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RED FLAGS RULE

You may have a vague recollection that there was a problem with a law and a Federal Trade Commission (FTC) rule regarding identity theft known as the "red flags rule." On November 9, 2007, the FTC and banking agencies published final rules and guidelines to implement the red flags provisions of the Fair Credit Reporting Act.

The rules required "financial institutions" and "creditors" to develop and implement a written identity theft prevention program. The elements were to include:

- Reasonable policies and procedures to identify signs – or "red flags" – of identity theft in the day-to-day operations of the business.
- Policies and procedures designed to detect the red flags of identity theft identified by the business.
- Actions the business will take upon detecting red flags.
- Regular self-re-evaluation of a plan to reflect new risks from this crime

The problem was the FTC decided that it covered everybody under the sun. They issued a final rule, that defined the term "creditor" to include "businesses or organizations that regularly provide goods or services first and allow consumers to pay later. It also covered businesses or organizations that regularly grant loans, arrange for loans or the extension of credit, or make credit decisions, as well as those who regularly participate in the decision to extend, renew, or continue credit, including setting the terms of credit."

Led by lawyers, doctors and accountants, the business community raised objections with Congress, and in December 2010, Congress passed the Red Flag Program Clarification Act which narrowed the scope of entities covered as "creditors" under the Red Flags Rule.

Now the FTC has issued an interim final rule that generally limits the application of the Red Flags Rule to those creditors that regularly and in the ordinary course of business engage in at least one of the following three types of conduct:

- Obtain or use consumer reports, directly or indirectly, in connection with a credit transaction; or
- Furnish information to consumer reporting agencies in connection with a credit transaction; or
- Advance funds to or on behalf of a person, based on an obligation of the person to repay the funds or repayable from specific property pledged by or on behalf of the person.

Just to make sure, the FTC has said "it has gotten the message." In its new rule, the FTC preemptively closed the door on the potential for extending the rule further. The FTC said, "In addition to limiting the scope of coverage for 'creditors' by creating these specified categories, the Clarification Act empowers the Commission, banking agencies, CFTC, and SEC to determine through a future rulemaking whether to include any other type of creditor that offers or maintains accounts that are subject to a reasonably foreseeable risk of identity theft. At this time, the Commission does NOT intend to use its discretionary rulemaking to extend coverage of the Red Flags Rule to additional creditors."

The FTC is seeking comment on the Interim Final Rule for 60 days. After the expiration of the 60-day comment period and a review of the comments received, the Interim Final Rule will become final.