



FTC's Red Flags Rule Set To Go Into Effect

(Apr. 27) By Hugh Latimer

Effective May 1, compliance with the FTC's Red Flags Rule will be mandatory for millions of U.S. "creditors." Financial institutions were required to comply as of Nov. 1, 2008, but the FTC suspended enforcement with respect to "creditors" for six months to "enable these entities sufficient time to establish and implement appropriate identity theft prevention programs."

Under the Red Flags Rule (16 CFR Part 681), every "financial institution" or "creditor" with "covered accounts," and which is subject to the jurisdiction of the FTC, federal bank regulatory agencies or the National Credit Union Administration, is required to have in place a written program that provides for the identification, detection and response to patterns, practices or specific activities—known as "Red Flags"—that could indicate identity theft. A worthy goal, to be sure, but somewhat daunting for those entities that must comply.

Unclear but Broad Coverage

The FTC and the other agencies involved published extensive regulations and comments, some 60 pages worth, last year, but compliance does not appear to be a simple matter. First, a "creditor" is broadly defined as "any person who regularly extends, renews or continues credit." The regulations specifically mention banks, automobile dealers, mortgage brokers, utility companies and telecommunications companies, but obviously there are many more. Second, "covered accounts" are broadly defined to mean "[a]n account that a financial institution or creditor offers or maintains, primarily for personal, family or household purposes, that involves or is designed to permit multiple payments or transactions." In short, any entity that extends consumer credit for goods or services may be covered.

"Written Program" Required

Under the Red Flags regulations, creditors must develop a written program that identifies and detects the relevant warning signs of identity theft. The written program also must describe appropriate responses that would prevent the illegal activity and describe in detail a plan to update the program, which must be managed by the board of directors or senior management of those entities that must comply.

In an effort to assist covered entities in setting up their programs, the FTC issued supplemental guidelines identifying 26 possible “Red Flags” as “illustrative examples.” According to the Guidelines, these examples fall into five categories:

- Alerts, notifications or warnings from a consumer reporting agency;
- Suspicious documents;
- Suspicious personally identifying information, such as a suspicious address;
- Unusual use of, or suspicious activity relating to, a covered account; and
- Notices from customers, victims of identity theft, law enforcement authorities or other businesses about possible identity theft in connection with covered accounts.

In addition to the original Guidelines, the FTC, in March, issued more detailed compliance guidelines, “Fighting Fraud With The Red Flags Rule: A How-To Guide For Business.” Finally, in connection with an Audioconference on April 23, the FTC issued further guidance for compliance with the Red Flags Rule and specified that there were “four essential features” of the identity theft prevention program:

- Identify relevant patterns, practices, and specific activities that signal possible identity theft (“red flags”);
- Develop policies and procedures to detect red flags, e.g.:
 - o Verify new customer information and authenticate existing account holders,
 - o Monitor account activity, and
 - o Verify the validity of address change requests.
- Respond appropriately to detected red flags in order to prevent and mitigate identity theft (e.g., call the customer, call law enforcement, change passwords, close the account, etc.)
- Update policy periodically to reflect changes in risks to customers from identity theft, or to the safety and soundness of the covered entity.

Significantly, during the April 23 Audioconference, after estimating that there were over 11 million “creditors” who would be required to comply with the Red Flags Rule, an FTC spokesperson stated that the Commission would soon be issuing a compliance template for small businesses, which can be utilized for compliance. When issued, such a template will be most welcome. The FTC spokesperson added that the Commission is not looking primarily to bringing enforcement actions, except in egregious cases, but rather to good faith efforts to comply.

Hugh Latimer is a partner with Wiley Rein LLP. His experience covers a broad range of complex litigation involving advertising, sweepstakes, trademark, antitrust, trade regulation, international trade and other commercial law issues.