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ALERT

October 2009

FTC RED FLAGS RULE-
PROTECTING AGAINST IDENTITY THEFT

Identity theft is a growing problem, whereby identity thieves use people's personally identifying information to open new accounts and misuse existing accounts. The FTC, working with other federal agencies including federal bank regulatory agencies and the National Credit Union Administration, issued regulations - known as the "Red Flags Rule" - which require financial institutions and creditors to develop and implement written identity theft prevention programs, as part of the Fair and Accurate Credit Transactions Act of 2003. The programs must identify, detect and respond to the warning signs, or "red flags" that could indicate identity theft.

The Red Flags Rule applies to all "financial institutions" and "creditors" with "covered accounts". Under the Rules, a "financial institution" is defined as a state or national bank, a state or federal savings and loan association, a mutual savings bank, a state or federal credit union, or any other person that, directly or indirectly, holds a transaction account belonging to a consumer. Examples of financial institutions under the FTC's jurisdiction include state-chartered credit unions and institutions that offer accounts where the consumer can make payments or transfer to third parties. The rules broadly define a "creditor" to include any person or business that arranges for the extension, renewal or continuation of credit and includes all businesses or organizations that regularly permit deferred payments for goods or services. Under this broad definition, not only are credit card companies and financial institutions subject to these rules, but so are automobile dealers, finance companies and any other company that regularly extends or merely arranges for the extension of credit. "Covered accounts" encompass both existing and new accounts and fall into two categories. The first category is a consumer account that is offered to a company's customers primarily for personal, family or household purposes and involves or is designed to permit multiple payments or transactions. Examples include credit card accounts, mortgage loans, automobile loans, margin accounts, cell phone accounts, utility accounts, checking accounts and savings accounts. The second category is any other account that a financial institution or creditor offers or maintains for which there is a reasonably foreseeable risk to customers or to the safety and soundness of the financial institution or creditor from identity theft, including financial, operational, compliance, reputation or litigation risks. Examples include small business accounts, sole proprietorship accounts or single transaction consumer accounts that may be vulnerable to identity theft.

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Companies subject to the Red Flags Rule are required to design and implement a written Identity Theft Prevention Program, which must be designed to prevent, detect and mitigate identity theft in connection with the opening of new accounts and the operation of existing ones. The program must be uniquely tailored to a covered entity's size, complexity of business and the nature and scope of its activities. The Red Flags Rule also enumerates steps that a covered entity must take to administer its program, including obtaining board approval, training of staff, ensuring oversight by the board or a senior management designee, and reporting on compliance, at least annually, to name a few.

Given the confusion and uncertainty that has arisen in some industries about their coverage under the Rules, the FTC has delayed enforcement of the Rules until November 1, 2009 to give creditors and financial institutions more time to develop and implement their compliance programs. Once enforcement begins, failure to comply with the Red Flags Rule could result in civil monetary fines and lawsuits so it is important that covered entities make a good faith, reasonable effort to comply.

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