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Client Alert

FTC Once Again Extends Enforcement Deadline for Red Flags Rule

New Deadline for Compliance – June 1, 2010

This delay in compliance with the Red Flags Rule applies only to creditors and financial institutions that are regulated by the FTC.

Late on October 30, 2009 the Federal Trade Commission (FTC) announced that at the request of Congress it was delaying its enforcement of the "Red Flags" Rule until June 1, 2010. This delay in compliance with the Red Flags Rule applies only to creditors and financial institutions that are regulated by the FTC. Financial institutions and creditors regulated by other federal agencies were required to implement their Red Flags Program by November 1, 2008, the same date that the FTC had initially ordered implementation.

The Red Flags Rule was promulgated under the Fair and Accurate Credit Transactions Act, in which Congress directed the FTC and other federal regulatory agencies to develop regulations requiring "creditors" and "financial institutions" to address the risk of identity theft. The FTC's Rule requires those creditors and financial institutions under its regulation with "covered accounts" to develop a written identity theft prevention program to identify, detect and respond to patterns, practices, or specific activities – known as "red flags" – that could indicate identity theft.

The first three delays in enforcement by the FTC (until November 1, 2009) were the result of a general misunderstanding of the breadth of the applicability of the FTC's Red Flags Rule. For example, the FTC includes within its definition of creditor any entity that provides services or goods to individuals or small businesses and defers payment to a later date and also includes as "creditors" businesses that arrange for credit. The FTC has interpreted this definition to include, for example, lawyers and physicians because they "defer" payment and, with respect to "arranging for credit," retailers that take applications from customers for private label credit cards issued for the retailer by unrelated banks.

This most recent delay, until June 2010, was likely partially the result of Judge Reggie Walton's ruling from the bench on Thursday October 29, 2009 in the U.S. District Court for the District of Columbia that the FTC may not apply the Red Flags Rule to attorneys. The American Bar Association (ABA), the plaintiff in the case, argued that the FTC's Rule would impose a serious burden on law firms. The FTC replied that lawyers should be covered because billing practices, such as charging clients on a monthly basis rather than upfront, made them "creditors" under the plain language of the Rule. Of particular interest in this ruling was the statement of Judge Reggie Walton, when rejecting the FTC's definition of a creditor, that under the FTC's interpretation, "a plumber who charges a customer after working on a toilet for two days also would be considered a "creditor."" Judge Walton's written decision was not available as of November 2, 2009.

If you have any questions about the FTC Red Flags Rule, please contact the following, or your Vorys relationship attorney:

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Further, when announcing its latest delay of enforcement, the Commission did not indicate whether it would appeal this decision, but its delay of enforcement of the Rule does not affect the separate timeline of the Court's proceeding.

At the same time the case was pending before the District Court, relief was also being sought in Congress by the ABA and American Medical Association. On October 20, 2009, the House by a vote of 400 to 0 passed a bill that was intended to at least partially resolve Red Flags enforcement by the FTC for some lawyers, physicians and businesses. H.R. 3763 creates an exclusion from Red Flag Guidelines for health care, legal or accounting practices with fewer than 20 employees. The bill also requires the FTC to promulgate regulations that would enable businesses to apply for, and receive, an exemption from the Red Flags Rule if the FTC determines that the business: is individually acquainted with all of its customers; only performs services in or around the residences of its customers; or has not experienced incidents of identity theft and identity theft is rare for businesses of that type. It would appear that as a result of the uncertainty created by the District Court's decision Congress asked the FTC to once again delay enforcement. A copy of H.R. 3763 is available here: http://thomas.loc.gov/cgi-bin/bdquery/z?d111:H.R.3763: