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# Red Flags Rules Overview

A White Paper  
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## THE FTC'S RED FLAGS IDENTITY THEFT PREVENTION RULE

### Identity Theft

Identity theft is rampant across the United States and has drastic effects on many dealerships. However, there are things that can be done to prevent this crime and reduce its impact on your business.

It is estimated that the United States experiences approximately \$50 billion worth of fraud in the form of identity theft each year. Identity theft causes much grief for its victims and it can take years for them to recover their good name and credit history. Identity theft has been a problem for sometime and is no stranger to dealerships.

Dealerships seem to be an easy target of identity theft. For example a Nissan dealership in the southwest had a finance manager commit fifty-two cases of identity theft within the store. The manager was substituting information from past customers with good credit for current customers with bad credit in order to secure financing for the current customers. The dealership incurred over a half million dollars in litigation costs associated with the theft.

Another example was a state government official who was convicted of embezzling from a state retirement account. The individual had previously spent time in jail for fraud. After prison, the individual was hired by a dealership as a salesperson. While working as a salesperson, the individual secured a customer's personal information to use as his own, and then, obtained a job in government without the government office seeing his criminal history.

In another case, a government agency conducted a sting operation at an Indianapolis dealership that resulted in the arrest of a dealership employee who was selling credit applications. The United States Attorney's Office prosecuted him for stealing and selling over one hundred credit applications. The court sentenced him to ten months in jail.

Cases of fraud, specifically identity theft, have occurred at dealerships throughout the United States. The internet is rife with examples that have cost dealerships huge amounts of money. When identity theft happens a lawsuit is usually lurking in the background as well as potential fines and/or audits from the Federal Trade Commission (FTC) for violations of its rules.

In 2003, the FTC began addressing the problem of identity theft by introducing regulation in the form of the "Safeguards" rule. In 2008, the FTC has provided the Red Flags rule, and in November 2009, the FTC will start to enforce this rule.

## Red Flags Rule

The FTC's Red Flags rule is specifically meant to prevent identify theft from occurring. The rule requires lending institutions, including auto dealers, and others, to establish and maintain a written Identity Theft Prevention Program (ITPP) that is designed to detect, prevent and mitigate identity theft. The rule became effective January 1, 2008 but those affected were given a mandatory compliance date of November 1, 2008. However, enforcement has been delayed till November 2009.

## Why Comply?

Because the Red Flags rule is a law and businesses must comply with the law. If that is not enough, compliance is good for your customers, and non-compliance is something that can cost you a lot. Your "knowing" failure to comply can result in significant fines, which can add up quickly and even bankrupt a dealership. The FTC is not the only one who can enforce this rule; sanctions can be brought to bear by state agencies as well. Additionally, violations of the rule could be considered unfair and deceptive practices under state law, which opens the door to even more fines, penalties, and lawsuits. Lender agreements usually require your compliance and failing to comply can subject you to contractual obligations such as forced buy-backs where your liability extends to the amount of the financing. Complying with the rule is not something to take lightly.

## What is a Red Flag?

The rule defines a Red Flag as "a pattern, practice, or specific activity that indicates the possible existence of identity theft." In other words, a Red Flag is something that suggests identity theft maybe occurring. Examples might include a customer who presents a credit card with someone else's name on it, the description on the driver's license does not match the description of the person presenting the card, the customer presents a driver's license that has a different address than his/her credit application, etc. The rule provides an appendix full of possible Red Flags that may be applicable to your dealership.

## What are the ITPP Requirements?

The Rule requires you to develop and maintain an ITPP that contains policies and procedures for:

- (1) Identification of Red Flags
- (2) Detection and evaluation of Red Flags
- (3) Response to detected Red Flags
- (4) Updating your ITPP

## Identification

The rule provides guidelines for assisting you in identifying the Red Flags that should be included in your ITPP. You should consider risk factors, sources, and categories. The risk factors should include the types of covered accounts you offer or maintain, the methods you use to originate covered accounts, how you allow access to covered accounts, and your previous experiences with identity theft. Sources of Red Flags to consider include incidents of identity theft you have experienced, new methods of identity theft that change the risks of occurrence, and third-parties that provide information about types of identity theft such as the FTC. Categories of Red Flags to consider should include alerts from consumer reporting agencies or other parties, suspicious documents presented by customers, suspicious personal identifying information, evidence of unusual use or activity, notice from customers or victims of identity theft or others regarding possible identity theft.

## Detection

After you have identified the Red Flags to be included in your ITPP, you should develop policies and procedures to detect them. Detection policies and procedures should specify acceptable forms of identifying information, methods for authenticating a Customer's identity with or without documents, when additional information is necessary, and should provide guidelines for instances of employee misconduct.

## Response

Your ITPP should set out appropriate responses for situations where either Red Flags or identity theft is detected. Those responses should be appropriate to the level of risk the Red Flag presents. Some appropriate responses include halting the transaction, not assigning the finance contract to the lender, notifying law enforcement, or even sometimes determining that no response is warranted.

## Updating

You cannot let your ITPP grow stale. The rule requires that you update it as is appropriate. Instances for updating include your experiences with identity theft, changes in methods of identity theft, changes in methods of detecting or preventing identity theft, changes in the types of accounts you maintain, and changes in your business arrangements. Other reasons may also exist.

## What are the Administration Requirements?

To appropriately administer the rule, you must obtain approval of your ITPP from the dealership's board of directors or senior management if there is no board ("Overseer"), involve the Overseer in the development and implementation of your ITPP, train staff to effectively implement your ITPP, exercise reasonable oversight of service providers, and produce an annual report regarding the dealership's state of compliance. These requirements are very similar to the "Safeguards" rule requirements with the only real difference being the Red Flags rule requires a higher level of oversight and an annual report. The report should include evaluations such as the effectiveness of your ITPP's policies and procedures, service provider arrangements, significant incidents involving identity theft with management response, and recommendations for updates to the ITPP.

## Conclusion

Complying with all the requirements of the rule will require an initial outlay of significant resources (i.e., someone's time), and to ensure future compliance will require a continual dedication of those resources. Dealers have a couple options in getting compliant with the rule.

First, you can self-comply. Dealers can refer directly to the regulation and use resources that are available through the NADA and local trade associations. If choosing this option, it would be wise to have your attorney review your compliance efforts.

Second, you can engage the services of a law firm, an accounting firm or consulting firm. For dealerships choosing this option it would be wise to engage the services of someone that has dealership experience, preferably in- dealership experience. Not many attorneys and accountants have such experience, as most have always been merely advisors to dealerships. Your best bet is to get someone that understands your business and can provide practical, and not just theoretical, advice.



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