

E-ALERT | Global Privacy & Data Security

December 14, 2010

PRESIDENT TO SIGN INTO LAW LEGISLATION NARROWING SCOPE OF FTC RED FLAGS RULE

Last week, on December 9, 2010, Congress delivered to President Obama for his signature the “Red Flag Program Clarification Act of 2010” (the “Act”), which is intended to narrow the types of entities that are subject to the Federal Trade Commission’s (“FTC”) Red Flags rule. The Red Flags rule requires “financial institutions” and “creditors” to establish programs to detect, prevent, and mitigate identity theft in connection with consumer accounts.¹ The Act, which President Obama is expected to sign into law before the end of this year, is designed to exclude from Red Flags rule compliance certain classes of entities that the FTC previously determined could be creditors, such as doctors, lawyers, accountants, pharmacists and others who deliver services before receiving payment.²

In 2009, the American Bar Association (“ABA”) brought suit to enjoin the FTC’s broad interpretation of the term “creditors.” Later that year, the United States District Court for the District of Columbia ruled in the ABA’s favor.³ The FTC appealed the District Court’s ruling but also delayed enforcement of its Red Flags rule until December 31, 2010, to allow Congress time to pass legislation clarifying the scope of the FTC’s authority in this area.

Congress acted earlier this month, and once President Obama signs the Act into law, it is expected that the FTC’s Red Flags rule will apply only to:⁴

1. *Financial Institutions*, defined specifically to include a state or national bank, state or federal savings and loan association, mutual savings bank, state or federal credit union, or any other person that, directly or indirectly, holds a transaction account (as defined in 12 U.S.C. § 461(b)(1)(C)) belonging to a consumer;
and,
2. *Creditors*, now defined to mean:
 - (1) 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; *and*,
 - (2) who regularly and in the ordinary course of business, (a) obtains or uses consumer reports in connection with a credit transaction; (b) furnishes information to consumer reporting agencies in connection with a credit transaction; or (c) advances funds to or on behalf of a person, based on an obligation of the person to repay the funds or repayable from specific

¹ For additional information on the Red Flags rule, please refer to our previous client alert, [Red Flags Rule Compliance Deadline](#) (Apr. 27, 2009).

² See Colloquy in Support of Legislation Clarifying the Definition of Creditor under the FTC “Red Flags” Rule, 156 Cong. Rec. S8288 (daily ed. Nov. 30, 2010) (statements of Senators Thune, Dodd, and Begich).

³ 671 F.Supp.2d 64 (D.D.C. 2009).

⁴ The FTC may promulgate further regulations or revise the existing Red Flags rule regulation to implement changes in the Act.

property pledged by the person (except for a creditor who advances funds for expenses incidental to a service provided by the creditor to that person).

Previously, the definition of “creditor” in the statute underlying the Red Flags rule was less encumbered and did not include the requirement that a person work with consumer reports in connection with credit transactions, furnish information to consumer reporting agencies in connection with credit transactions, or advance funds to or on behalf of a person based on an obligation to repay from specific property pledged by the person. This enabled the FTC to seek to apply its Red Flags rule broadly. The practical effect of the Act’s clarification is that doctors, attorneys, accountants, and many others who deliver service before receiving payment will be excluded from Red Flags rule compliance.

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