State of North Carolina
Office of the State Controller

Michael F. Easley, Governor

David McCoy, State Controller

October 8, 2008

MEMORANDUM

TO: Agency Chief Fiscal Officers
University Vice Chancellors
Community College Business Officers

FROM: David T. McCoy

RE: Red Flag Rules Advisory

This advisory is to alert all North Carolina governmental agencies and institutions of new federal regulations that may be applicable to your agency or institution. Each governmental agency/institution should review the regulations and determine their applicability to your organization. If the regulations are determined to apply, you must take the necessary actions to comply.

The Federal Trade Commission (FTC) and other federal agencies have issued joint regulations, which are being referred to as "Red Flag Rules." The Rules require financial institutions and creditors to each develop a "written Program" to detect and prevent identity theft. **The mandatory compliance date is rapidly approaching, November 1, 2008.**

It has been determined that a governmental agency could be included in the definition of either a "financial institution" or a "creditor" should it have "covered accounts." This advisory is intended not only to alert state agencies, universities, community colleges, and other component entities of the pending regulations, but to provide general information to assist in making a determination whether the regulations apply.

The following link will take you to the regulations: http://ftc.gov/os/fedreg/2007/november/071109redflags.pdf. In addition, you or your staff may find the FTC guidance contained in the following links helpful:

MAILING ADDRESS
1410 Mail Service Center
Raleigh, NC 27699-1410

Telephone: (919) 981-5454
Fax Number: (919) 981-5567
State Courier: 56-50-10
Website: www.ncosc.net

LOCATION
3512 Bush Street
Raleigh, NC

http://www.ftc.gov/bcp/edu/pubs/business/alerts/alt050.shtm; in addition, the National Association of College and University Business Officers also provides guidance at http://www.nacubo.org/x10808.xml.

The Office of the State Controller is only able to provide general guidance regarding the Red Flag Rules and I urge you to consult with your agency's legal counsel for appropriate counsel to determine their application to your agency or institution. As with most new federal regulations, there will be situations that only the federal regulatory agency can adequately address, general questions regarding this advisory may be addressed to OSC's Support Services Center by calling (919) 875-HELP (4357).

Thank you.

DM:dr

RED FLAG RULES ADVISORY

Red Flag Rules apply to "**financial institutions**" and "**creditors**" with "**covered accounts.**"

Definitions
Pertinent definitions that may apply:

Red Flag
Account
Covered Account
Financial Institution
Creditor

Red Flag means a pattern, practice, or specific activity that indicates the possible existence of identity theft.

Account means a continuing relationship established by a person with a financial institution or creditor to obtain a product or service for personal, family, household or business purposes. Account includes: An extension of credit, such as the purchase of property or services involving a deferred payment…

Covered account means:
(i) An account that a financial institution or creditor offers or maintains, primarily for personal, family, or household purposes that involves or is designed to permit multiple payments or transactions such as a credit card account, mortgage loan, automobile loan, margin account, cell phone account, utility account, checking account, or savings account; and

(ii) Any other account that the financial institution or creditor offers or maintains for which there is a reasonably foreseeable risk to customers or to the safety and soundness of the financial institution or creditor from identity theft, including financial, operational, compliance, reputation, or litigation risks. Periodic Identification of Covered Accounts. Each financial institution or creditor must periodically determine whether it offers or maintains covered accounts. As a part of this determination, a financial institution or creditor must conduct a risk assessment to determine whether it offers or maintains covered accounts

Creditor has the same meaning as in 15 U.S.C. 1681a(r)(5), and includes lenders such as banks, finance companies, automobile dealers, mortgage brokers, utility companies, and telecommunications companies. *(The FTC has indicated that: "Where non-profit and government entities defer payment for goods or services, they, too, are to be considered creditors.")*
http://www.ftc.gov/bcp/edu/pubs/business/alerts/alt050.shtm

Financial institution has the same meaning as in 15 U.S.C. 1681a(t). The term "financial institution" means a State or National bank, a State or Federal savings and loan association, a mutual savings bank, a State or Federal credit union, or any other person that, directly or indirectly, holds a transaction account (as defined in section 461 (b) of title 12 belonging to a consumer.
(b) The term "**person**" means any individual, partnership, corporation, trust, estate, cooperative, association, government or governmental subdivision or agency, or other entity.
(c) The term "**transaction account**" means a deposit or account on which the depositor or account holder is permitted to make withdrawals by negotiable or transferable instrument, payment orders of withdrawal, telephone transfers, or other similar items for the purpose of making payments or transfers to third persons or others. Such term includes demand deposits, negotiable order of withdrawal accounts, savings deposits subject to automatic transfers, and share draft accounts.

If your agency fits the definition of "financial institution" or "creditor" with "covered accounts" then you need a Red Flag Program.

Program Requirements

The regulations list the four basic elements that must be included in the Program of a financial institution or creditor. The Program must contain "reasonable policies and procedures" to:

- Identify relevant Red Flags for covered accounts and incorporate those Red Flags into the Program;
- Detect Red Flags that have been incorporated into the Program;
- Respond appropriately to any Red Flags that are detected to prevent and mitigate identity theft;
- Ensure the Program is updated periodically, to reflect changes in risks to customers or to the safety and soundness of the financial institution or creditor from identity theft.

The regulations also enumerate certain steps that financial institutions and creditors must take to administer the Program. These steps include:

- Obtaining approval of the initial written Program by the board of directors or a committee of the board;
- Ensuring oversight of the development, implementation and administration of the Program, training staff;
- Overseeing service provider arrangements

A program's requirements are found primarily in Subpart J of the Regulation, and Appendix J. There are 26 listed "triggers" which your agency/entity will need to consider if it needs a Red Flag Program.

Determination of applicability of a government functioning as a "Creditor"

The state or local governmental agency could be considered a "creditor," as defined in 15 U.S.C. 1681a(r)(5). The FTC has indicated that: "Where non-profit and government entities defer payment for goods or services, they, too, are to be considered creditors."
http://www.ftc.gov/bcp/edu/pubs/business/alerts/alt050.shtm

An obvious example of an agency functioning as a creditor would be a state or university operated hospital which provides medical services to patients, where the patients are extended credit for the services. There may be other situations where an agency may be considered a creditor, which are not as obvious. Agencies should examine their various operations to make a determination of applicability.

Determination of applicability of a government functioning as a "Financial Institution"

While a state or local governmental agency could be considered a "person" as defined in 12 U.S.C. 461(b), it would only be considered a financial institution if the accounts it holds for individuals are considered "transactional accounts," as defined in 12 U.S.C. 461(c). If funds can only be disbursed from an individual's account by the agency, and not by the individual (typical of an account maintained with a commercial financial institution), the account would not likely be considered a transactional account. If the account functions like a typical bank account, from which funds can be disbursed to third parties, the account would likely be a transactional account, and the governmental agency could be considered a financial institution.

For example, the NC Department of Correction (NCDOC) maintains internal accounts for inmates, but the funds are withdrawn by the NCDOC making the disbursement (issuing a check to the inmate), not by the inmate initiating instruments to effect payments to third parties. Such internal accounts would not likely be considered transitional accounts.

Another example would be student accounts, where the funds are accessed by debit cards. The applicability may not be readily identifiable, and will likely depend upon the arrangements made with the card vendor regarding how the accounts are maintained and administered. Determination needs to be made regarding who functions as the "financial institution," the vendor, commercial bank, or the university/college.