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Transferral of pension fund databases

Israel's data protection authority (ILITA) expressed concerns after Israeli banks were ordered to divest their holdings in pension funds and mutual funds, transferring client databases containing sensitive financial information to new owners. Yoram Hacoen, head of the ILITA and Omer Tene, Associate Professor at the College Management School of Law, examine the concerns and how they were resolved.

In the summer of 2005, Israeli banks were mandated to divest their holdings in pension funds and mutual funds, as part of a set of reforms intended to reduce concentration in the financial market'. Consequently, the banks sold their holdings in pension funds to insurance companies and other investment vehicles. The ensuing series of transactions, of significant scale and scope relative to the size of the Israeli market, raised a host of data protection issues requiring regulatory resolution. In this article, we introduce several questions and dilemmas which arose from the regulatory review of the divestitures and acquisitions in Israel's pension fund industry.

Regulatory cooperation

Interestingly, the Israeli Law and Information Technologies Authority (ILITA) - the data protection regulator - came to scrutinise the transactions as a result of requests of the purchasers to change the details of the databases' registration status. These requests, in turn, were motivated by the instruction of financial market regulators, who provided the parties with a check list of regulatory assignments to be completed prior to the authorisation of the transactions. This process underlines the importance of cooperation among

regulatory agencies. By integrating privacy considerations into their regulatory frameworks, telecoms, financial market and consumer protection regulators may help weave a regulatory web, ensuring compliance with data protection law.

Israeli data protection law

The right to privacy has been elevated to constitutional status in Israel in Section 7 of Basic Law: Human Dignity and Freedom of 1992. Dating from 1981, Israel's Privacy Protection Act (PPA) is one of the first data protection statutes in the world. Under the PPA, databases containing 'sensitive data', defined as, *inter alia*, information about an individual's financial condition, are subject to mandatory registration with the Database Registrar, which is currently a unit of ILITA. Section 9(b)(2) of the PPA provides that the controller must specify in its registration application 'the purposes for which the database was established and for which the data are intended'. Section 10(a)(2) of the PPA authorises ILITA to 'register a database with a purpose different than the one specified in the application, register several purposes, or order the controller to file several applications in place of the one filed, if such modifications better reflect the actual use of the database'. Any post-registration change in the identity of the controller or the purposes for which the data are intended must be notified to ILITA under Section 9(d) of the PPA.

Section 11 of the PPA requires controllers to provide data subjects from whom data are collected, information concerning the purposes for which the data are intended; any recipients of the data; and the purpose of any data transfer. The purpose limitation principle is set forth in Section

2(9) and 8(b) of the PPA, under which the use or transfer of personal data for a purpose other than that for which the data were provided, constitutes an invasion of privacy. An invasion of privacy is both a civil tort and a criminal offence.

Members' consent

An initial question that arose from the sale of the pension funds' assets was whether the transfer of a database containing information about the fund members' financial condition requires such members' prior consent. Needless to say, the banks and insurance companies wanted to perform the transactions without having to solicit consents. Yet under the PPA, data transfers to third parties, including corporate affiliates, may constitute a breach of the purpose limitation provisions, absent such consent. Under Section 11 of the PPA, any prospective transferees must be notified in advance to the data subjects. It is not clear, however, if consent is required under the PPA where a transfer does not alter the initial purpose for which the data were collected. In addition, the parties could have relied on Section 18(2)(b) of the PPA, which exempts from liability privacy infringements that were mandated by a legal obligation - in this case financial reform legislation. ILITA concluded that specific consent is not required to effectuate the transfer of a database between pension fund management companies. ILITA reasoned that the transactions were mandated by statute and that fund members were granted an opt-out option to transfer their savings to a different fund if they were dissatisfied with the incoming management company.

The controllers

The pension fund purchasers

sought to register the parent entity of the insurance group as data controller. This would facilitate intra-group data transfers, integration of data into a central database and potential expansion of the legitimate uses of data. The purchasers pointed to the economic structure of the acquisition, which typically featured the parent company, as opposed to the pension fund management company executing the transaction. ILITA rejected this approach and required pension fund management companies ('fund managers') - which are lower down the corporate hierarchy - to register as controllers. ILITA relied on pension fund regulation, which imposes duties of care and loyalty on fund managers, as well as on data protection law, which restricts uses of data to those authorised by data subjects. ILITA exercised its authority under Section 10(a)(2) of the PPA, to mandate separate registration of each fund's database under the name of that fund's management company. It explicitly stated that the consequence of separate registration is that insurance groups operating more than one pension fund may not integrate members' data into a central database without such members' prior consent. ILITA stressed, however, that the restrictions on data transfers do not reflect on the economic ownership of the pension funds. Thus, while a pension fund's database must be locally controlled by its management company, the fund's assets may be managed centrally by the insurance group's parent company.

The processors

Under the acquisition agreements, despite divesting their holdings in pension funds, banks would continue to provide fund

The data subject's consent hinges on a specific database, and once that database is sold, the consent is 'transferred' with it

purchasers with data processing services. This is due to the technical expertise and IT systems developed by the banks over the years. The banks argued that as sellers and/or data processors, they may continue to lawfully use the fund databases for their own business purposes. ILITA held that while fund managers may authorise banks to act as data processors on their behalf, they may do so strictly for the purpose of operating the funds for their members' benefit. Any additional use of the data by the banks is strictly prohibited. Consequently, the banks were ordered to comprehensively map the information flows in their system and delete and avoid use of any copy of the pension fund data, except in connection with the provision of processing services to the purchasers. Under Section 10(b3) to the PPA, the banks were required to verify the deletion of the data by an affidavit. However, ILITA recognised that the banks may have a legitimate interest or even a legal obligation to retain certain data and documentation for potential use as evidence at trial. In these limited circumstances, banks would be permitted to lawfully retain the data, provided that they would not be used for any additional purposes. Finally, ILITA instructed the purchasers to verify the processors' compliance with data security requirements under Section 17A of the PPA.

An additional argument raised by the banks in this respect was that the pension fund members initially granted their consent to use the data for both the operation of a pension fund and the provision of pension advice. The Bachar Reform required banks to terminate the former activity, but not the latter. Hence, banks claimed that despite the sale of the

pension funds, they were entitled to continue to use the fund databases in order to provide members with pension advice. ILITA rejected this argument, holding that the transfer of a database from a controller to a third party has the effect of 'resetting' the data subject's consent. The transferor cannot maintain a 'portion' of the initial consent. The data subject's consent hinges on a specific database, and once that database is sold, the consent is 'transferred' with it. ILITA reasoned that any other interpretation would allow parties to duplicate data subjects' consent time and again by transferring the database.

The purpose of the database

ILITA determined that the purpose clause in the funds' database registrations must state that 'the database will be used for the lawful managing, operation and marketing of a pension fund'. ILITA exercised its authority under Section 10(a)(2) of the PPA to reject attempts to register broader purpose clauses. It held that the databases may be used strictly to perform tasks allocated to fund managers under pension fund regulations; such as accounting for deposits and withdrawals, managing fund assets, preparing periodic reports, and marketing services 'of the pension fund itself' to the members. ILITA held that the purpose clause marks the boundaries of the members' implied consent to the processing of their personal data upon joining a pension fund. ILITA rejected fund manager claims to legitimise additional uses of data, particularly for marketing purposes or the provision of direct marketing services to third parties.

Direct marketing by fund managers

Substantial legal controversy revolved around the extent of lawful use by fund managers of members' personal data for direct marketing purposes. Besides the purpose limitation provisions of Section 2(9) and 8(b) of the PPA, such marketing activities are subject to Subchapter B of Chapter B of the PPA, governing direct marketing, and to the recent amendment to the Telecommunications Act, governing unsolicited communications via electronic means².

ILITA approached these questions by making several factual distinctions. It distinguished between marketing:

- services that are substantially equivalent to pension savings or other goods and services;
- by the fund manager, a member of the insurance group or a third party;
- with or without an actual data transfer;
- based on specific profiles or categories of data or to the customer list as a whole.

The result of these distinctions is a matrix delineating the lawful uses of data for direct marketing services in the pension fund sector.

The relatively simple case is where the fund manager itself approaches its members to market its own products. Such approach is permitted, provided that the fund manager complies with the direct marketing provisions of the PPA, which include an opt-out right for data subjects³. At the other extreme is a transfer of data from the database to a third party for direct marketing purposes, an activity

defined in the PPA as 'direct marketing services'⁴. Such a transfer is prohibited without the data subjects' prior informed consent and without registering direct marketing services as one of the purposes of the database.

After careful deliberation, ILITA held that in order to balance the competing interests of controllers and data subjects, it would allow direct marketing services to third parties, provided that all of the following conditions are met:

- the approach must not be based on profiling or segmenting but rather to the customer base as a whole;
- the marketed product must be a pension product as defined by pension regulations;
- the third party must be a corporate affiliate of the fund manager; and
- the fund manager must comply with the direct marketing provisions of the PPA, including proper notice to the data subjects and provision of an opt-out right.

Under the recent amendment to the Telecommunications Act, unsolicited communications to individuals via electronic media require affirmative opt-in consent, with a 'soft opt-in' exception for existing customers.

Conclusion

From a regulatory perspective, engaging a set of transactions such as the pension fund sales creates a positive externality, by raising data protection compliance to the attention of dominant actors in the financial sector as well as leading law firms. Hopefully, with increased awareness and the

involvement of legal professionals, increased compliance will come.

The fluid, replicable nature of data raises the difficulty of controlling their use or verifying their deletion subsequent to a business sale. In addition, the data protection objective of purpose limitation must be balanced in these cases against the legitimate interest of the seller to retain copies of the data as evidence in potential prospective litigation.

Upon close scrutiny, significant mergers and acquisitions may turn out to be motivated by the use of personal data. In these cases, data protection regulators should try to identify the correct balance between enforcing data subjects' privacy rights and facilitating legitimate economic activity.

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1. The Bachar Reform, named after Dr. Yossi Bachar, Director General of the Ministry of Finance, who led a government committee charged with the restructuring of the financial market, resulted in the enactment of the Increasing Competition and Reducing Concentration and Conflicts of Interests in the Israeli Financial Market (Legislative Amendments) Act, 2005; Regulation of Financial Services (Pension Funds) Act, 2005, and the Regulation of Financial Services (Pension Advice and Marketing) Act, 2005.
2. Amendment No. 40 to the Telecommunications Act (Telephone and Broadcast) 2008, adding Section 30A to the statute.
3. Section 17F(a)(2) of the PPA.
4. Section 17C of the PPA.

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