



IADA LEGAL BULLETIN



ILLINOIS AUTOMOBILE DEALERS ASSOCIATION

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RED FLAGS RULE TAKES EFFECT JANUARY 1, 2011

On January 1, 2011 the federal Red Flags Rule will take effect. (Implementation was postponed from the original November 1, 2008 deadline). The Red Flags Rule is an outgrowth of the federal Fair and Accurate Credit Transactions Act of 2003 and is administered by the Federal Trade Commission (FTC). It requires dealers to develop and adhere to a program to detect and respond to identity theft "Red Flags". The Red Flags Rule requires all creditors (including banks, finance companies, **automobile dealers**, mortgage brokers, utility companies, and telecommunications companies) to have a program to identify, detect, and respond to identity theft "Red Flags" in place by January 1, 2011. The program must be approved by the dealership's senior management or, if applicable, its Board of Directors.

The Red Flags Rule is summarized in this bulletin and a simple model Red Flags Program is enclosed.

Red Flags Rule

The Red Flags Rule requires dealers who **offer or maintain** consumer credit to:

- (1) Identify the dealership's accounts that could be susceptible to identity theft and are covered by the Red Flags Rule;
- (2) Determine identity theft indicators (Red Flags) that are associated with those susceptible transactions and develop a procedure for detecting the Red Flags;
- (3) Develop reasonable policies and procedures to identify, detect, and respond to identity theft Red Flags; and
- (4) Administer the dealer's red flag policies and procedures and periodically update them to account for evolving Red Flag risks.

Each dealership must designate a senior employee as the program manager, who will be charged with creating, administering, and approving changes to the Red Flags program.

(1) Identify Covered Accounts

You must review the different types of "accounts" you offer and determine whether they are covered by the Red Flags Rule. The rules define an "account" as "a continuing relationship established by a person with a financial institution or a creditor to obtain a product or service for personal, family, household or business purposes".

Any consumer account offered or maintained by the dealer that provides for multiple payments or transactions or that contains a reasonably foreseeable risk of harm to either the customer or the dealership is a covered account. The most common examples for dealers will be installment sales contracts, leases, and open accounts or charge accounts for parts, service, or warranty work. A one-time transaction with a service customer or a customer who makes a one-time payoff on his or her vehicle loan is not a covered account and is not subject to the rule.

LEGAL ISSUES DISCUSSED HEREIN ARE FOR GENERAL INFORMATION AND DEALERS SHOULD CONSULT PRIVATE LEGAL COUNSEL FOR APPLICATION IN PARTICULAR CASES.

(2) Determine identity theft indicators (Red Flags)

The following is a description of 5 basic types of red flags and examples of each. The FTC's rule contains other examples, but this bulletin addresses only those Red Flags that are most likely to arise in the context of a vehicle dealer.

(a) Alerts, notifications, and warnings from consumer reporting agencies and fraud detection services.

- a. Fraud or active duty report.
- b. Credit freeze notice.
- c. Notice of address discrepancy.
- d. A consumer report indicates unusual activity pattern (spike in volume of inquiries, high number of new credit relationships, material change in use of credit, account closed for abuse of account privileges by financial institution or creditor, etc.).

(b) Presentation of suspicious identifying information from a customer.

- a. Identification documents appear forged or altered.
- b. Photograph on identification does not match the customer.
- c. Various pieces of identification information provided by the customer are inconsistent with each other.
- d. External identification information is not consistent with information provided by the customer.

(c) Suspicious personal identifying information.

- a. Customer fails to provide all required personal identifying information requested on an application.
- b. Customer provides a fictitious address

(d) Suspicious requests from or actions by the customer.

- a. The customer seeks to finance or lease a vehicle and take possession at a location other than the dealership.
- b. A listed co-buyer or co-lessee is not present to sign the contract or lease.
- c. Customer is reluctant to remove his or her identification from a wallet or to let you photocopy it.
- d. Customer requests that the title or other paperwork be completed for an address that is different than the address shown on his identification documents.
- e. Customer's trade-in is registered in somebody else's name.
- f. The customer's down payment check is written on another person's bank account.

(e) Notice from a victim or from law enforcement concerning possible identity theft.

A customer, a financial institution that you do business with, an identity theft victim, a law enforcement authority, or other person notifies you that a potential identity thief may attempt to open an account with another person's personal identifying information.

(3) Develop policies and procedures to detect and respond to Red Flags.

After the dealership determines which Red Flags apply to it, it must develop reasonable policies and procedures for dealership employees to detect and respond to them. Methods that the dealership can employ to detect identity theft Red Flags include:

- a. Inspecting and photocopying the customer's driver's license or other government-issued identification.
- b. Examining identification documents for signs of alteration or forgery.
- c. Comparing the customer's actual appearance with the likeness and description on his or her identification
- d. Obtaining the customer's complete, signed credit application.
- e. Reviewing the credit application for completeness and for indications of alteration or forgery.
- f. If the dealership obtains a consumer credit report on the customer:
 - i. Comparing the address information on the identification document with the information provided in the consumer credit report.
 - ii. Checking for a Fraud or Active Duty Alert.
 - iii. Checking for Credit Freeze Notice.
 - iv. Checking for an Address Discrepancy Notice.
 - v. Reviewing the report for inconsistencies with the credit application.

Detecting a Red Flag is not a guarantee that identity theft has occurred. Therefore, if a dealership employee detects identity theft Red Flags, he or she must notify his or her manager so that the dealership can respond appropriately. In the case of a customer who does not closely resemble the likeness on his identification, the appropriate response could be as simple as obtaining additional identification from the customer to verify that he is who he says he is. On the other hand, if the Red Flag is a Fraud or Active Duty Alert, the dealership may want to contact the customer using the contact method listed in the Alert to obtain authorization to proceed with the transaction AND take other reasonable steps to verify the customer's identity in order to prevent identity theft before it proceeds with the transaction.

If, after reasonable investigation, you determine that there is no reasonably foreseeable risk of identity theft, you may proceed with the transaction. If the dealership is not satisfied that it has eliminated all reasonable risks of identity theft, it should not enter into the transaction with the customer.

For more information about detecting and responding to Red Flags, please review the attached model policy.

(4) Administer Red Flags policy and procedures and periodically update them.

Once the dealership develops Red Flag policies and procedures, it must implement them. This involves designating a program manager and training dealership employees about detecting and responding to Red Flags.

The program manager must report at least annually on the Red Flag program to the senior management and, if applicable, to the board of directors. The report should discuss the effectiveness of the program, significant incidents involving Red Flags and the dealership's response to them, and recommendations for improving the Red Flags Program.

If you have any questions about the Federal Trade Commission's Red Flags Rule, you may contact IADA Legal at (217) 753-0220.

Model Program

The draft that appears on the following pages is a guidance model written administrative procedure for FTC Red Flags compliance. It is a model only. It will not work for every dealership.

The model makes the following assumptions about dealer practice:

- Dealership assigns all of its motor vehicle installment and lease paper. The dealership is not a "buy-here pay-here" operation.
- Dealership does not offer consumer open accounts for parts or service. All payments for parts and service are made by cash, check, or credit card.
- If a dealership has business open accounts for parts or service, a determination has been made that there is little likelihood of identity theft on these accounts.
- The dealership does not hire outside companies to examine identification documents and sign out customers on installment sales or lease paper.

If the dealership has a Board of Directors, the Program must be approved by the Board. The minutes of the Board's corporate records should reflect this approval. The Program must be approved and in place by January 1, 2011.

A person at the level of senior management should be named as the Program Manager. That person has many responsibilities in the way of reporting, training, updating the Program and determining new Red Flags. The Model Program provides as much flexibility and informality in discharging these responsibilities as the FTC rules allow. However, the ongoing duties do exist. The program should be reviewed periodically.

Again, this is a "bare bones" minimum model Program that may not work for every dealership. Read it carefully and see if it can work for your dealership. It may well need modifications to match your dealership's practices and corporate culture.

Red Flags Identity Theft Prevention Program

Dealership Name

Identity theft is a serious national problem faced by consumers and businesses alike. Both are potential victims and can suffer serious financial harm at the hands of identity thieves. To combat this very real threat, this dealership maintains strong policies and procedures designed to minimize the risk.

This document creates a Red Flags Identity Theft Prevention Program designed to comply with rules issued by the Federal Trade Commission and reflects the dealership's good faith efforts to reduce the potential for identity theft. This document and the Program it creates is an administrative policy only. It does not create a warranty, representation, or contractual obligation in favor of any person or group.

Approval and Management

This Red Flags Identity Theft Program was approved by the dealership board of directors - or if none - by the dealership's senior management.

The designated Program Manager who is a senior manager at the dealership and charged with overall Program management and administration is:

Program Manager's Name

Transactions at Risk

The dealership reviewed its transactions and determined that among those subject to the Federal Trade Commission rule, there is a reasonably foreseeable risk of identity thieves targeting only its consumer motor vehicle installment sales and lease transactions.

Relevant Red Flags

"Red Flags" are indicators of potential identity theft. Their presence does not necessarily mean that identity theft has occurred. However, they may not be ignored and must be resolved before a consumer credit or lease transaction can be completed.

It may not be possible to look for every Red Flag in all consumer credit or lease transactions. For example, a number of the Red Flags listed below pertain to information and alerts obtained from a consumer credit reporting agency. Our dealership may not always obtain such a report.

The Program Manager is responsible for monitoring the list of Red Flags and periodically updating it. The dealership has identified the following Red Flags as currently relevant to our consumer credit and lease transactions.

- Identification documents provided by the customer appear to be altered or forged.
- The photograph or physical description shown on an identification document does not match the customer's appearance.
- A credit application appears to be altered or forged.
- A customer fails to provide all required personal identifying information on a credit application or in response to notification that the application is incomplete.
- A consumer reporting agency provides a Fraud or Active Duty Alert.
- A consumer reporting agency provides a Credit Freeze Notice.
- A consumer reporting agency provides an Address Discrepancy Notice.
- Personal identifying information provided by the customer is inconsistent when compared against other information sources used by the dealership. For example, the address on the credit application does not match any address in the consumer report.
- Customer provides inconsistent personal identifying information. For example, the credit application states that the customer owns his home but the residence address reflects an apartment number.

- Dealership is notified by a customer, financial institution, identity theft victim, law enforcement authority, or other person that a person posing as a credit or lease customer is really an identity thief.
- A customer requests to execute a motor vehicle installment sales contract or lease and take delivery of the vehicle off site at a location other than the dealership's facility.
- A co-buyer or co-lessee is included in the vehicle credit sale or lease but is not present at the dealership facility to sign the installment contract or lease.

Detecting Red Flags

Before entering into a consumer installment sales contract or lease, the dealership:

- Obtains, inspects, and photocopies the customer's current driver's license or other government issued photo identification.
- Examines the identification document for signs of alteration or forgery.
- Compares the photo and physical appearance information on the identification with the customer's in-person appearance.
- Obtains the customer's complete signed credit application.
- Reviews the credit application for completeness and indications of alteration or forgery.
- If the dealership obtains a consumer credit report on the customer:
 - Compares the address information on the identification document with the information provided in the consumer credit report.
 - Checks for a Fraud or Active Duty Alert.
 - Checks for Credit Freeze Notice.
 - Checks for an Address Discrepancy Notice.
 - Reviews the report for inconsistencies with the credit application.
- Assumes that the installment sales contract or lease will be signed and delivery will occur on-site at dealership's facility. Be alert to any effort by the customer to request or steer the transaction toward having the co-buyer or co-lessee sign documents off-site.

Responding to Red Flags

Detection of a Red Flag does not necessarily mean identity theft is involved. If a dealership employee detects one or more Red Flags as a customer enters into an installment sales or lease transaction, the employee shall notify his or her manager.

If the Red Flag is a Fraud or Active Duty Alert, do not proceed with the transaction until both of the following steps have been satisfactorily completed:

- Contact the customer using the telephone number or other means of contact stated in the Alert, if any, and obtain authorization to proceed with opening the account.
- Take all reasonable steps to verify the customer's identity and that the transaction will not result in identity theft.

For all other Red Flags including a Notice of Address Discrepancy appearing on a consumer report, the employee and manager will investigate the Red Flag by obtaining additional information from the customer or third parties.

Unless a determination can be made after reasonable investigation that there is no reasonably foreseeable risk of identity theft, the dealership will not enter into an installment sales contract or lease with the customer.

Training

Dealership personnel will receive training, as necessary, to effectively implement the Program. The training will include, at a minimum:

- Distributing a copy of this Program to all employees having duties that may involve using consumer reports or closing retail installment sales or leases.
- Describing to these employees the policies and procedures set forth in the Program.
- Emphasizing the importance the dealership places on complying with the Program and ultimately preventing identity theft.

Reports and Periodic Updates

The Program Manager is responsible for ongoing reports to senior management and the dealership board of directors. The reports should address:

- The overall effectiveness of the Red Flags policies and procedures.
- Significant incidents involving identity theft and the dealership's response.
- Recommendations for improving the Red Flags Program.

These reports should be made continually on an ad hoc basis – but at least annually. Unless otherwise directed, the reports may be made orally or in writing.

The Program Manager is responsible to review, assess and update the Program periodically as necessary based on new regulatory guidance, the dealership's experience with identity theft, new identity theft schemes, new identity theft detection methods and potential new dealership transactions covered by the Federal Trade Commission identity theft rules.