Red Flags Update from NACM:

FTC Official Offers “Red Flags” Clarification to Trade Creditors

Federal Trade Commission (FTC) Attorney Tiffany George, in a recent discussion with representatives of NACM, offered the clearest guidance yet on the extent to which the “Red Flags” Rules apply to business to business (B2B) transactions involving trade creditors. The comments by Ms. George are Informal Staff Opinions. The discussion included NACM staff along with NACM lobbyist Jim Wise, and Bruce Nathan, Esq. and Wanda Borges, Esq., both of whom have lectured extensively on the “Red Flags” Rules and their application to trade creditors.

The entire meeting was geared toward gathering definitive answers for trade creditors still uncertain about how the “Red Flags” Rules apply to them. Ms. George addressed these concerns by noting that the process of determining whether or not a trade creditor has to comply with the Rules requires two steps: first, a trade creditor must determine whether or not it is a “creditor” and second, if it is a “creditor,” it must then determine whether it has covered accounts that are subject to reasonably foreseeable risk of identity theft.

Ms. George added that the Red Flag Program Clarification Act of 2010, signed into law at the end of the year, limits the applicability of the “Red Flags” Rules to a creditor, as defined in the Equal Credit Opportunity Act (ECOA), that regularly, and in the ordinary course of business:

-(i) obtains or uses consumer reports in connection with a credit transaction;
-(ii) furnishes information to consumer reporting agencies in connection with a credit transaction; or
-(iii) advances funds to or on behalf of a person based on that person’s obligation to repay the funds or repayable from specific property pledged by or on behalf of that person.

A trade creditor that does not fall into any one of these categories is not a “creditor” under the “Red Flags” Rules.
Ms. George was also very clear that should a trade creditor regularly obtain and rely on an individual credit report in making credit decisions, whether the report is on the principal of a small business or a personal guarantor or a non-corporate entity like a mom-and-pop store or sole proprietorship, then the trade creditor is subject to the “Red Flags” Rules, meaning that, if it has covered accounts based on an analysis of its risk level, it must create its own written program for fighting identity theft.

During the discussion, Ms. George further explained that the terms “advances funds” in the above third category for the definition of “creditor” refers to money, rather than goods or services, narrowing this remaining category of “creditor” only to entities making loans.

If a trade creditor does not meet the definition of “creditor” because, for example, it only deals with established corporate entities and does not rely on personal consumer credit reports or furnish information to consumer reporting agencies or make loans, then the Rules do not apply. A scenario pertaining to fraud was also described during the discussion, wherein a company was selling to a buyer company whose purchase order form was stolen. The buyer’s identity had been stolen, a fraudulent order was submitted to the seller and the seller sold goods according to the false purchase order. According to Ms. George, the seller in this instance, who accepted a fraudulent order from a corporate buyer whose identity and purchase order form had been stolen, does not have to comply with the “Red Flags” Rules.

Ultimately, if a company sells on a purely B2B basis, and does not fall into any of the defined categories of creditor, then it does not have to comply with the “Red Flags” Rules.

If you have any lingering questions about the FTC’s “Red Flags” Rules, please contact Jacob Barron at jakeb@nacm.org. *Jacob Barron, NACM staff writer (www.nacm.org)*

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