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Red Flag Rule

Background

In 2003, Congress passed the Fair and Accurate Credit Transactions Act in response to the growing crisis of identity theft. The law required financial institutions and creditors to develop and implement identity theft protection programs.

On Nov. 7, 2007, the Identity Theft Red Flags regulations and guidelines, or the "Red Flags Rules," were published in the *Federal Register*. Under the regulation, certain businesses and organizations are required to act upon red flags that are often signs of identity theft. However, there have been several questions over which businesses and organizations are affected by the regulation. As a result, NAHMA requested that the law firm Hessel, Aluise, and Neun, P.C. analyze the regulations and how they affect the multifamily affordable housing industry.

Summary

The Red Flag Rules have two parts. The first, 16 CFR Section 681.1, applies to all who use credit reports, including multifamily affordable housing owners and agents. *This rule is already in effect.* The FTC has determined that changes in addresses are a potential indicator for identity theft activity and now requires those who use credit reports to disclose "substantial differences" in addresses reported by consumers, in this case the tenants and applicants. Owner/agents must develop and implement policies that will enable them to be reasonably certain that the information received from a consumer reporting agency (CRA) is relevant to the tenant. Once the owner/agent determines the information is applicable to the tenant, the owner/agent must provide the CRA with the tenant's verified address.

The second portion requires financial institutions and "creditors" to have a plan and procedures in place to help prevent, detect, and report identity theft. For the purposes of the FTC, a "creditor" is one "who in the ordinary course of business, regularly participates in a credit decision." Landlords, owners, and agents do not regularly extend credit to tenants as part of regular business practices and are not considered "creditors" under this definition. This part of the rule is not applicable to multifamily owners and agents.

Positive Aspects

NAHMA members who are property owners and agents are not subject to the more burdensome“Red Flag Rule” requirements for preventing and mitigating identity theft. We also understand that many landlords, owners, and agents who use credit reports for their tenants already follow the address discrepancy requirements and will probably not have to change or implement new policies.

Negative Aspects

Unfortunately, there was much confusion over whom these “Red Flag Rules” applied to and how they would be applied. The Hessel, Aluise, and Neun, P.C. analysis memorandum clarifies that owners and agents are not subject to the “Red Flag Rule” requirements for creditors and financial institutions and only need to change their policies if they use credit reports and are not reporting address discrepancies to the CRA.

NAHMA’s Position

NAHMA will continue to watch for any additional changes to the “Red Flag Rules” and will follow up in consultation with our Regulatory Affairs Committee if any changes are made.

Please find a copy of the Hessel, Aluise, and Neun, P.C. analysis memorandum attached for further information.

HESSEL, ALUISE AND NEUN, P.C.
ATTORNEYS AT LAW

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MEMORANDUM

TO: Kris Cook, Executive Director
Michelle Kitchen, Director of Government Affairs
National Affordable Housing Management Association

FROM: Lisa A. Tunick, Esq.
Andrea R. Ponsor, Esq.
Hessel, Aluise and Neun, P.C.

DATE: February 4, 2009

RE: Federal Trade Commission "Red Flags" Rule

Out of concern for the growing problem of identity theft, the Fair and Accurate Credit Transactions Act of 2003 (the "Act") was implemented as a means of increasing consumer protections against such theft. In general, the Act requires financial institutions and creditors to develop and implement identity theft prevention programs. Because of the number of interests and stakeholders affected, it took four years for the federal bank regulatory agencies, the National Credit Union Administration and the Federal Trade Commission ("FTC") to develop a joint notice of final rulemaking implementing the Act.

The Identity Theft Red Flags regulations and guidelines were published in the Federal Register on November 9, 2007.[1] Known as the "Red Flags Rules", these rules affect both "creditors" and "financial institutions," as such terms are defined by the Act and the implementing regulations, as well as users of credit reports. You have asked this firm for a review of the Red Flags Rules and an analysis of how they affect owners, landlords and management agents (collectively, "Owners/Agents"). Owners/Agents need only concern themselves with the FTC regulations, and only a portion of the FTC rules are in fact applicable.

Applicability of the Red Flags Rules

For purposes of the Red Flags Rules, a "creditor" is defined as one who "in the ordinary course of business, regularly participates in a credit decision," but not someone whose only connection is honoring a credit card, for example.[2] Because rent is typically paid in advance, landlords do

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[1] 72 Fed. Reg. 63,718.
[2] 12 CFR Section 202.2(l), Federal Reserve System "Regulation B" (2008).

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not regularly extend credit to tenants as part of normal business practices, therefore Owners/Agents are not considered to be "creditors" for purposes of the Red Flags Rules.

The Red Flags Rules have two parts. The most basic provisions, found at 16 CFR Section 681.1, apply to all who use credit reports, which would include Owners/Agents. The majority of the Red Flags Rules provisions, dealing with detection, prevention and mitigation of identity theft as well as rules specific to credit card issuers, apply to creditors and financial institutions only, which excludes the multi-family rental housing industry generally.

The Red Flags Rules became effective on January 1, 2008, however full implementation was originally delayed until November 1, 2008. In October 2008, the FTC extended the deadline for full compliance to May 1, 2009 for financial institutions and credit card issuers to develop and implement written identity theft programs.[3] The sections applicable to credit report users and credit card issuers regarding change of address information are currently in effect.

FTC Red Flags Rules Affecting the Multi-Family Rental Industry

The FTC and the other regulatory agencies have determined that changes in consumer addresses are an important indicator of potential identity theft activity. Thus, pursuant to 16 CFR Section 681.1, users of credit reports are required to be on the alert for and report a "substantial difference" in consumer addresses. In those situations in which the user receives a notice of address discrepancy regarding a consumer from a consumer reporting agency ("CRA"), the user is required to take certain steps under the rules.

First, the user must develop and implement policies that will enable it to be reasonably certain that the information received from the CRA pertains to the consumer.[4] For an Owner/Agent, the "consumer" would be an applicant (in certain circumstances) or a tenant. Examples of reasonable verification practices include comparing the information in the discrepancy notice to (1) information the Owner/Agent has independently gathered to confirm the consumer's identity and address – such as driver's license and residency information; (2) the Owner's/Agent's own records (e.g., applications, change of address notifications, etc.); or (3) information obtained from a third party, such as through employment verification or via other references.[5] The Owner/Agent may also verify the information in the CRA discrepancy notice directly with the consumer.[6]

Once the Owner/Agent has determined that the CRA-provided information indeed pertains to the consumer, the Owner/Agent is obligated to provide the CRA with the consumer's verified address.[7] The obligation to report address discrepancies presumes that (1) the Owner/Agent has a continuing relationship with the consumer (tenant/applicant), such as leasing a unit or placing an applicant on the waiting list; and (2) the Owner/Agent corresponds with and provides information to the CRA in the regular course of business. Such information sharing is

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[3] See http://ftc.gov/opa/2008/10/redflags.shtm
[4] 16 USC §681.1(c)(1) (2008).
[5] Id. at §681.1(c)(2)(i)
[6] Id. at §681.1(c)(2)(ii)
[7] Id. at §681.1(d)

expected to take place on the same schedule when the user normally corresponds with the CRA.[8] For instance, if an Owner/Agent receives a notice of address discrepancy for an applicant who enters a lease in January and the Owner/Agent typically provides information to the CRA on a monthly basis, the applicant's verified address should be submitted to the CRA in January.

Owners/Agents are likely already providing this information to CRAs as part of their regular and customary correspondence regarding credit reports. Even if they do not regularly share such information with CRAs, they may wish to start such a practice, which we understand would be consistent with Congressional intent that CRAs receive timely notice of consumer address information. In order to comply with the applicable Red Flags Rules, Owners/Agents that use credit reports must implement a policy for verification of consumer addresses, which would include reporting address discrepancies to CRAs if sharing information with the CRA is part of their regular practice. These policies must be documented as well.

As previously noted, Section 681.1 of the FTC Red Flag Rules is currently in effect. The FTC could elect to take enforcement actions for non-compliance, including seeking Civil Money Penalties, however we are unaware of any active enforcement efforts. This may change after May 1, 2009, when the full complement of Red Flag Rules will be enforced.

Other Red Flags Rules Applicable to "Creditors" and "Financial Institutions" Only

The Red Flags Rules that are attracting the most media attention are those that pertain to creditors and financial institutions. Although 16 CFR Sections 681.2 and 681.3 do not apply to Owners/Agents, we include a brief overview of these requirements so the NAHMA membership will have an understanding of their scope, and also because there has been some confusion regarding their applicability to Owners/Agents.

The balance of the Red Flag Rules apply to financial institutions and creditors exclusively. Section 681.2, which will become effective on May 1, 2009, requires financial institutions and creditors to establish an on-going written identity theft prevention program designed to detect, prevent, and mitigate identity theft in connection with their consumer accounts, and in accordance with the guidelines laid out in Appendix A to the Red Flag Rules. The guidelines call for detection of and response to Red Flags in the consumer accounts, and must be incorporated into the prevention program. An extensive list of potential Red Flags are identified in a supplement to Appendix A of the rule.[9] Section 681.3 pertains only to issuers of credit cards and requires that the issuer establish policies for validating change of address requests, particularly when received close in time to a request to reissue an existing credit card.

If you have questions about the FTC Red Flag Rules or their applicability to Owners/Agents, please contact Lisa A. Tunick at (202)466-5300 or ltunick@hapc.com.

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[8] Id. at §681.1(d)(3)

[9] 72 Fed. Reg. at 63,774.