

Dealers Face New Substantial Burden If Proposed “Red Flag” Rules Are Adopted

By Mark Westmoreland and Tom Hudson

Sometimes the light you see at the end of the tunnel is the end of the tunnel. Other times it's the headlight beam of an oncoming train. This time it looks like another train coming down the tracks, and, as usual, it's headed for car dealers.

On May 9, 2006, the federal banking agencies and the FTC approved for publication proposed interagency rules regarding “Red Flag” guidelines and address reconciliation procedures required by sections 114 and 315 of the Fair and Accurate Credit Transactions Act of 2003 (FACTA). The reference in the previous sentence to the FTC should get the attention of car dealers – the FTC is the policeman on the car dealer's beat when it comes to enforcement of federal laws and regulations.

The proposed “Red Flag” guidelines would require financial institutions (yes, that includes car dealers) to establish a written, risk-based identity theft program designed to address the risk of identity theft to customers and the safety and soundness of the financial institution (the “Red Flag Program”).

The Red Flag Program must address financial, operational, compliance, reputation, and litigation risks including policies and procedures to:

1. Identify Red Flags
2. Verify the identity of persons opening accounts
3. Detect Red Flags
4. Assess whether a Red Flag evidences a risk of identity theft
5. Mitigate the risk of identity theft using a risk-based approach
6. Train staff to implement the Program
7. Oversee service provider arrangements including an independent assessment of any third party fraud or identity theft detection programs that are used by the institution to determine if the programs meet the requirements of the Red Flag Regulations and Red Flag Guidelines.

The Board of Directors or an appropriate committee of the Board must approve the Program. The Board, committee of the Board or senior management must also exercise oversight of implementation and receive reports at least annually on the state of the institution's compliance with the Red Flag Regulations. The proposed rule contemplates that an institution will continually monitor, evaluate and adjust its Program.

The agencies have also included a listing of proposed Red Flags in an appendix to the proposed rule. Included in this list are 31 examples of Red Flags. The examples include the following, among others:

- A fraud or active duty alert is included with a consumer report;
- A notice of address discrepancy is provided by a consumer reporting agency;
- A consumer report indicates a pattern of activity that is inconsistent with the history and usual pattern of activity of an applicant or customer, such as (a) a recent and significant increase in the volume of inquiries, (b) an unusual number of recently established credit relationships, (c) a material change in the use of credit, especially with respect to recently established credit relationships, (d) an account was closed for cause or identified for abuse of account privileges by a financial institution or creditor;
- Identification documents appear to have been altered;
- The photo or physical identification on the identification is inconsistent with the appearance of the applicant or customer;
- Other information on the identification is inconsistent with information provided by the applicant;
- Other information on the identification is inconsistent with information that the financial institution has on file for the applicant;
- Personal information provided is inconsistent with information from external sources, such as a credit bureau report;
- Personal information provided is internally inconsistent (no correlation between the SSN and the date of birth, for instance);
- Personal information is associated with known fraudulent activity;
- Personal information provided is of a type commonly associated with fraudulent activity;
- The address, SSN or home or cell number is the same as that submitted by other applicants;
- The applicant fails to provide all required information on the application;
- Personal information provided is not consistent with information that is on file;
- The applicant can't provide authenticating information beyond that generally available from a wallet or a consumer report;

- The financial institution has been notified that it has opened a fraudulent account for a person engaged in identity theft;
- The financial institution is notified that the customer is not receiving account statements;
- An employee of the financial institution has accessed or downloaded an unusually large number of customer account records;
- The financial institution detects attempts to access a customer's account by unauthorized persons;
- The financial institution learns of unauthorized access to a customer's personal information.

This list is not meant to be exhaustive (whew, that's a relief!). The agencies are soliciting comment on whether the proposed list is too specific or not specific enough.

Finally, the address reconciliation rules implementing FACTA section 315 would require users of consumer reports to respond to notices of address discrepancies from consumer reporting agencies and reconcile discrepancies within standard reporting time periods (30 days).

The agencies stated that most institutions are likely to have implemented most of the proposed requirements as a result of having to comply with other existing regulations and guidance. As a result, the agencies expect the proposed regulation to impose a minimal burden on affected institutions.

If the agencies actually think that most dealers have implemented everything that the GLB Act and the FTC's Privacy Regulations require, they must surely also believe in the tooth fairy. Dealers will be severely burdened by these requirements.

If F&I people are to be responsible for spotting the Red Flags described above, they are going to have to put each credit application, each applicant, each identification document, the dealership's own records concerning past dealings with the applicant and a host of other items under a microscope in an effort to determine whether these Red Flags exist. They will have to go beyond the mechanical task of simply checking off items that they have gathered for the file and will have to actually analyze the information. The level of endeavor sounds a bit like "CSI" in the F&I office.

There is reason for concern on the part of the car dealer community over the proposed rules, but it is a little early for blind panic. The rules are, at this point, only proposed rules – they are not final. Individual dealers, and their trade associations, can comment on the rules and attempt to relieve some of the pain. Comments on the proposed rules are due 60 days from the publication in the

Federal Register which was at this writing expected to occur the week of May 15th.

Time to call your dealers association and tell them to strap on the helmet and pads.

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