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Corporate Law Alert
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WHAT COMPANIES NEED TO KNOW ABOUT THE "RED FLAG RULES"

As you may or may not be aware, on January 1, 2008, the Federal Trade Commission ("FTC"), the federal financial institution regulatory agencies ("Agencies"), and the National Credit Union Administration ("NCUA") issued the Red Flag Rules ("Rules") pursuant to Section 114 of Fair and Accurate Credit Transactions Act of 2003 ("FACT Act"). By way of background, Section 114 of the FACT Act required the foregoing Agencies to issue guidelines and procedures for use by financial institutions and creditors with respect to identity theft.

Under the Rules, covered entities must establish policies and procedures to recognize, detect, prevent, mitigate and respond to identity theft. Consequently, the final Rules apply to financial institutions and creditors with covered accounts. It is imperative that covered entities become familiar with the Rules immediately because compliance with the Rules is required as of November 1, 2009.

The Rules define a financial institution 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 or entity that holds a transaction account belonging to a consumer. These accounts include, but are not limited to, checking accounts and savings deposits subject to automatic transfers.

A creditor, under the Rules, is any entity that extends, renews or continues credit; regularly arranges for the extension, renewal or continuation of credit; or the assignee of original creditor who participates in the decision to extend, renew or continue credit. Under this definition, creditors include, but are not limited to, lenders such as banks, finance companies, automobile dealers, utility companies and telecommunications companies. As such, most, if not all, creditors (including non-profit entities that defer payment for goods and services) come under the jurisdiction of the FTC and are therefore covered under the Rules, provided they deal with covered accounts.

By way of example, "covered accounts" include mortgage loans, automobile loans, cell phone accounts, utility accounts and checking and savings accounts. The definition of covered account also includes any account where there is a reasonably foreseeable risk for identity theft (*i.e.* sole proprietorship accounts).

Each of the covered entities described above must develop and implement a written Identity Theft Prevention Program ("Program"). The Program shall be designed to detect, prevent, and mitigate identity theft in connection with the opening of a covered account and must be correlated to the size, complexity, and nature of the covered entity's business. The Program should include policies and procedures that will identify and incorporate relevant Red Flags for the covered accounts an entity offers or maintains; detect Red Flags; respond to any Red Flags detected; and ensure that the Program is periodically updated.

For purposes of the Rules, a Red Flag includes the some of the following:

- A fraud alert, notice of credit freeze, or notice of address discrepancy provided by a consumer reporting agency;
- A consumer report that indicates a pattern of activity inconsistent with the usual pattern of activity for an applicant, (*i.e.* a recent and significant increase in the volume of inquiries);
- Suspicious documents provided by the applicant (*i.e.* documents that appear to have been altered; photographs that are inconsistent with the information provided; or other information on an individual's identification that is inconsistent with information on file with the covered entity);
- Suspicious personal identifying information that is inconsistent when compared to other personal information on file with the covered entity. For example, the addresses do not match in the consumer report or the Social Security Number does not correlate with the applicant;
- The individual opening the account fails to provide all of the required personal information;
- The covered entity receives notification that the customer is not receiving account statements or mail is returned as undeliverable; or
- The account is used in a manner that is inconsistent with the usual patterns of activity.

Based upon your business, the Rules may require you to adopt a "Program" prior to the November 1, 2009 deadline. We are available to assist you if you have questions or concerns with respect to the creation or implementation of a Program, or to determine whether you are covered under the Rules.

This *Corporate Law Alert* was written by **Edward Easterly,** an associate with Tallman Hudders & Sorrentino, the Pennsylvania office of Norris McLaughlin & Marcus. If you have any questions regarding the information in this Alert, please do not hesitate to contact the author at **eeasterly@thslaw.com**.