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FACTA Red Flags Rule: Parameters in Flux?

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OVERVIEW

- Parameters of Legal Coverage
- Recent Court Decision on “Creditor” Definition
- Proposed Legislation Limiting Regulated “Creditors”
- Selected Products: Whose “Covered Accounts”?
- Compliance Guidelines

Scope of Application

- Applies to "financial institutions" and "creditors" with respect to their "covered accounts"
  - Banking agencies' rule applies to banks, credit unions, and other entities regulated by any of the federal banking agencies (Federal Deposit Insurance Corporation, Federal Reserve Board, Office of the Comptroller of the Currency, Office of Thrift Supervision) or the National Credit Union Administration
  - Federal Trade Commission (FTC) rule applies to all others

Who is a “Financial Institution”?

- A bank, savings and loan association, mutual savings bank, credit union; or “any other person that directly or indirectly holds a transaction account . . . belonging to a consumer.” 15 U.S.C. § 1681a(t)
  - “***Consumer***” means an individual
  - “***Transaction account***” means “a deposit or account on which the depositor or account holder is permitted to make withdrawals . . . for the purpose of making payments or transfers to third persons or others.” 12 U.S.C. § 461(b)(1)(C)

Who is a "Creditor"?

- "Any person or entity who regularly extends, renews, or continues credit; . . . regularly arranges for the extension, renewal, or continuation of credit; or any assignee of an original creditor who participates in the decision to extend, renew, or continue credit." 15 U.S.C. § 1691a(e)
  - "***Credit***" means "the right granted by a creditor to a debtor to defer payment of debt or to incur debts and defer its payment or to purchase property or services and defer payment therefore." 15 U.S.C. § 1691a(d)

FTC Rule Examples of "Creditor"

- ***Lenders*** such as banks, finance companies, automobile dealers, mortgage brokers, utility companies, and telecommunications companies
- No explicit reference in the rule to health care providers, attorneys, or accountants

FTC Position on Scope of "Creditor"

- "Creditor," as defined by Congress for purposes of FACTA, "has a broad scope and may include entities that have not in the past considered themselves to be creditors." FTC Extended Enforcement Policy, at 1 n.3
- Creditors include "professionals, such as lawyers or health care providers, who bill their clients after services are rendered." *Id.*
- "Creditors also include "retailers and a wide range of businesses that invoice their customers." *Id*. at 1.

Objections to FTC Position on “Creditor”

- American Medical Association has protested the FTC’s view that health care providers are “creditors”
- American Bar Association (ABA) sued the FTC in a challenge to the agency’s position that attorneys are “creditors” and won partial summary judgment
- American Institute of Certified Public Accountants (AICPA) also has sued the FTC, arguing that accountants too are not “creditors”

Court Ruling That Attorneys Are Not "Creditors"

- Congress did not mention attorneys in enacting FACTA
- FTC did not mention attorneys in proposed or final rule
- Case law and regulations under related statutes do not support the FTC's view that attorneys are "creditors"
- FTC lacked authority to extend the rule to attorneys, whose practice is governed by state, not federal, law

Court Analysis of "Creditor" Definition

- "Credit" is "the right" to defer payment -- attorneys do not give their clients a *right* to defer payment for legal services
- "Defer" means *postpone* or *delay* -- billing a client with a time period for collection is not a "deferral" of debt
- To be a "creditor" one must "regularly" extend credit -- even if attorneys sometimes continue representing clients while allowing them to postpone payment, they do not *regularly* do so

Court Comparison of Attorneys to Other Service Providers

- Unlike repairmen and caterers that provide a one-time service, attorneys generally cannot collect payment simultaneously with providing legal representation -- that should not make attorneys "creditors"
- Attorneys are not like utility providers, cellular phone service providers, and gas suppliers, "all which logically fit the notion of the type of entities that provide services to *customers* and *account holders*" and thus have been found to be "creditors" *ABA v. FTC*, -- F. Supp. 2d --, 2009 WL 4289505, at *9 (D.D.C. Dec. 1, 2009)

AICPA Arguments in Suit Against FTC

- Congress did not mention accountants in enacting FACTA
- The FTC did not mention accountants in its proposed or final rule
- Like attorneys, accountants are primarily regulated by the States, not the federal government
- Accountants do not “regularly” extend “credit” or grant their clients the “right” to defer payment for services rendered

What About Health Care Providers?

- Congress did not mention health care providers in enacting FACTA
- The FTC did not mention health care providers in its proposed or final rule
- Like attorneys, health care providers are primarily regulated by the States, not the federal government
- Arguably, health care providers do not “regularly” extend “credit” or grant their patients the “right” to defer payment for services rendered

What Other Entities Could Reasonably Argue They Are Not Creditors"?

- Lawn care providers
- Home cleaning services
- Data management/processing companies
- Expert witnesses
- Editors
- Language translation services
- Statistical analysts

Proposed Legislative Solution: HR 3763

- House-passed bill would narrow the scope of "creditor" definition in Fair Credit Reporting Act
- Amended definition excludes any health care, accounting, or legal practice with 20 or fewer employees
- Also excludes any other business, if the FTC determines that business:
  - knows all of its customers or clients individually;
  - only performs services in or around the residences of its customers; or
  - has not experienced incidents of identity theft and identity theft is rare for businesses of that type

Legislative Prospects and Implications

- Senate approval seems likely, as House passed HR 3763 unanimously
- For businesses not specifically mentioned, would the bill make a substantial difference?
  - FTC has already said entities that know their customers or clients personally, provide services at their customers' homes, or have not experienced identity theft have minimal compliance obligations
- By excluding only *small* health care, accounting, and legal practices from "creditor" definition, does the bill confirm that other health care, accounting and legal practices *are* "creditors"? If enacted, would the bill nullify the ABA victory in court for larger law firms?

Regulatory Compliance Issues: Complex Accounts

- Who “offers or maintains” these types of accounts?
  - Health savings accounts
  - Flexible spending accounts
  - Retained asset accounts
- How should compliance responsibility be ascertained and allocated?
- How can you ensure service provider compliance?

Selected Product Issues: Money Cards

- Credit and debit card issuers must comply with the Red Flags rule, as well as the address discrepancy regulations
- Other types of cards linked to financial accounts may also be covered by the Red Flags rule, including:
  - Payroll cards
  - Health savings account debit cards
  - Flexible spending account debit cards
  - Prepaid reloadable stored value cards (not other gift cards)
- Who is responsible for compliance regarding these card accounts? Are employers responsible with respect to payroll cards?

How to Choose Relevant Red Flags?

- Examine and analyze:
  - All types of accounts and monetary relationships with consumers
  - Methods used to open or access covered accounts
  - Previous experiences with identity theft
  - Information on how identity thieves operate
- Exercise diligence and stay informed about possible risks

What Procedures Can Serve To Detect Red Flags?

- Methods to verify identity:
  - Obtain signature, photo, or secret keyword from client/customer at outset of relationship
  - Obtain and periodically update individual's ID number(s), address, e-mail address and telephone number
  - Request and cross-check personal information on file for major transactions
- Monitor accounts for ID discrepancies and unusual transactions
- Verify validity of address changes
  - Send request for confirmation to both new and old addresses

What are Appropriate Responses to Red Flags?

- Seek verification of identity from multiple sources (other institutions, additional documents from individual, Internet)
- Investigate and analyze apparent inconsistencies/errors in records and remove/correct any inconsistent or erroneous data
- If there is a sign of theft through records on file, change passwords for access to computer records and mechanisms for access to paper files
- Notify identity theft victim and encourage him/her to file a police report and to take steps recommended by FTC (*see* www.ftc.gov/bcp/edu/microsites/idtheft)
- Notify law enforcement authorities

What Types of Occurrences Would Trigger the Need to Amend A Red Flags Program?

- Establishment of new accounts or changes in account operations
- Changes in technology
- Creation of new service provider relationships
- Incidents of identity theft
- Awareness of new methods to detect, prevent, and mitigate identity theft

Contact for Further Information

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