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Client Alert

A Report for clients and friends of the Firm

Clifton N. Miller
Attorney at Law

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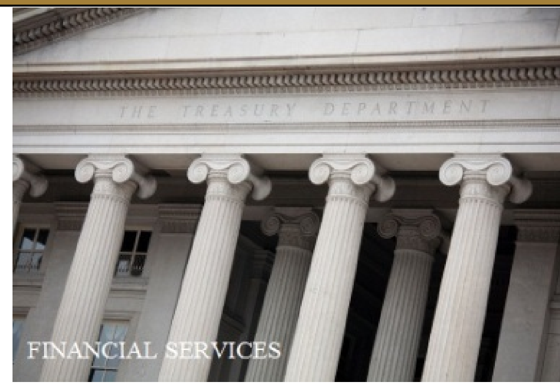
The impact of the RED FLAG CLARIFICATION ACT on the FAIR AND ACCURATE CREDIT TRANSACTIONS ACT



The Fair and Accurate Credit Transactions Act of 2003 (“the FACT Act”) directed the Federal Trade Commission (“FTC”) to promulgate rules requiring creditors to implement programs to detect and respond to so-called red flags that could indicate identity theft.

The FTC's Red Flags Rule implementing Section 114 of the FACT Act became effective on January 1, 2008 (Federal guidelines for use by financial institutions and creditors in establishing policies and procedures to mitigate identity theft risks). Section 114 of the FACT Act (hereafter “Section 114”) directed financial regulatory agencies, including the Federal Trade Commission, FTC, to promulgate rules requiring ”creditors” and ”financial institutions” to implement programs to detect and respond to red flags-patterns, practices, or specific activities-that could indicate identity theft. The section applied to ”creditors,” defined under the FACT Act the same way as in the Equal Credit Opportunity Act, ECOA, to include *any person that sells a product or service for which the consumer can pay later*. This, obviously, is a very broad definition.

As is, Section 114 could require small businesses to undertake costly and burdensome measures to prevent identity theft in industries where it poses little threat. Identity theft is a serious problem, but the definition of ”creditor” for purposes of the FTC's red flags rule is too broad and would cover small businesses that pose little risk to consumers.

After the red flags rule became final, many businesses and other entities indicated that they were not aware that they would be covered by this rule. At first, the FTC delayed enforcement of the rule several times to allow these entities time to come into compliance with the rule. Then, a number of professional organizations, including the American Bar Association and the American Medical Association, sued the FTC for taking the position that professionals were ”creditors” when they allowed consumers to pay later, and would have to comply with its Red Flags Rule. The FTC announced on May 28, 2010 that the Red Flags Rule would be delayed through December 31, 2010, in order for Congress to pass legislation to resolve questions as to what entities should be considered ”creditors.”

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The Senate then introduced “The Red Flag Program Clarification Act of 2010” to narrow the scope of Section 114 “creditors.” Under the legislation, a ”creditor” would only include those entities who *regularly and in the ordinary course of business obtain or use consumer reports in connection with a credit transaction, furnish information to consumer reporting agencies in connection with a credit transaction, or who advance funds that would be required to develop and implement a written identity theft prevention and detection program***:** banks, payday lenders and credit card issuers, for instance.

The effect of this legislation is to lift a burden off of small businesses because they should not have to spend the money to comply with regulatory burdens disproportionate to the scope of the identity theft problem. For example, an accountant would not become a creditor simply for obtaining a consumer report-with the permission of any consumer whose report is obtained-in order to examine the integrity of a company's management. An “advance of funds” would no longer include payment in advance for fees, materials, or services that are merely to a creditor's ability to provide another service that a person initiated or requested, like advance payment of expert witness fees by a lawyer for a client.

Thus, lawyers, doctors, dentists, orthodontists, pharmacists, veterinarians, accountants, nurse practitioners, social workers, other types of health care providers and other service providers will no longer be classified as ”creditors” just because they do not receive payment in full from their clients at the time they provide their services. These types of creditors do not offer or maintain accounts that pose a *reasonably foreseeable risk* of identity theft.

A more risky type of creditor may be covered through a rulemaking based upon an agency's determination that these types of creditors *do* pose such a risk. These creditors would receive notice that they could be covered by a rule, and there would be a public airing of the issues when the proposed rule is published for notice and comment.

See RED FLAG PROGRAM CLARIFICATION ACT OF 2010, 156 Cong. Rec. S8288-01, S8288-89, 2010 WL 4861255, 1-4, RED FLAG PROGRAM CLARIFICATION ACT OF 2010, 156 Cong. Rec. H8059-01, H8059, 2010 WL 4962454, 1-3

Telephone: (931) 455-9301 ♦ **Street Address:** 300 North Jackson Street, Tullahoma, TN 37388 ♦ www.henry-mccord.com