court of Appeals for the Tenth Circuit reached precisely the same conclusion in 1999, when the court struck down the Federal Communication’s Commissions “opt-in” rule for the use of telephone subscriber information.²³

Nevertheless, opt-in proposals aimed at providers of financial services have proliferated in recent years at both the federal and state levels. Proposed opt-in laws take many forms. Indeed, one of the problems muddying the ongoing debate over opt-in and opt-out is a lack of specificity about the scope of coverage (i.e., exactly what types of information sharing and usage is the consumer being given the opportunity to approve). For purposes of this study we will discuss examples that illustrate the impact of three distinct and successively more restrictive opt-in regimes. The three regimes described below are points along a continuum of rules that range from no restrictions on the sharing of personal information at one extreme to explicit consumer permission for the use of

¹⁹Martin v. Struthers, 319 U.S. 141 (1943).

²⁰Lamont v. Postmaster General, 381 U.S. 301 (1965).

²¹Denver Area Educational Telecommunications Consortium, Inc. v. FCC, 518 U.S. 727 (1996).

²²319 U.S. at 141.

²³U.S. West, Inc. v. FCC, 182 F.3d 1224 (10th Cir. 1999).

any kind of personal information at the opposite extreme. Elements of each of these regimes can be found in laws already enacted in the United States and Europe and in major proposals for new opt-in legislation currently pending before state legislatures and Congress.

i. Opt-In Regime 1—Third Party Sharing Opt-In

The least restrictive set of rules that we consider are opt-in laws that would permit an organization's internal use of personal information about customers or members, *but would require opt-in consent before personal information could be disclosed to third parties outside the organization*. This type of opt-in can be found in bi-partisan proposals that would amend the privacy provisions of the Gramm-Leach-Bliley Financial Services Modernization Act (GLB) that cover the use of personal information by financial institutions.²⁴ A similar application of opt-in principles governing data sharing with third parties has been suggested in a number of states for businesses other than financial institutions. Opt-in limits on certain kinds of *public records* have also been proposed or enacted, such as the 1999 amendments to the federal Drivers Privacy Protection Act.²⁵ Those amendments generally prohibit state motor vehicle departments from disclosing information from motor vehicle registration records (such as owner's age and the type of car owned) without first obtaining opt-in consent. As we shall see in the next section, the adoption of opt-in rules for third-party sharing would affect MBNA mostly by reducing or eliminating certain types of information from external sources upon which the company depends.

ii. Opt-In Regime 2—Affiliate Sharing Opt-In

Moving toward the more restrictive end of the spectrum, the second opt-in regime we consider would limit the *sharing of personal information across corporate affiliates within the same organization*. Affiliate sharing of personal information is a key issue in proposed amendments to GLB and in proposed legislation in many states. In essence, the debate centers on whether separate affiliates under a single corporate umbrella should be treated as third parties. At present, most U.S. privacy laws (including GLB) do not apply an opt-in standard to information sharing among affiliates, but bills pending in Congress and at the state level propose to do so.

The irony in the proposed opt-in amendments to GLB is that the Act itself was predicated on the concept that many financial services could be offered at lower cost to consumers if provided by affiliated companies under a single corporate umbrella, rather than kept separate by artificial limits on the scope of services that could be provided by a single company. Accordingly, the privacy provisions of GLB established tiered consent rules regarding the sharing of personal financial information. GLB requires financial institutions to offer customers a mechanism to opt-out of data sharing with third parties, but does not give consumers the option to limit the sharing

²⁴ 106 Pub. L. No. 102, tit. V, 113 Stat. 1338 (1999) (codified at various sections of 15 U.S.C.). The list of organizations covered under GLB as financial institutions is broad. It includes regulated financial companies including banks, securities firms, insurance companies, insurance agencies, thrifts, and credit unions, as well as other institutions "the business of which is engaging in financial activities," such as finance companies, mortgage brokers and check cashers. So, for example, retailers with credit programs are covered under GLB.

²⁵ Department of Transportation and Related Agencies Appropriations Act, 2000, § 350, 106 Pub. L. No. 69; 113 Stat. 986 (1999), amending Pub. L. No. 103-322, 108 Stat. 1796 (1994) (codified at 18 U.S.C. §§ 2721-2725).

of such information across the institution's corporate affiliates, or its partners in joint marketing agreements.²⁶

The rationale for putting fewer limits on data-sharing among affiliates reflects two significant considerations. First, the responsible sharing of information among affiliates creates demonstrable benefits for the customer, as we shall see in the examples below. Second, as a practical matter, consumers expect different divisions of the same company to know them and to offer services and benefits based on that knowledge. A consumer's decision to do business with a company carries an implicit approval (and expectation) of information-sharing under the corporate umbrella. This is true whether the affiliate is a credit card division of a bank or the auto servicing division of a major retail store chain. The expectation of information-sharing is especially true if affiliates are all operating under the same brand name, such that the affiliate distinction is invisible to the consumer (and often even to company employees).

Corporations organize themselves into divisions that may or may not exist as separately owned affiliates for a variety of reasons including federal and state tax laws, licensing rules and insurance regulations. For these and other legal reasons, MBNA Corporation is organized into the affiliated subsidiary units listed below.

- *MBNA America Bank, N.A.*—The principle subsidiary of MBNA Corporation, MBNA America is a national bank with \$84 billion in managed loans
- *MBNA Europe*—This subsidiary issues credit cards in the United Kingdom and Ireland.
- *MBNA Canada*—This subsidiary issues credit cards in Canada
- *MBNA Insurance Services*—Markets and services credit-related Life and Disability, personal Property and Casualty, and Life and Health insurance products
- *MBNA Consumer Services*—Licensed to provide home equity loans in 42 states and the District of Columbia
- *MBNA Marketing Systems*—Maintains and operates telephone sales facilities to support account acquisition and cross-sell consumer loan, deposit and insurance products. Facilities are located in Delaware, Florida, Maine, Maryland, New Hampshire, Ohio, Pennsylvania and Texas
- *MBNA Hallmark Information Services*—Provides information technology support and services to MBNA America bank and its affiliates. Headquartered in Texas
- *MBNA.com*—The online division of MBNA Corporation. Allows customers to access their account information, apply for new credit products, shop for other products and services, plan and finance travel, and open deposit accounts.

An *affiliate* opt-in regime would restrict the sharing of personal information about prospects and customers across these corporate divisions, all of which operate under the MBNA brand name and under its direct management, despite the fact that customers are likely unaware of the legal distinctions that make certain divisions “affiliates.”

²⁶ Separately from GLB, the 1996 amendments to the Fair Credit Reporting Act do require companies to offer their customers a chance to opt-out of having credit report information acquired for one purpose from being shared across affiliates for other purposes. This provision does not restrict a company from sharing its own transaction experience with the customer among its affiliates.

iii. **Opt-In Regime 3—Blanket Opt-In**

In the most restrictive of the three scenarios we consider, opt-in consent would be required for *any internal use of personal information* subject to exceptions specified in the law (such as for collecting debts, performing requested services, or providing product recall and safety notices). Examples of this form of opt-in can be found both in the United States and abroad. The Federal Communications Commission adopted this type of opt-in system when it prohibited telephone companies from using information about their customers' calling patterns for marketing new services without first obtaining those customers' explicit consent.²⁷ The European Union's Data Protection Directive also mandates such a system.²⁸ The impact of blanket opt-in will obviously depend upon the scope of information uses for which opt-in consent is required (and the companion list of exemptions), but blanket opt-in limits what a business or other organization can do with information it already legally possesses.

b. The Differential Impact of Opt-In vs. Opt-Out

Proponents of opt-in claim that requiring explicit consent for the use of personal information gives consumers greater privacy protection than an opt-out system. But, in fact, both opt-in and opt-out give consumers the final say about whether their personal information is used. Neither approach gives individuals greater or lesser rights than the other. Under both systems the customer makes the final and binding determination about data use. However, there is a stark difference between the opt-in and opt-out systems in terms of their cost.

A pipeline analogy is helpful in thinking about how opt-in vs. opt-out rules affect the flow of personal information through the economy. An opt-out system sets the default rule governing use of personal information to "free flow." In essence, opt-out presumes that consumers *do want* the benefits (greater convenience, wider range of services and lower prices) facilitated by a free flow of information, and then allows people who are particularly concerned about privacy risks to remove their information from the pipeline.²⁹ In contrast, an opt-in system sets the default rule to "no information flow," under the presumption that consumers harbor greater concern about the risk of information usage than the loss of benefits consequent to shutting off the flow. Under an opt-in system, those benefits evaporate unless consumers explicitly grant permission for information about them to flow in the pipeline.

By setting the default rule to "no information flow," an opt-in system restricts the information lifeblood on which today's economic activity depends. Companies that seek to use personal information to enter new markets, target their marketing efforts, and improve customer service

²⁷ Second Report and Order and Further Notice of Proposed Rulemaking: In the Matter of Implementation of the Telecommunications Act of 1996; Telecommunications Carriers' Use of Consumer Proprietary Network Information and Other Customer Information; Implementation of Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, 63 Fed. Reg. 20,326 (1998) (FCC).

²⁸ Directive 95/46/EC of the European Parliament and of the Council on the Protection of Individuals with Regard to the Processing of Personal Data and on the Free Movement of Such Data (Eur. O.J. 95/L281).

²⁹ The phrase "free flow of information" throughout this article refers to personally identifiable information flowing between consumers and companies, across affiliated and non-affiliated companies, and to and from public record repositories.

must restore the information flow by contacting one customer at a time to gain their individual permission to use information. Consequently, an opt-in system for giving consumers choice over information usage is always more expensive than an opt-out system. Opt-in requires that every consumer be contacted individually to gain an explicit consent. In contrast, opt-out is less costly because it infers permission if consumers don't explicitly object. Information about consumers who are either indifferent about the usage or for whom it matters so little as to not be worth the trouble of responding remains in the pipeline.

How large a drag does an "explicit-consent" system impose on economic efficiency? According to the U.S. Postal Service, 52 percent of unsolicited mail in this country is never read.³⁰ If that figure translates to opt-in requests, then more than half of all consumers in an opt-in system would lose the benefits or services that could result from the use of personal information because the mandatory request for consent would never receive their attention. Moreover, even if an unsolicited offer is read, the long-standing experience with company-specific and industry-wide opt-out lists, as well as the recent experience of financial services companies providing opt-out opportunities in compliance with the GLB privacy provisions, demonstrates that less than 10 percent of the U.S. population ever opts out of a mailing list—often the figure is less than 3 percent.³¹ *Indeed, the difficulty (and cost) of obtaining a response of any sort from consumers is the primary drawback of an opt-in approach.*

Under an opt-out system, the failure of consumers to respond does not limit either the use of information about them in the market or the benefits that flow from such use. Under opt-in, however, the failure to respond makes the collection and use of personal information illegal in the absence of explicit consent. To the extent that consumers do not respond to requests for opt-in consent—whether due to the failure to receive or read them, lethargy, confusion, or the competing demands of modern life—their inaction amounts to a total prohibition on the collection and use of information about them.

In addition, because opt-in requires specific, individual contact with each consumer, such a system imposes higher costs that may make the proposed use of information, and the services and products that depend on that use, economically untenable even for those consumers who would have opted in. In 1997, U.S. West (now Qwest Communications), one of the largest telecommunications companies in the United States, conducted one of the few affirmative consent trials for which results are publicly available. In that trial, the company sought permission from its customers to utilize information about their calling patterns (e.g., volume of calls, time and duration of calls, etc.) to market new services to them. The direct mail appeal for permission received a positive response rate between 5 and 11 percent for residential customers (depending upon the size of a companion incentive offered by the company). Residential customers opted-in at a rate of 28 percent when called about the service.³²

³⁰ "Briefs," *Circulation Management*, May 1999 (referring to the U.S. Postal Service's *Household Diary Study* (1997)).

³¹ Internet Privacy, Hearings before the Senate Commerce Committee, July 11, 2001 (statement of Fred H. Cate).

³² *U.S. West, Inc. v. Federal Communications Commission*, 182 F.3d 1224, 1239 (10th Cir. 1999), cert. denied 528 U.S. 1188 (2000). Interestingly, when an opportunity to consent was presented to the customer at the conclusion of a call that the *customer* initiated, 72 percent opted-in.

When it was actually communicating in person with the consumer, the positive response rate was 3-6 times higher than when it relied on consumers reading and responding to mail. But even with telemarketing, the task of reaching a customer is daunting. U.S. West determined that it required an average of 4.8 calls to each consumer household before they reached an adult who could grant consent. In one-third of households called, U.S. West never reached the customer, despite repeated attempts. In any case, many U.S. West customers received more calls than would have been the case in an opt-out system, and despite repeated contact attempts, one-third of their customers missed opportunities to receive new products and services.³³ The approximately \$20 cost per positive response in the telemarketing test and \$29-\$34 cost per positive response in the direct mail test led the company to conclude that opt-in was not a viable business model because it was too costly, too difficult, and too time intensive.

Undoubtedly, explicit consent is easier to obtain in some settings. For example, on-line requests for consent that require a response prior to advancing into a website reduce the non-response problem, although there is mounting evidence that consumers click through these notices without reading them in an effort to obtain the desired products and services. However, direct mail response rates and the very few publicly available studies of telemarketing opt-in campaigns suggest that a broad-based opt-in system would be so costly as to pose a significant risk to the flow of personal information that supports competition and commerce in the United States.

Consequently, for analytical purposes in the following sections *we assume that each opt-in regime effectively blocks the affected forms of data sharing*. That is, we assume that the response to opt-in requests would be too small and costly to make the collection and subsequent distribution of such data economically viable. Depending upon the specific data context, this may or may not be a strong assumption. However, the advantage is tractability of the analysis. By posing the issue this way we can assess the impact on the operations of the business units we study if certain categories of data currently in use were to become unavailable (vs. being devalued to some intermediate degree in terms of accuracy, depth, currency, etc.). Consequently, the resulting discussion illustrates the benefits *at risk* should opt-in be broadly applied without implementing ways for even indifferent consumers to register their opinions at little or no cost to themselves.

³³ U.S. West provided Ex Parte Comments on September 9, 1997 to the Federal Communications Commission highlighting the results from their affirmative consent trials. See brief for Petitioner and Intervenors at 15-16, U.S. West v. FCC, 182 F.3d 1224 (10th Cir. 1999) (No. 98-9518).

4. THE IMPACT OF OPT-IN ON MBNA PRODUCTS, SERVICES AND CUSTOMERS

The following examples illustrate how each of the three opt-in regimes described in the prior section would affect both MBNA and its customers. At the outset we note that *MBNA does not derive revenue streams from selling information about its customers to third parties*. Rather, it purchases information from third parties, gathers information from its own affiliates, and makes extensive use of that data to identify those consumers to whom offers of credit cards and other products should be made. Consequently, broad-based opt-in rules impact MBNA by restricting its ability to collect and use it to deliver products and services to customers and prospects. The examples below do not catalogue all of the effects of various opt-in laws. Instead, they have been selected to illustrate the broad and often subtle impact that a rule as seemingly innocuous as requiring affirmative consent can have on businesses and consumers alike.

A. Impact on Affinity Cards, Customers and Prospects

i. Acquisition of Member Lists

MBNA's core product is the affinity card tailored for and marketed to each of more than 4,700 affinity groups. As discussed in Section 2, the foundation of MBNA's affinity strategy is access to the member lists of each of its affinity organizations. This marketing partnership with thousands of member organizations nationwide makes MBNA unique among major credit card issuers and accounts for much of the company's superior financial performance and reputation for outstanding customer service. However, in the absence of an explicit joint-marketing exception in an opt-in law, a third-party opt-in regime could effectively end MBNA's unique direct marketing approach by sharply limiting an organization's ability to share its member list.³⁴ One result could be that no new affinity programs would be created for the benefit of the organization's members, and existing programs would wilt over time since acquisition of new member names and addresses would be subject to the opt-in requirement. Had a *third-party* or *blanket* opt-in statute existed 20 years ago, MBNA likely would not have built an account base on the affinity marketing strategy.

Affinity groups receive substantial payments when they agree to joint-marketing partnerships with companies like MBNA, payments that would disappear if opt-in brought an end to new affinity partnerships. Disclosure of the contractual terms of such marketing agreements, especially the size of the fee paid to the affinity group, is usually prohibited under confidentiality agreements signed by the issuer and the organization. This is not surprising given that the negotiated fee or royalty arrangement for the exclusive rights to market an affinity card is a critical competitive margin.³⁵ However, evidence from other sources suggests that these

³⁴In light of U.S. West's and other companies' experience with affirmative consent trials, it seems unlikely that many of the 4,700 organizations which currently offer their members an MBNA affinity card product would incur the costs of soliciting affirmative consent from their customers/members. Of course, some or all of those costs could be passed along to the companies (including MBNA) with which the affinity organization negotiates marketing agreements. But, the result would be to drive up the cost of new account acquisition for those companies, possibly by several multiples, relative to the existing environment in which member lists can be legally exchanged. This would neutralize much of the advantage of the affinity marketing strategy.

³⁵ MBNA declined to release even aggregated data for this study, although the company did indicate that the payments to its 4,700 affinity partners are classified as a "marketing expense" in its financial statements.

payments represent a significant revenue source for many non-profit organizations. For example, a U.S. General Accounting Office study of college student credit card marketing found that *“Alumni associations at most of the universities we visited sought additional revenue sources through relationships with credit card issuers. Eleven of the 12 associations we spoke with had affinity relationships with credit card issuers that generated substantial income. Alumni association officials told us that credit card issuers offered a flat fee or a lump sum plus royalties for completed credit card applications from association members or a percentage of the total charges made on affinity credit cards. Officials further told us that the income the associations received from the credit card issuers provided significant support for both the association’s programs and the universities. Income from the affinity agreements was used to cover such things as the association’s budgets, university operating costs, scholarships and mentoring, and long-term projects such as the construction of new buildings.”*³⁶

ii. Culling Prospect Lists to Target Solicitations

Like all major credit card issuers, MBNA uses personal information to increase the chance that its credit card offer will reach an interested and qualified customer. This process greatly reduces the number of solicitations that must be sent to achieve a given target volume of new accounts, thereby reducing the cost of account acquisition. It also reduces the burden on consumers of receiving unwanted direct mail offers, or offers for which they are not qualified. *Third-party* or *affiliate* opt-in systems would eliminate MBNA’s access to a significant portion of the information that it currently uses to identify which individuals on the member lists it receives would be good prospects for a given credit card or other product. A *blanket* opt-in system applicable to marketing activities would impose similar limits.

The MBNA direct mail marketing operations obtain and consider about 800 million consumer “leads” during the course of a year. The vast majority of these leads are names that appear on affinity group member lists (e.g., university alumni groups and professional associations), or names of consumers who are customers of institutions that have endorsed MBNA’s credit card product. Since this is an annual figure, many names appear more than once because the individuals are on more than one list acquired during the course of a year, or may be considered in conjunction with a specific group’s marketing campaign several times during the year.³⁷ Some of the more creditworthy names among them may receive multiple solicitations during the year.

MBNA does not wish to mail to all names on the list. Not all are equally likely to respond to a solicitation nor will all meet the credit underwriting standards for a particular card product. In 2000, the MBNA direct marketing budget supported approximately 400 million mailings of card

³⁶ U.S. General Accounting Office, *College Students and Credit Cards*, GAO-01-773, June, 2001, p. 30.

³⁷ Think of the 800 million names on the company’s annual master lead list as the sum of all the separate member/prospect lists obtained from each affinity organization during the course of a year. Duplication on consecutive versions of the same organization list is actually desirable. Most prospect names remain candidates for solicitations multiple times during a year because circumstances that make them likely cardholders continually change. For example, a customer who appears too risky to solicit in February may have a substantially improved credit profile by September. Similarly, a prospect who declines a solicitation one month may be interested in a new card 9 months later. Consequently, the company will end up screening 800 million names during the course of a year to develop its targeted mailings.

offers. The challenge to the company in managing the acquisition of new accounts is to cull the “lead list” of 800 million prospect names to identify and target the 400 million direct mail solicitations to consumers who are *most likely to become new cardholders*. Generally speaking, MBNA has developed a set of targeting criteria such that for a name to reach the final mailing list of 400 million an individual must:

- Have a higher likelihood of responding to the offer and using the card, and
- Have a higher likelihood of meeting MBNA’s creditworthiness standards for the card.

MBNA prepares hundreds of distinct solicitations throughout the year for its various affinity groups. As part of the targeting process for each new solicitation, the prospect list is scrubbed via comparison to a series of “suppression files” which the company maintains and routinely updates. These files pull information about either individuals or addresses from a variety of internal and external data sources.

A few examples of the specific criteria illustrate the process:

1. The company builds and maintains a list of business addresses and prison addresses that it uses to pare the “prospect” list. In large part these address lists are acquired from external sources. These screens result in about 1 million names being dropped from the annual prospect list. Another 1 million names may be eliminated after being matched against a file of deceased individuals obtained from external public record sources. Altogether, perhaps 20 million names are suppressed based on all kinds of public record information obtained externally.
2. Like most direct marketers, MBNA has developed proprietary response models that help it determine which customers are likely to respond to offers for a credit card, or a card with particular features. These models are based on the company’s past experience with solicitations, and were developed from analyses of the demographic and credit characteristics of those who have accepted past card offers vs. those who did not respond. For these models to be useful, MBNA must gather some demographic information from external sources about its prospects. The models use this information to gauge the likelihood of response. Those least likely to respond are dropped from the list. Removing the likely non-responders would reduce the prospect list by another 45-50 million names.³⁸
3. Creditworthiness, of course, is another key component of a well-targeted credit card solicitation. MBNA’s large national portfolio gives it credit history information for many of the consumers on the prospect list because they already have another card or loan account with the company. For a variety of credit-related reasons, including past or current delinquency, or high existing balances outstanding relative to payment ability, typically another 100-120 million names will be eliminated from the prospect list because

³⁸ For an excellent discussion of the relative importance of internal vs. external information for predicting responses in the context of apparel catalogue marketing, see Michael A. Turner, “The Impact of Data Restrictions on Consumer Distance Shopping,” a report published by the Information Services Executive Council (ISEC), of the Direct Marketing Association, 2001.

they do not meet MBNA's underwriting standards for a particular card offer. The individuals dropped from the target list exhibit a higher risk of delinquency or probability of a loss at the time the solicitation mailing is prepared than those who remain on the list.³⁹ Credit information can also identify those consumers who, due to their extraordinary creditworthiness, are probably solicited frequently by card issuers and are consequently not likely to respond to yet another offer. Perhaps another 20-25 million names fall into this category of "unlikely to respond" and are dropped.

The bottom line from the culling process is that approximately 40 percent of the 800 million names are suppressed. The initial lead list is typically reduced by an additional 10 percent through a combination of eliminating duplicate records, suppressing undeliverable addresses and dropping customer names that appear on various "do not mail" lists that record customer preferences not to be solicited. This last point will be addressed in greater detail below. The approximately 400 million names remaining on the lead list receive targeted direct mail offers with the endorsement of the affinity group to which they belong.

Both *third-party* and *affiliate-sharing* opt-in regimes would dramatically limit MBNA's ability to access the information necessary to determine which of the 800 million "leads" it receives are appropriate candidates to receive card offers. So even if a *third-party* opt-in regime exempted the exchange of organization member lists through some type of joint-marketing exception, opt-in rules would still impose costs on both MBNA and consumers by reducing the availability of the other external and internal data upon which the company relies to refine its targeted marketing.

For purposes of this case study, we worked with MBNA analysts to estimate the likely impact of various opt-in rules on its ability to effectively target its offers to prospective cardholders. For analytical purposes, we will assume that opt-in rules prevent the company from using three categories of information that it normally uses to screen prospect lists. Specifically, we assume that *third-party* and *affiliate* opt-in rules:

- a. Prevent MBNA from accessing data from companies that collect and sell public record information.
- b. Eliminate MBNA's sources of external demographic information on prospects
- c. Block the utilization of credit information about a prospect who also held another MBNA account unless that credit information was based exclusively on the customer's handling of the MBNA account. That is, MBNA could use only its own experience with that customer, but could not use information it might have on that customer based on a credit report, such as balances with other creditors or a bureau-based risk score.⁴⁰

³⁹ Because of its heavy reliance on the affinity group member lists to identify prospects, and its large existing portfolio, MBNA is unusual among major credit card issuers in that it doesn't make extensive use of pre-screening (as authorized under FCRA) to identify creditworthy customers. MBNA indicated that only about 25 percent of all direct mail offers are prescreened by credit bureaus. In part this is also due to its underwriting practice, also unusual in the industry, of manual (as opposed to automated), judgmental review of each application that is returned, a process that presumably includes pulling credit bureau information at that time.

⁴⁰ As previously noted, current FCRA rules require companies to give customers the chance to opt-out of having information from their credit report shared across corporate affiliates. We are assessing the impact of a shift in the FCRA rules to an opt-in regime.

MBNA's proprietary response models indicate that its use of information in these three categories to cull likely prospects accounts for approximately a 19 percent reduction in names from the annual prospect list. In other words, by targeting offers under current rules, about 150 million names on the prospect list during the course of a typical annual solicitation cycle do not receive solicitations because the direct mail piece would otherwise reach a consumer who was either not interested or not qualified for the card product.

The loss of the information used to cull these names from the prospect list blurs the company's view of likely prospects. After the culling process under the opt-in scenario, approximately 550 million names would remain, instead of 400 million under the current rules. Lacking the information necessary to further distinguish good prospects from poor prospects, the company's targeting efficiency would be impaired.

MBNA would have two choices. It could increase its direct mail volume to send solicitations to all 550 million names remaining on the prospect list after the culling process, or it could arbitrarily remove 150 million names from the list after the culling process so that its direct mail volume remained unchanged at 400 million. *Under either scenario, approximately 27 percent of the solicitations (150 million/550 million) would go to consumers who were less interested in, and/or less qualified for, the offer, and who would have been dropped from the target list had MBNA been allowed to access and use the information on which its presently relies under current privacy rules.*

Under the expanded-mailing option, we know that 150 million solicitations would go to consumers who would have been eliminated from the target list had MBNA been permitted to use the best information available. The resources devoted to the extra mail volume are essentially wasted purely as a result of artificial limits on MBNA's access to more complete information about its prospects. Some unqualified prospects would undoubtedly respond, so MBNA would also incur the extra cost of receiving, reviewing and ultimately rejecting these applications.

Alternatively, suppose that MBNA chooses to leave the direct mail volume unchanged at 400 million pieces. Without more precise targeting information, MBNA must randomly select 400 million prospects from the 550 million names on the list. The probability of selecting a less qualified prospect onto the final mailing list is .273 (150 million/550 million). Consequently, we would expect that out of the 400 million recipients of the resulting card offers, 109 million (27.3 percent) will be consumers who would otherwise have been excluded for lack of interest or qualifications. Significantly, this also means that another 109 million consumers who should have received the solicitation (i.e., who the available information would have predicted were both interested in and qualified for the offer), miss out on the opportunity to learn about the product or service. And, the exclusion of these 109 million likely prospects means that the average quality (as measured by expected profitability) of the responses received by MBNA will fall.

Applying the known response and approval rate factors for each of the formerly screened groups, we worked with MBNA analysts to calculate that the net converted rate (percentage of individuals receiving an offer who actually become new cardholders) under the opt-in scenario

would fall by 18 percent. *This results in a 22 percent increase in the direct mail cost per account booked.*⁴¹

Although MBNA's actual response rate and cost per account booked is proprietary we can illustrate the impact of the decline by utilizing the credit card industry average response rate to direct mail solicitations for 2000 which was 0.6 percent.⁴² For every 100 million solicitations mailed to individuals under the opt-in scenario, only 492,000 new accounts would be booked, as compared to 600,000 if the offers were targeted under existing rules, an 18 percent reduction in new accounts for the same expenditure on direct mail solicitations. Of course, the higher cost per account booked is borne not only by MBNA, but by MBNA's customers as well in the form of higher prices, reduced benefits, diminished service and/or higher acceptance standards for new credit products.

But, the negative impact doesn't stop there. Regardless of whether MBNA's response to opt-in is to mail more solicitations or mail the same number to a less-targeted prospect list, under either scenario, the recipient group of 400 million individuals will, on average, be more risky and less profitable than MBNA's target group reached under the current rules. As a result, MBNA's delinquency and charge-off rates will rise, relative to its current experience, thereby imposing additional costs which will be passed along to all of MBNA's customers. Card usage will also be affected by booking cardholders who are less likely to use the card.

In a simulation using MBNA's proprietary data on average card balances, finance charges and operating expenses (based on the company's current experience with new accounts), we determined that *the first five years of account activity for the cohort of new accounts generated annually under the opt-in scenario would generate an 8 percent reduction in net income before taxes, relative to the more precisely targeted group acquired under existing rules.* It is important to note that this cost only measures the impact of opt-in on the credit card account acquisition component of MBNA's business, and does not reflect the impact on cross-selling opportunities or customer service. Examples of how opt-in affects these activities are discussed in the next section.

To summarize, third-party and affiliate opt-in would raise by 22 percent the cost to MBNA of booking a new credit card account via direct mail. In addition, because offers would be sent to customers less interested in using the card as well as higher risk customers, third-party opt-in would cost MBNA and its shareholders approximately 8 percent of the net income earned before taxes on each new cohort of accounts over a five year period.

The irony in these results is that MBNA customers already have several options to instruct the company not to use their personal data for marketing purposes. The number of customers who

⁴¹ Let C_1 = current cost per account booked, M = Total direct mail marketing budget and X = number of accounts booked. Then, $C_1 = M/X$. The MBNA simulation revealed that the percent of prospects receiving offers who actually become new cardholders would fall by 18 percent under the opt-in scenario. Consequently, the accounts booked under the opt-in scenario = $.82X$. Let $C_2 = M/.82X$ = cost per account booked under the opt-in scenario. Then $C_2 = C_1/.82 = 1.22C_1$.

⁴² According to BAIGlobal, Inc., a widely cited source of credit card marketing data based in Tarrytown, NY, card issuers mailed 3.543 billion card solicitations in 2000, with a response rate of 0.6 percent. For more details see their website at www.baiglobal.com.

have expressed such a preference is small relative to the customer base. For example, out of more than 30 million notices mailed by MBNA alerting customers they could opt-out of the transfer of their credit report information across affiliates, only 130,000 customers indicated such a preference. Additionally, just over one million customers have opted out of receiving any type of direct mail marketing offers from the company. Since these customers have their preferences respected under current privacy rules, it suggests that an opt-in regime to accomplish the same purpose is unnecessary, as well as expensive and burdensome to all consumers regardless of their privacy preferences.

B. Impact on Cross-Selling

i. Cross-Selling as Customer Service

Like most financial institutions, MBNA builds value for its customers by offering them additional financial services tailored to their needs. Mass marketing of products is being supplanted by Customer Relationship Management (CRM), a fundamentally different approach in which customer acquisition (e.g., via a credit card product) is just one stage of a long-term relationship between a business and its customers.⁴³

Nowhere are the advantages of CRM more keenly felt than in the financial services industry. An Executive Vice President in charge of the consumer credit division at Wachovia Bank wrote recently that “It used to be relatively simple for a skilled banker to create an effective banking experience for customers. But today there are diverse products, a broader geography, new technology and delivery channels. . . Even the best and brightest bankers cannot service their customers themselves in a customized manner. They must rely on information to direct their efforts more effectively, to personalize the interaction their customers have with the bank.”⁴⁴

The concept of “know your customer” is at once ancient and revolutionary. The 19th century shopkeeper built long-term relationships with his customers. The storeowner knew customers personally, could greet them, anticipate their needs and win their continued business. In today’s markets dominated by large corporations, relationships can’t be built around a customer contacting the same company employee every time. Instead, technology allows firms of all sizes to collect and store information about customers derived from multiple contact points (some human and some automated), and make it available to company employees in order to personalize the service whenever they have contact with customers. In essence, today’s company knows its customers through its database.

MBNA offers a variety of financial services in addition to credit cards, including home equity loans, closed-end installment loans, a variety of property, life and casualty insurance products, and various deposit products. The company’s cross-sell challenge is to identify which of its

⁴³Three realities are pushing marketers like MBNA to adopt CRM strategies. First, the growing diversity of the U.S. population is making traditional segmentation overly complex so that even targeted marketing campaigns are increasingly missing their mark. Second, demographic shifts have reduced the flow of new, young customers entering the marketplace, raising the value to customer retention. Third, customers like personalized service and reward it with continued patronage.

⁴⁴Beverly Wells, “At Wachovia, Customer Focus Means Information-Driven Continuous Relationship Management,” *Journal of Retail Banking Services*, Summer, 1999, pp 33-36.

products would be useful to a particular cardholder. Since it never sees its cardholders, the process of getting to know its customers in order to tailor new opportunities must rely solely on the skillful acquisition of relevant data and the use of information technology to translate the data into products and service.

MBNA analyzes card usage patterns and appends additional information acquired from a variety of external sources as well as other MBNA affiliates to put a face on the customer. As a simple but typical example, MBNA's Consumer Services affiliate may build a telemarketing campaign to offer home equity loans to current credit cardholders. The process would begin with a list of existing cardholders who have high balances on their MBNA cards and match it against an externally acquired list of homeowners. Targeting the solicitation at homeowners avoids the obvious waste of contacting renters for a home equity product. Use of the high-balance cardholder list raises the likelihood of contacting a cardholder who will be interested in tapping a home equity line product because past research has shown that many people use home equity lines to pay off higher-rate credit card balances (at the same time taking the advantage of the tax-deductibility of interest paid on home equity accounts). Presumably, credit information on the current cardholder (either based on MBNA experience or possibly credit bureau information) would be applied to screen for creditworthiness, which reduces the potential ill-will associated with the company offering a product to an existing customer and later rejecting them.

How would the opt-in regimes impact this home equity offer? Opt-in for *third party* sharing would limit the availability of the externally acquired homeowner list. Opt-in for *affiliate* sharing would limit the ability of the credit card affiliate to share the prospect list with the home equity affiliate. And *blanket* opt-in applicable to marketing would restrict MBNA's ability to use any customer information to cross-sell. All three regimes would sharply reduce MBNA's ability to get the right offer to the right cardholder. Replace the home equity line example with other cross-selling opportunities for products that are valuable and relevant for only certain customers (e.g., student loans, retirement annuities, college savings funds), and it becomes clear why nascent CRM efforts would be crippled by movement toward Opt-in rules.

Without the personal information necessary for targeting, cross-selling would revert to the bygone days of blind mass marketing, generating a higher percentage of offers to unqualified or uninterested consumers. Low response rates and potentially high annoyance among current customers could conceivably prevent such a marketing campaign from being launched. Many cardholders would miss the opportunity to even learn about a useful product. In the home equity line example, customers who maintain high balances on their credit cards would miss the opportunity to reduce both their monthly payments and their interest rate with lower-rate home equity loans.

MBNA's diverse activities offer other examples of lost opportunities to customers as a result of an opt-in applied to *affiliate sharing*. For example, MBNA will occasionally do direct marketing of closed-end consumer finance loans to consumers who have been rejected for credit cards. The company's ability to find a way to serve that customer, even if not with a credit card, would be impaired if opt-in limited the ability to transfer the rejection list data across the affiliates participating in building the offer.

Consider the reverse situation. Currently the company has the ability to coordinate new offers with the activities of other affiliates. So, for example, the credit card unit can suppress direct mail offers to individuals who have recently been declined by the consumer finance affiliate. Since the approval criteria for consumer finance loans is typically less stringent than for the credit card products, the company already knows that the customer is unlikely to be approved for a new card. The ability to suppress such names saves the irritation to the consumer (and ill will toward the company and possibly the affinity organization) from soliciting a customer you've already turned down and know you will turn down again.

ii. The Impact on Efficient Corporate Organizational Structure

A separate but important dimension of opt-in's impact on MBNA's cross-selling activities deserves mention. An opt-in rule for *affiliate sharing* would limit MBNA's ability to telemarket its cardholders for any product or service because the company's call centers are administratively housed within a separate affiliate. Consequently, the data needed to assemble and screen the prospect list could not be transferred from the other company affiliates without the customer's explicit permission. To overcome this problem, the obvious solution would seem to be to reorganize the company's administrative structure to bring the telemarketing unit back into the credit card affiliate, making opt-in consent unnecessary. Of course, this perfectly legal move highlights the inherently arbitrary nature of opt-in limits on the movement of data across affiliates.

The practical implications are more complex. The existing corporate structure was not chosen by accident. Like many service organizations, MBNA located its telephone sales call centers (which handle outbound telemarketing) in areas where labor is plentiful and skilled, and labor costs are relatively low. The company maintains telemarketing call centers in states such as Texas, Maine, New Hampshire, Ohio and Florida. However, if the telemarketing centers were administratively part of the credit card affiliate, then locating the telemarketing centers in a variety of states other than where the credit card affiliate was headquartered (Delaware) would open the credit card unit to tax, licensing and regulatory exposure in multiple jurisdictions. Consequently, to capture the advantages of both lower operating costs and lower administrative costs, the existing administrative structure was adopted which sets up the telemarketing and card-issuing units as separate affiliates. Of course, while the savings to the company are significant, both the administrative structure and its rationale are invisible to MBNA's customer.

Nevertheless, if an opt-in regime restricted its ability to move data from the credit card affiliate to the telemarketing affiliate, MBNA would be forced to *administratively move* the telemarketing unit back into the card division (being unwilling to operate without a telemarketing function). But, the threat of multiple-state tax and regulatory liability could force the company to *physically move* the telemarketing unit back to Delaware, and to incur relocation costs, disruption to services, and lost efficiency over the long term, as well as lost jobs in the vacated communities.

C. Impact on Efforts to Prevent and Detect Fraud and Identity Theft

Like all major financial institutions, MBNA invests heavily in preventing and detecting credit card and other forms of financial fraud. The single most important tool in that fight is personal

information. For example, MBNA monitors account activity to determine unusual or out-of-the-ordinary charges. Through sophisticated computer models, and access to a wide range of information from many sources about “normal” charging patterns, MBNA can spot unusual charges that may indicate a card has been stolen or an account has been taken over by an identity thief. Many MBNA customers report that they first learn of a missing card or fraudulent activity when an MBNA Customer Service representative calls to verify unusual charges.

MBNA also monitors account activity to apprehend criminals perpetrating fraud. Close monitoring can identify patterns of activity that help law enforcement officials track down crime syndicates, fraud rings, and other sophisticated, organized efforts to defraud the company and its customers.

MBNA uses data from across its affiliates to identify suspicious behavior, watch for identity thieves who attempt to open multiple accounts in the names of other people, and prevent people who are delinquent on one MBNA account from inappropriately opening other accounts with the company to cover their shortfall. Data about identified thieves is shared among affiliates to help reduce losses and protect customers, employees, and shareholders.

With 51 million customers, MBNA receives thousands of change-of-address notices every day. Most involve routine moves, but a few reflect the efforts of an identity thief to take over an existing account by changing the address to which statements are sent. By accessing directory information from public records and third parties, MBNA can verify a change of address to see if it matches any known address of the account holder. If not, MBNA can inquire further to determine whether the change is legitimate.

Each MBNA unit makes extensive use of information from its own accounts in the fight against fraud, and shares information across affiliates to gather a more complete picture of charging patterns, target troubled accounts, warn of known identity thieves, and ensure that customers are served both efficiently and safely when changing address or updating account information. MBNA also relies heavily on third party data to verify addresses and other information, spot abnormal charges, prevent and detect fraud, and apprehend perpetrators. All of these efforts require ready access to personal information from both internal and external sources. Any form of opt-in regime—whether it applied to third parties or affiliates—would degrade the effectiveness of those efforts.

Even if an opt-in regime specifically exempted the use of personal information for antifraud uses, the reality is that many of the external sources of information that MBNA uses to prevent and detect fraud could be seriously diminished (if not eliminated) by broadly applied opt-in rules. Few such data sources are assembled only for antifraud purposes or paid for only by such uses. The data and systems that support antifraud uses also serve other purposes, which help cover the cost of collecting and maintaining the information. For example, the records used to verify addresses are affordable precisely because they are used for a variety of marketing purposes.⁴⁵ These other uses subsidize the fraud prevention and detection services. Permitting

⁴⁵ The most sophisticated systems on the market for identifying individuals (i.e., ensuring that someone purporting to be John Doe is indeed John Doe) are “relationship databases” (we are aware of at least two companies, Experian, Inc. and Acxiom, that drive a variety of commercial identity-related applications from such databases). Such

their use in connection with antifraud measures, while using an opt-in regime to restrict their use for those other, economically important uses, is tantamount to preventing access altogether.

5. Conclusions

The practice of offering consumers a choice over many uses of their personally identifiable data is now well accepted in both the public policy and business communities. If a way could be devised such that consumers could register their preferences regarding personal data usage at no cost to themselves or to businesses, then the debate over whether to impose an opt-in vs. opt-out rule would largely disappear. However, in the absence of a costless method of registering consumer preferences, *an opt-in system remains significantly more restrictive than an opt-out system because non-response is treated as disapproval, even if it arises from consumer inattention or indifference to the choices.*

The preceding case has demonstrated a variety of ways in which a move to opt-in would impact a large financial services firm. We have considered the imposition of three types of opt-in rules: *third-party* data sharing, *affiliate* sharing and *blanket* opt-in which restricts use of data a company already possesses. Based on prior experience, we assumed for analytical purposes that a move to opt-in would effectively block the affected forms of data sharing. That is, we assumed that the positive response to opt-in requests would be insufficient to make the collection and subsequent distribution of such data economically viable. We then examined the impact on MBNA's operations if certain categories of data currently in use were to become unavailable. Thus, the analysis assesses the benefits to consumers and the economy that are *at risk* should opt-in be broadly applied.

To briefly summarize the impact on MBNA, we found that mandatory opt-in requirements on MBNA's operations would:

- **Hobble MBNA's affinity group business model:** A *third-party* opt-in rule would drastically affect MBNA's central business model which has built a cardholder base of over 50 million customers around the affinity marketing strategy. Access to member lists for organizations such as professional associations and alumni groups allows MBNA to identify likely cardholder prospects and tailor a product for them that builds on their affinity for the organization. This strategy implodes with loss of access to member records. Of course, a joint-marketing exception to a *third-party* opt-in rule could be

databases assemble a wide variety of information (including age, social security number, previous addresses, etc.) in order to amass a knowledge base against which to evaluate new pieces of information. If a name, address and social security number combination doesn't exactly match the information on file, a relationship database can compare the new information against the collection of past information and determine the probability of a match. The deeper the knowledge base, the more reliable the match. These databases are built from billions of pieces of information collected mostly for commercial purposes and assembled to support a variety of commercial applications. Fraud prevention is but one of them. When one piece of information is no longer available (e.g., date of birth), the ability to evaluate new information and verify identity with a given degree of precision is degraded. Thus, an opt-in statute like the 1999 amendments to the Drivers Privacy Protection Act (which has all but eliminated state motor vehicle records as a source of age/date of birth data) has significant ripple effects because it degrades the value of such databases.

written to preserve access to such member lists. But, the need to do so reinforces the point that broadly applied opt-in rules can undermine relationships and widely accepted marketing practices that have brought benefits to millions of American consumers. More generally, a public policy approach of writing exceptions into broad-based opt-in rules in an attempt to preserve certain practices clearly runs the risk of overlooking some beneficial relationships.

- **Raise account acquisition costs and lower profits:** Target marketing efficiency deteriorates under opt-in rules. Both *third-party* and *affiliate-sharing* opt-in regimes would dramatically limit MBNA's ability to acquire and use the information necessary to determine which of the 800 million annual "leads" it receives are appropriate candidates to receive card offers. By reducing its ability to cull prospect lists, these opt-in rules would boost MBNA's cost per account booked via direct mail by 22 percent. Moreover, the accounts booked would have lower revenues and higher losses relative to the more precisely targeted group, yielding an 8 percent reduction in net income over the first five years of experience.
- **Reduce supply and raise credit card prices:** The economy-wide impact of opt-in is far greater than its impact on a single company. Since opt-in restrictions of the type analyzed above would impact all credit card issuers (not just MBNA), the reduction in supply (from both incumbent firms and new entrants) resulting from higher production costs would inevitably impact all cardholding consumers through higher prices, limits on card features or reduced access to credit cards. Consider just the pricing issue. The data presented in Section 2 revealed that credit card interest rates dropped by several percentage points between 1990 and 1993 *consequent to the influx of new competitors*. The friction imposed by opt-in restrictions would raise entry barriers and begin to reverse that trend. Simulating the precise impact of a move toward opt-in rules on credit card interest rates is beyond the scope of this paper. However, we estimate that every percentage point hike in credit card interest rates as a result of less vigorous entry and competition would cost consumers approximately \$5 billion in additional finance charges annually.⁴⁶
- **Generate more offers to uninterested/unqualified consumers and raise the number of missed opportunities for qualified consumers:** Not all of the additional costs imposed by opt-in would be financial. All of the opt-in scenarios considered in this case study would reduce the targeting accuracy of credit card solicitations. More consumers would receive offers in which they were not interested and for which they are not qualified, resulting in a higher incidence of "junk mail" and higher rejection rates on card applications. In addition, each of these opt-in regimes impairs MBNA's ability to implement effective Customer Relationship Management, and cross-sell other financial services. Consequently, consumers would miss opportunities for products and services that they might value.

⁴⁶ This calculation is based on average outstandings and total interest revenue for all general purpose credit cards in the United States for 2000. Total interest income for bank credit card issuers (including Visa, MasterCard, Discover and American Express) in 2000 was \$64.3 billion, which equaled 13.7 percent of average receivables outstanding. Source: Card Industry Directory, 2002 edition, Thomson Financial Media, New York, NY, 2001, p11.

- **Impair efforts to prevent fraud and identity theft:** Broad-based opt-in laws would pose a significant risk to the antifraud efforts of all credit card companies, even if written to exempt the specific use of personal information to prevent and detect fraud. Much of the external information on which MBNA and other companies rely may no longer be available under broadly applied opt-in rules. Uses of such information for a variety of commercial purposes make it economically feasible to create the databases that are later tapped in conjunction with antifraud efforts. MBNA and all of its customers would be harmed if opt-in rules led to shrinkage of those databases, and subsequent dilution of MBNA's effectiveness at preventing fraud.

The irony is that MBNA already offers customers opportunities to limit the company's use of their personal information. As of the end of 2000, about 130,000 customers had opted out of having their credit report information transferred across MBNA affiliates. Over one million customers had opted out of receiving any type of direct mail marketing offers. Since these customers have their preferences respected under the current privacy rules, it suggests that an opt-in regime to accomplish the same purpose is unnecessary, as well as expensive and burdensome to all customers regardless of their privacy preferences.

Finally, it should be noted that while legislation may impose practical limits on business access to personal information, it does not change the underlying value of that information. MBNA has an economic incentive to improve its targeting efficiency in either an opt-in or opt-out environment. *Legal restrictions on the collection of useful data simply boost the incentives to devise proxies for the attributes the restricted data were useful for measuring.* These proxies are necessarily less accurate and/or more expensive (or they would have been used in the first place), and quite possibly more intrusive and less equitable. For example, if individually specific data is no longer available, MBNA and other card issuers might adopt rougher proxies for an individual's attributes based on census tract data for the person's neighborhood.

Movement in this direction as a consequence of opt-in rules, especially in the context of credit and financial services markets, is a step backward from the broad "democratization of credit" experienced over the past generation. Opponents of targeted marketing would do well to study the lessons learned following the implementation of statistical risk scoring in consumer credit markets. The use of risk scoring to evaluate loan applications has garnered both overwhelming commercial success and regulatory approval precisely because the resulting credit decision is based on an applicant's own credit history and past payment performance. Relative to older "judgmental" underwriting rules, credit decisions that incorporate risk scoring have repeatedly been shown to be more accurate (lower losses for a given number of approvals) and more equitable in terms of making more credit available to a wider range of consumers.

Similarly, targeted marketing of financial services to consumers uses information about each individual's past purchasing experience to tailor future offers. Targeted solicitations and messages liberate marketing from reliance on stereotypes that lump consumers into categories based on socioeconomic characteristics rather than actual behavior. More precise information about consumers' likes and dislikes (as inferred from past shopping and buying patterns) gives marketers an incentive to design and deliver solicitations to the mix of prospects most likely to

be interested in the offers. Businesses incur lower costs of reaching interested customers. Consequently, consumers enjoy greater access to new products. But, opt-in rules in the name of privacy “protections” choke off the information flows that make targeting possible.