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Volume 34 | Issue 16 | February 15, 2011

New Law Narrows the Scope of the Red Flags Rule

The Red Flag Program Clarification Act of 2010 narrows the definition of "creditor" under the Fair Credit Reporting Act for purposes of the Red Flags Rule. Under the narrower definition, professionals who bill for services after they are performed are generally excluded from being covered creditors.

Background

The Fair and Accurate Credit Transactions Act of 2003 (FACTA) amended the Fair Credit Reporting Act (FCRA) to address identity theft among other things. FACTA directed the Federal Trade Commission (FTC), in coordination with several of the federal financial agencies, to develop rules requiring "financial institutions" and "creditors" to protect consumers from the risk of identity theft. In November 2007, the FTC issued a final rule (Red Flags Rule) requiring financial institutions and creditors to create and implement written identity theft prevention programs to identify, detect, and respond to the warning signs ("red flags") of identity theft in connection with covered accounts. The Red Flags Rule was effective on January 1, 2008, with an initial compliance date of November 1, 2008. The FTC subsequently delayed enforcement through December 31, 2010. (See our June 9, 2010 *For Your Information*.)

Under the FACTA amendment to the FCRA, the definition of "creditor" includes "any person who regularly extends, renews, or continues credit; any person who 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." The FTC interpreted the term "creditor" broadly to include businesses or organizations that regularly defer payment for goods or services or provide goods or services first and bill customers later (e.g., lawyers, health care providers).

On December 18, 2010, President Obama signed into law the Red Flag Program Clarification Act of 2010 (Clarification Act), which amends the FCRA to narrow the definition of "creditor" for purposes of the Red Flags Rule.

The Red Flag Program Clarification Act of 2010

The Clarification Act narrows the applicability of the Red Flags Rule to creditors (as defined above) that regularly and in the ordinary course of business meet one of the following standards:

- Obtains or uses consumer reports, directly or indirectly, in connection with a credit transaction,

- Furnishes information to consumer reporting agencies in connection with a credit transaction, or
- Advances 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.

Most notably, the amended definition specifically excludes from the third category those creditors that "advance funds on behalf of a person for expenses incidental to a service provided by the creditor to that person" such as attorneys, accountants, and health care providers. The Clarification Act does not, however, define the terms "expenses," "incidental" or "service." Creditors that fall within this exclusion may still be covered by the Red Flags Rule if they meet one of the other standards mentioned above.

BUCK COMMENT. *The American Bar Association and American Medical Association had sued the FTC over the definition of "creditor" in the Red Flags Rule. The legislative history of the Clarification Act indicates that its language was intended to resolve that issue by excluding as "creditors" professionals who sometimes let clients pay after the services were provided.*

Effective Date

The Clarification Act's narrowing amendment to the FCRA definition of "creditor" was effective upon enactment (December 18, 2010).

Conclusion

The Clarification Act changes are aimed at excluding from compliance burdens under the Red Flags Rule professionals classified as creditors simply because they bill for services after they are performed or advance funds for client expenses incidental to those services. Because of the complicated distinctions under the Red Flags Rule, each business needs to determine whether it is covered by the Red Flags Rule or other identity theft protection laws, and whether it satisfies its compliance obligations.

Buck's consultants are available to discuss the application of the Red Flags Rule to your business and to help you address identity theft and data security issues in your workplace.