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THE FTC'S NEW 'RED FLAGS' IDENTITY THEFT PREVENTION RULE

Identity Theft

Identity theft is rampant across the United States affecting many dealerships. However, there are things that can be done to reduce this crime. It is estimated that the United States experiences approximately $50 billion worth of fraud in the form of identity theft each year. The crime also causes much grief for its victims sometimes taking 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 is 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 April of 2003, a government agency conducted a sting operation at an Indianapolis dealership that resulted in the arrest of a dealership employee that 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. The dealership employee was a custodian.

Cases of fraud, specifically identity theft, have occurred at dealerships throughout the United States. Many examples can be found by doing a search on the Internet. When occurring, 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 Federal Trade Commission ("FTC") began addressing the problem of identity theft by introducing regulation in the form of the "Safeguards" rule. Now, in 2008, the FTC has provided the "Red Flags" rule ("Rule")

Red Flags Rule

The Federal Trade Commission's (FTC's) "Red Flags" Rule is specifically meant to prevent identify theft from occurring. The rule requires 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 I, 2008 but those effected were given a mandatory compliance date of November I. 2008, however enforcement has been delayed till December 2010.

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Why Comply?

Because the "Red Flags" rule is a law and decent moral business people 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 fines of up to $2,500 per occurrence. If the FTC issues a "cease and desist" order, your fines for failure to comply can jump to $1,000 per violation. These can add up quickly and even bankrupt a dealership. It does not take the FTC to en-force this rule, it can be enforced by state agencies. Additionally, violations of the rule could be considered unfair and deceptive under state law, which opens the door to other fines, penalties, and/or 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 for example a customer 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 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.

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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 and when additional information is necessary, and should provide guidelines for in- stances of employee misconduct.

Response

Your ITPP should set out appropriate responses for situations where "Red Flags" and/or identity theft have/has been 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, determining that no response is warranted, etc.

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, a continual dedication of those resources. Dealers have a couple options in getting compliant with the Rule.

First, they 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.

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