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FTC Publishes Red Flags Rule Compliance Guide; Confirms Broad Interpretation of the Rule

On March 20, 2009, the Federal Trade Commission ("FTC") published its long-awaited guide to the Red Flags Rule (the "Rule"), entitled "Fighting Fraud with Red Flags Rule: A How-To Guide for Business." The guide applies to creditors and certain financial institutions (such as state-chartered credit unions and mutual funds that offer accounts with check-writing privileges) that are subject to the FTC's jurisdiction and addresses the provision of the Rule that requires implementation of an Identity Theft Prevention Program. For entities subject to the FTC's jurisdiction, the relevant compliance deadline is May 1, 2009. Financial institutions that are regulated by federal bank regulatory agencies or the National Credit Union Administration (which issued their own versions of the Red Flags Rule) were required to comply by November 1, 2008.

The guide adopts the broad interpretation of the Rule that FTC lawyers previously have articulated on panels and in FTC publications. First, the guide confirms that any entity that is a "creditor" under the Rule's broad definition is subject to the Rule. The FTC appears to interpret this definition to encompass entities that may have little or no involvement in credit decisions, such as retailers that accept credit card applications for forwarding to credit card companies. Second, the guide adopts an expansive view of the term "covered accounts." For example, based on the guide, a "creditor" would need to evaluate not only accounts that involve credit but also any accounts the business offers or maintains, including non-credit and single transaction accounts, to determine which accounts are "covered" under the Rule. Financial institutions, which had been required to evaluate consumer and non-consumer accounts that involve multiple transactions and have check-writing or similar withdrawal or transfer privileges, may now also have to determine whether their single transaction accounts and accounts without check-writing privileges may be "covered."

Broad Definition of "Creditor"

According to the guide, any business that sells goods or services and allows customers to pay later is a "creditor" under the Rule and, therefore, is subject to the provisions requiring the implementation of an Identity Theft Prevention Program. This definition of "creditor" may encompass any "invoice billing" arrangement, including those often used by law firms, doctors, manufacturers, utility companies and myriad other businesses that do not require immediate payment for their products or services. Based on the FTC guide, retailers that offer "no

interest/no payment" programs are also likely "creditors" under the Rule.

The second category of "creditors" includes entities that "participate" in credit decisions. This definition, found in Regulation B (from which the definition of "creditor" is derived for purposes of the Rule), covers businesses that may: (i) arrange for loans, (ii) participate in decisions to renew, continue or extend credit, or (iii) set the terms of credit, or participate in credit decisions in other, often tangential ways. A business may be deemed a "creditor" under the Rule if it participates in conducting an initial assessment of credit applications, deciding which applications to send to a lender, receiving proceeds from a portion of the interest rate charged on a loan, restructuring the terms of the sale to meet the concerns of the creditor, or advocating for extending credit.

Notably, Regulation B also defines "creditors" for certain purposes as businesses that "do not participate in credit decisions" but rather only: (i) accept applications, (ii) refer applicants to creditors, or (iii) select or offer to select creditors to whom credit requests can be made. This definition, relevant only to the Equal Credit Opportunity Act's anti-discriminatory provisions, suggests that businesses that merely accept credit applications and are not involved in the approval process or any of the activities that constitute "participating" in a credit decision (for example, retailers, restaurants, hotels or airlines) are "creditors" subject to the Rule. The FTC appears to take this position in its guide, which lists as an example of creditors, "retailers that offer financing or help consumers get financing from others … by processing credit applications."

Expanded Scope of "Covered Accounts"

After a business determines that it is a "creditor" or "financial institution" under the Rule, the next step is to determine if the business offers or maintains any "covered accounts." If it does, the business must implement an Identity Theft Prevention Program for those accounts.

The guide appears to take a broader view of the definition of "covered accounts" than what had previously been the conventional wisdom. For example, it was thought that "creditors" needed to consider only consumer and non-consumer credit accounts in deciding which accounts were "covered." Under the guide's interpretation of the Rule, however, a creditor's covered accounts could include any accounts, rather than only those involving credit. Thus, for example, if an insurance company allows some consumers to pay for policies after the coverage period and requires others to make periodic payments that prepay coverage, the guide appears to suggest that all relevant accounts would be "covered" and that the insurance company would need to evaluate the risk of identity theft associated with its non-consumer credit and non-credit accounts to determine if those accounts are covered. The implication of the guide's interpretation for financial institutions subject to the FTC's jurisdiction is that the coverage of the Rule would extend to non-transaction accounts (*i.e.*, accounts that do not allow check writing or similar withdrawal or transfer transactions).

Finally, the guide suggests that, in deciding which accounts are "covered," financial institutions and creditors must evaluate the risks associated with "single transaction" accounts. This requirement appears to significantly expand the scope of the Rule, which defines an account only as a "continuing relationship." Here, the guide also appears to be in conflict with the position the FTC and the federal banking agencies articulated in the preamble to the Rule in which the agencies "determined that… the burden that would be imposed upon financial institutions and creditors by a requirement to detect, prevent and mitigate identity theft in connection with single, non-continuing transaction by non-customers would outweigh the benefits of such a requirement."

The FTC guide is available on the new FTC website dedicated to the Red Flags Rule, located at: http://www.ftc.gov/bcp/edu/microsites/redflagsrule/index.shtml.

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