

# FACTA Red Flags Rules

## September 16, 2008

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# Red Flags Rules

Under the Fair and Accurate  
Credit Transactions Act of  
2003



# Background to the New Rules

- During FACTA legislative process, identity theft was a central concern of Congress
- FACTA imposes new obligations for lenders and others to prevent, detect, and mitigate identity theft

# Key Features of New Rules

- Compliance mandatory as of November 1, 2008
- No private right of action
  - Enforced by federal regulators
- Preempts state laws with respect to conduct regulated
- “Bank-like” regulation
  - Focuses on internal processes and controls

# Who is Subject to the Rules?

- Financial Institutions—
  - Banks, thrifts, credit unions, other holders of accounts accessible for third-party payments
- “Creditors” as defined in Equal Credit Opportunity Act
  - Expansive definition includes any person that participates in a credit decision
  - Can include brokers, assignees

# Who is Subject to the Rules?

- “Creditors” as defined in ECOA (cont’d)
  - “Credit” also defined expansively to include any right granted to defer payment
  - Is a servicer that offers workouts extending credit?
    - May be easier to comply in close cases than to run risk of later enforcement

# Which Accounts Are Covered?

- “Account”
  - Continuing relationship established by a person
  - With a financial institution or creditor
  - To obtain a product or service for personal, family, household or *business* purposes
  - Includes extensions of credit and deposit accounts

# Which Accounts Are Covered?

- “Covered Account” (subject to rules)
  - **Automatic coverage:** Account established primarily for personal, family, or household purposes that involves or is designed to permit multiple payments or transactions
  - Mortgage loans specifically covered

# Which Accounts Are Covered?

- “Covered Account” (subject to rules)
  - **Other accounts are covered accounts if:**
    - Reasonably foreseeable risk to customers or to safety and soundness of institution from identity theft
    - Examples could include investor loans for residences, small commercial real estate loans with principals co-signing

# Key Definitions

## ■ Identity theft

- “A fraud committed or attempted using the identifying information of another person without authority”
  - This is the existing definition that applies to alerts and blocks

## ■ Red Flag

- “A pattern, practice, or specific activity that indicates the possible existence of identity theft”

# Components of Red Flags Rule

- Rule requires covered entities to develop **written** ID theft prevention program
- Must consider accompanying guidelines in developing rule
- “Optional” list of possible Red Flags in appendix
  - But should have good reasons not to include a Red Flag

# Identity Theft Program

- Applies to both new and existing accounts
- Includes policies and procedures to
  - Identify relevant red flags
  - Detect them and respond to them
- Must be reviewed and updated periodically to reflect new risks

# Identity Theft Program

- Program must –
  - Be approved by the Board or Board committee
  - Be overseen by senior management
  - Include staff training and oversight of service providers
- Consider agency guidelines

# How Should a Lender Create a Program?

## ■ Consider—

- Types of covered accounts it offers or maintains
- Methods of opening and accessing such accounts
  - Most risk in closed-end loan at opening?
- Previous experiences with ID theft
- “May” consider list of possible Red Flags prepared by agencies
  - But examiners will want to understand why some were excluded

# How Should a Lender Create a Program?

- Can build on GLBA data security, section 326 USA PATRIOT Act, AML/BSA programs
- But must combine into a single written program
- Must consider 4 major categories—
  - Alerts and notifications received from credit bureaus and third-party service providers
  - Presentation of suspicious documents or identifying information
  - Unusual or suspicious account usage patterns
    - Won't apply to mortgages but may apply to HELOCs
  - Notice from customer, victim, or law enforcement

# What Should Program Include?

- Verifying the identity of a person opening account
- Monitor open-end transactions
- Verify change-of-address requests
- Action taken should be commensurate with the risk
  - Risk may be lower for mortgages than HELOCs

# What Should Program Include?

- Responses to identity theft can include:
  - Monitoring account
  - Contacting customers
  - Changing passwords or PINs
  - Closing account or creating new account number
  - Suspending collection
  - Notifying law enforcement
  - Determining no response is necessary
- Board of directors or senior management must monitor
- At least annual staff reports
- Monitor service providers

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