OKLAHOMA MUNICIPAL LEAGUE, INC.

MUNICIPAL POLICY REVIEW

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NEW ISSUES ALERT
RED FLAGS: IDENTITY THEFT PREVENTION

OML staff participated in a conference call on Tuesday, July 22, 2008, with Federal Trade Commission (FTC) representatives and other state leagues around the country. The FTC summary of the new "Red Flag Rules", prepared for the conference call, plus the regulatory Guidelines will be placed on the OML Website.

This Means YOU. The FTC representatives confirmed that the Red Flag requirements apply to all municipal utilities and other operations which provide services before they bill the customer.

Local Identity Theft Prevention. League staff is working with our sister leagues to identify sample plans and programs to address these new regulations. We are exchanging information on the best way to obtain trainers who are experts in this area. Additional information can be found at RedFlags@ftc.gov or by calling 1-877-FTC-HELP (1-877-382-4357).

FACT Act. As OML previously reported in the July 11, 2008 Municipal Policy Review, new federal rules effective November 1, 2008, mandate the creation of identity theft prevention programs for all affected financial institutions and creditors. These new regulations are part of the Fair and Accurate Credit Transactions (FACT) Act of 2003. A major issue for municipal utility operations nationwide is whether the regulations are broad enough to catch utilities as "creditors" under the Act.

Deferred Payment? The key to whether municipalities are "creditors" is whether they defer payment for goods and services as defined under the Red Flag Rules. This includes utility billing.

Extending Credit? FTC personnel clarified that it is their view that municipalities "defer payments" by their utility customers when water, electric, gas, trash and the like are sold to customers day-by-day but paid for at the end of the billing cycle. They specifically rejected the idea that an up-front deposit equal to an average monthly bill would remove cities and towns from falling under the regulations. *In answer to a direct question, they stated that the only way to escape coverage would be for a municipal utility to bill the customer prior to providing the monthly utility service.*

What Its All About. The premise of the Red Flag Rules is for covered creditors to identify a "pattern, practice or specific activity that indicates the possible existence of identity theft." This might be an alert issued by consumer reporting agencies, customers or law enforcement. A customer may present suspicious documents – particularly in the context of a customer address change.

Basic Requirements. Once a "Red Flag" pops up, the creditor must respond to possible evidence of identity theft to mitigate damage in both existing and new accounts. The regulations require a written plan approved by the governing board and implemented by senior management, annual reporting to the board/senior management on "significant events" and recommendations on program changes due to evolving risks. Training is required for key personnel. Covered entities are responsible to oversee a third-party service provider's identity theft prevention plan.

Franchised Utilities? When questioned whether municipalities have Red Flag duties for their franchised utilities, it was clear that the FTC officials were unaware of how franchises work. The issue here is whether the new regulations would require municipalities to investigate whether the franchised utility had an adequate identity theft prevention program in place. FTC staff will research this issue and update us on their determination.

Flexible Regulation? FTC representatives stressed in the conference call that the regulations are purposefully flexible so each municipal utility operation would have the regulatory freedom to design an identity theft program that best suits its operation. In other words, the program you put in place is an individual assessment based on what is reasonable for your utility operation. *So, what is reasonable?*

The size of your customer base, number of staff members available to monitor the program, the degree of technology available in your operation all factor into your calculation of what identity theft program to create. How complex or streamlined your program needs to be depends on the reasonable risk of identity theft in your community. Be sure to consult the regulatory guidelines prepared by FTC.

Who to Train? Municipal Leagues around the country report that various companies selling Red Flag educational products are stating that all employees with access to data must be trained. This is not the case. In the conference call, FTC officials clarified that the only employees that need to be trained under the new regulations are those who deal with the identity theft protection program.

What To Look For. It's important to start with requiring identification in order to verify the identity of those opening a new account or changing an existing one or, changing an address. This could include photo ID, passwords and user ID for online transactions.

Monitoring Account Activity. Monitoring transaction activity in existing customer accounts is vital in an effective identity theft prevention program. This includes special emphasis on a change of address closely followed by new service requests or a material change in customer credit use. There are rules-based database scanning technologies that look for suspicious patterns and issue an alert. It is important to verify the validity of an address change.

Risk Assessment. Experts recommend a risk assessment to determine possible exposure in your individual utility operation. This includes the number and types of covered accounts, likelihood of damage from identity theft, costs of tracking Red Flags, effectiveness of the plan implemented and determination of appropriate response if a situation of identity theft develops.

SALES TAX HOLIDAY
August 1 to August 3, 2008

As you recall, in 2007 the Legislature passed the Sales Tax Holiday which was held the weekend of August 3, 2007. The rationale for the holiday was to compete with the Texas holiday in order to keep back-to-school sales in Oklahoma. The 2008 Holiday will be held from Friday, August 1 at 12:01 am until midnight on Sunday, August 3, 2008.

The Sales Tax Holiday law is found at 68 O.S. Section 1357.10. It applies to the sale of "an article of clothing or footwear if the sales price of the article is less than $100 and the sale covers the three day period from the first Friday in August and ending at midnight on the following Sunday." Three limitations to this language are contained in the successful 2007 bill.

Additional information on the 2008 Sales Tax Holiday can be found at www.tax.ok.gov. Or, information can be obtained by calling 405 521 3160.

After several years of defeating the proposal, in 2007 the Legislature agreed to "hold harmless" municipalities from the resulting revenue loss. OML staff and the finance directors of several OML members met with Oklahoma Tax Commission (OTC) officials to better understand how the revenue reimbursed by the state was determined.

The basis for the calculation for state reimbursement and future activity:

A. **What formula was used?**
   To determine the 2007 municipal reimbursement, OTC used the local sales tax percentage that each municipality had in August 2006. OTC estimated that the holiday cost the state $2.9 million based on Texas' experience. Texas even now only estimates its percentage of loss over several years of experience.

B. **Is there a report on the separate amounts reimbursed?**
For those municipalities that receive a detailed ledger report, the amount of reimbursement was a line item. Otherwise, the amount is not separated on the monthly report.

C. **Were there similar legislative proposals in 2008?**
Yes. **SB 1149** by Sen. Barrington (R.Lawton) proposed adding school supplies to the Sales Tax Holiday. The estimate was that municipal sales tax would drop $6.6 million annually. Although this bill failed, it is reasonable that additional exemptions will be proposed in future legislative sessions.

D. **Were major sales tax reductions proposed outside the context of the sales tax holiday?**
Yes. An exemption for Grocery Sales Tax made its way into **SB 2129** as a house floor amendment. In addition, Senator Gumm (D.Durant) proposed an exemption for Grocery Sales Tax in **SB 1153**. Both attempts were unsuccessful.

E. **What is the estimated cost to municipalities of the repeal of grocery sales tax?**
In FY 2006-2007 the estimated loss to municipalities was $228.7 million.

F. **Is it reasonable to anticipate that there will be future attempts to remove municipal sales tax from groceries?**
Yes. OML has been contacted by legislative staff inquiring about the effects of removal on municipal revenue.