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September 15, 2006

Office of the Comptroller of
the Currency, 250 E Street, SW.
Public Reference Room, Mail Stop 1–5
Washington, DC 20219

Chief Counsel's Office,
Office of Thrift Supervision
1700 G Street, NW.
Washington, DC 20552
Attention: No. 2006–19

Jennifer J. Johnson, Secretary,
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW.
Washington, DC 20551

Robert E. Feldman, Executive
Secretary, Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW.
Washington, DC 20429

Re: Proposed Identity Theft Red Flag Guidelines

Ladies and Gentlemen:

The California Bankers Association ("CBA") appreciates this opportunity to submit comments regarding the proposal, which is required under provisions of the FACT Act. CBA is a professional nonprofit organization established in 1891 and represents most of the depository financial institutions doing business in the state of California.

Introduction

The industry is well aware of the risks of identity theft to customers and institutions. There is not a bank that is not concerned about the impact of identity theft on customer relations, on earnings, and on the bank's reputation. So we begin with the proposition that banks are already highly motivated to take precautions to prevent identity theft.

We also acknowledge that it would be helpful for the banking agencies to ensure that all banks have access to certain guidelines and standards. We are, however, troubled by the agencies' unnecessarily heavy-handed approach. The structure of the proposal has similarities to the Bank Secrecy Act—banks are required to establish written policies and procedures, conduct an assessment of risks, establish a monitoring program, establish a training program, and even obtain board of director approval, thus automatically adding one more bank function that a board must exercise direct responsibility over. Can not the goals of the FACT Act be achieved without imposing yet another rigid regulatory regime?

Banks are already laboring under a multitude of legal and regulatory burdens. We concur with the agencies' intent that any guidelines and regulations must be flexible and risk-based. But we believe that the agencies' approach would not meet this objective. We urge the agencies to work with the industry to adopt a less onerous approach to implementation that still assists all banks to combat ID theft. Our specific comments follow.

Comments

Litigation risk. One of our chief concerns about the proposal is that it could create a standard of care that could subject banks to increased civil liability. The proposal would require banks to adopt and implement policies to identify red flags, to detect them, and to take steps to mitigate risks. Losses from identity theft purportedly run into the billions of dollars annually, and neither the agencies nor anyone else believes that the proposal would put an end to losses. But when a loss does occur and a civil claim is made, a bank may find itself subjected to a raft of new and difficult questions all based on alleged "violations" of or deviations from regulation. Indeed, defendant banks could find themselves having to rebut a presumption that, since a loss occurred, it must be because of a compliance failure—in other words, failure to meet industry standards.

Written program. CBA does not believe that the FACT Act requires banks to establish a written ID prevention program. Banks already employ such policies and procedures that are part of and integrated into their financial fraud and risk management efforts. Some programs are written, some are not. Carving out and highlighting ID theft prevention would simply transform banks' organically-developed practices into regulatory compliance exercises, and at great costs. It would tend to focus examiners' attention on documentation and thus encourage banks to produce needless paperwork. It would be more effective for the agencies to articulate objectives and allow banks to reach them in any manner suited to their particular circumstances. (See below).

Board approval. CBA strenuously opposes mandatory board approval of a written ID theft prevention program. The FACT Act does not require it. A board of directors has the duty to direct the affairs of the bank and management's duty is to manage. The agencies posit no compelling reason why directors must, as a matter of regulatory policy, become directly

involved, and why management is presumed not to be able to give this issue adequate attention without involving the board. Board approval of a comprehensive, written program such as contemplated here entails extensive preparation work and documentation by management and would consume more time and attention from increasingly busy boards.

Regulation by objective. In light of banks' historical and inherent interests in combating fraud of all types, we suggest that a more reasonable approach is for the agencies to articulate objectives for banks to reach without mandating inflexible processes and procedures that must be followed. At places, the proposed guidelines are static and prescriptive. For example, banks would be expected to produce and, presumably, document a reasonable basis for concluding that a listed red flag does not evidence a risk of identity theft.

This approach ignores not only banks' vastly divergent experiences, but also the fact that crooks constantly change the way they operate, and that they respond to banks' defensive measures. Requiring banks to justify any change in the type of red flags that they monitor simply creates needless work and time-consuming paperwork. It may even set banks up for liability if, in hindsight, the bank is found to have "guessed wrong" in changing its list.

Relation to business accounts. The proposed definitions of "account" and "customer" are too broad and not mandated by the FACT Act. The guidelines and regulation should be limited in scope to consumer financial services. We suggest that the agencies not attempt to craft a definition of "account," as that term is already defined inconsistently in several regulations, both state (e.g., UCC) and federal (Regulation E, Regulation Z, Regulation J, Regulation DD, etc.). The agencies should clarify that the proposed guidelines are not extended to business and commercial accounts.

Staff training. There being no statutory basis for the agencies to require staff training, we urge that the relevant provisions are withdrawn. Once the agencies articulate policy objectives, it is up to the banks to comply. Specifically requiring training would only generate an additional layer of regulatory burden and paperwork. As discussed above, banks have sufficient incentives to ensure that appropriate staff is trained.

Service provider oversight. Similarly, we do not believe it is necessary to address service provider arrangements. The FACT Act does not address this issue. There is no doubt that if a bank delegates any of its operations to a third party that it will remain responsible for related regulatory compliance. Again, writing specific duties into regulation only generates extra work for banks and examiners.

Listing of red flags. The industry appreciates the agencies' work in identifying potential red flags, in essence, acting as a clearinghouse of current fraud trends. But we caution against attaching any duties on banks, as proposed, to adopt them formally into their programs or justify their exclusion. Such an approach would only require banks to enshrine a static list into their policies and procedures regardless of their relevance. It would also make banks less nimble in managing fraud risks. Many of the red flags either are too general or presumes capabilities that most banks may not have.

For example, red flag number three cites information in a consumer report indicating "a pattern of activity that is inconsistent with the history and usual pattern of activity of an applicant or customer." Examples include a significant increase in the volume of inquiries, an unusual number of recently established credit relationships, changes in the use of credit, and account closures for cause. The agencies have not demonstrated that these factors are indicative of identity theft. We believe the list would generate too many false positives to be useful, in part because such factors are probably more indicative of financial stress or lack of creditworthiness than ID theft.

Conclusion

For the reasons stated above, CBA requests that the agencies revise the proposal by giving banks more flexibility in achieving clear objectives, and by eliminating those provisions that are not specifically required by the FACT Act. Banks are highly motivated to prevent ID theft and all other forms of fraud. This proposal merely makes banks more vulnerable to civil liability, adds tremendous regulatory burdens without making banks more prepared, and could even hamper risk management efforts with is rigid and cumbersome approach. Please do not hesitate to contact me if you have any comments or questions.

Sincerely,

Leland Chan
General Counsel