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# Red Flags Rules

## FREQUENTLY ASKED QUESTIONS

### **1. What dealers are subject to the Red Flags Rule?**

The Rule casts an extremely wide net that brings within its coverage a very large share of the nation's business economy. Not only are financial institutions subject to the Rule, but so are creditors. In that sense, virtually all dealers are covered by the Red Flags Rule because virtually all dealers are creditors. In fact, the Red Flags Rule specifically identifies automobile dealers in its list of creditors. However, the requirement to develop and implement an ITPP only applies to financial institutions or creditors that open or maintain "covered accounts." As discussed under "Identifying Covered Accounts," this includes multiple-payment transactions with consumers, such as retail installment sale contracts and lease agreements (even if they are immediately assigned to a third-party finance source), and also includes other accounts where there is a reasonably foreseeable risk to customers or to the dealership from identity theft. If you are a medium- and/or heavy-duty truck dealer, see the information under "Application to Commercial Truck Dealers" on page 7.

### **2. What dealers are subject to the Address Discrepancy Rule?**

The rule applies to dealers who order consumer credit reports from a CRA.

### **3. Does each dealership in a dealer group need to comply individually?**

Each legal entity subject to the Red Flags Rule must comply, whether or not it is owned by a dealer group that owns other dealerships. However, nothing in the Rule prohibits the dealer group from developing an ITPP for use by its individual dealer entities, provided that any unique circumstances relevant to the development and operation of the Program at the dealer-entity level is accounted for and provided that the board of directors (or appropriate board committee or, if there is no board, a designated senior management employee) for each dealer-entity approves the Program for use by that entity.

### **4. Am I required to have a written Address Discrepancy policy?**

There is no express requirement to have a written policy to comply with the Address Discrepancy Rule. However, you must have policies and procedures to verify the identity of customers for whom you receive a Notice of Address Discrepancy, and it would be prudent to set forth those procedures in writing. The Sample ITPP contains procedures at Section 13 for this purpose.

### **5. Can we combine our ITPP with our Customer Information Safeguards Program under the FTC Safeguards Rule?**

Yes, and doing so may have the benefit of encouraging comprehensive training for both

your safeguarding policies and your identity theft detection policies. However, the complexity of both Rules could hamper any effort to compose a unified program that complies with both Rules. In addition, although there are similarities between the Rules, they have significant differences, such as being the products of entirely separate legislative enactments with different sets of defined terms.

#### **6. If we fall victim to identity theft, have we automatically violated the Red Flags Rule?**

No. The Rule does not impose strict liability for failing to detect identity theft in any particular instance. Instead, the FTC would, upon investigation, examine the particular circumstances surrounding the incident. The focus of the Rule is on having financial institutions and creditors create and follow reasonable policies and procedures designed to prevent and mitigate identity theft, but it does not require perfect policies that eliminate the possibility of identity theft from ever occurring (hence the need to develop reasonable policies and procedures under the Rule). If the dealership does fall victim to identity theft, the Rule would require you to take everything learned from that experience into consideration in revising and updating your Program.

#### **7. What are the penalties for violating the Red Flags or Address Discrepancy Rules?**

There is no federal private right of action for violating either the Red Flags Rule or the Address Discrepancy Rule. Enforcement falls to the FTC as the agency responsible for interpreting and enforcing the Rules as they pertain to dealers. All enforcement matters begin with an investigation. When the facts point to law violations, these investigations can lead to administrative settlements. These settlements can include both injunctions that require the company to comply with the Rule, other reporting obligations, and civil penalties of up to \$2,500 for each “knowing” violation of the Rule(s). If the dealer fails to comply with that order, the FTC could file a federal lawsuit seeking fines of up to \$11,000 for each future violation, injunctive

relief, and/or a long-term consent decree. Keep in mind that the civil penalties (up to \$2,500) that may be required to resolve the investigation could apply to past violations, while fines stemming from a lawsuit apply only to future violations. If the parties do not reach a settlement, the FTC can bring an action in Federal district court for civil penalties and injunctive relief.

In addition, it is also possible that violations of these Rules could subject a dealer to state law claims (including class action claims) under state “unfair and deceptive acts and practices” (UDAP) statutes. These laws typically permit actual and punitive damages, as well as attorneys’ fees and costs.

#### **8. What are some examples of non-multiple payment consumer accounts involving a continuing relationship that may be considered covered accounts under the Red Flags Rule?**

While the Red Flags Rule provides no definitive answer, one example might be a zero-down installment contract that calls for only one payment—a balloon payment—at the end of the contract term. In such an extension of credit, the continuing relationship could be seen to result from the contractual terms unrelated to payment that the buyer must observe over the duration of the contract, such as maintaining the vehicle, keeping it insured, and renewing registration. Another possible example would be a rental car contract for an extended term where only one payment is due at the end of the term even though the renter is obligated to various contractual duties during the term.

#### **9. Under what circumstances, if any, do we need to notify law enforcement under the Red Flags Rule?**

The Rule does not directly identify any circumstances that require you to notify law enforcement. The Rule includes notification of law enforcement as a possible response if such a response would prevent or mitigate identity theft considering the degree of risk posed by the Red Flag(s) you detect

and any aggravating factors. For example, if an identity thief presents identification documents that you determine are clearly counterfeit and your review of the consumer credit report reveals overwhelming evidence of ongoing identity theft, in addition to not opening the account, your Program Coordinator may determine it appropriate in accordance with state and local law to notify law enforcement. Another example where notifying law enforcement may be appropriate would be if the dealership finds that it has been targeted by a ring of identity thieves in the dealer's community that law enforcement has been attempting to apprehend.

**10. Do these Rules mean that we cannot conduct transactions with persons who never come to the dealership, such as someone in another state who contacts us by phone after visiting our website?**

No. The Rules do not in any way prohibit telephone, online, or interstate transactions. However, a dealer that enters into installment sale contracts or leases with customers who never come to the dealership or meet dealership employees in person will require an ITPP that takes that method of opening an account into consideration in identifying, detecting, and responding to relevant Red Flags. For example, for accounts opened remotely and without meeting the customer in person, the dealer may determine that additional Red Flags and/or customer identification methods are necessary due to the inability to physically inspect identification documents and determine, for example, if the customer's appearance matches the photograph on the identification documents. As noted in our discussion of "Substantive Elements of the ITPP," the CIP rules contain examples of "non-documentary" identity verification procedures that allow verification of identity without reliance on identification cards and other documents.

**11. What documents should we retain to demonstrate compliance with these Rules and how long should we retain them?**

You should retain all of the following:

- The initial and all subsequent versions and updates of your ITPP
- All documents used in the process of creating and updating your ITPP, such as worksheets and annual compliance reports
- All documents supporting your Program administration responsibilities, such as training outlines, training attendance sheets, and documents related to your oversight of service providers

These documents may be necessary if you are ever called upon to verify that you followed the required processes to develop and update your ITPP.

These documents should be retained indefinitely, or at least for the full statute of limitations (SOL) period under the laws mentioned above. Regarding the FCRA and the FTC Act, the FCRA has the longer SOL, which can extend up to five years from the date of a FCRA violation. Your state UDAP statute may impose a longer SOL period. ■