

# Check fraud

October 2023



## Today's check fraud patterns

- Despite total check transactions decreasing by 7.2% annually since 2018, the value of check transactions slightly increased, highlighting greater risk exposure per transaction each year.<sup>1</sup>
- Although the use of checks by customers is decreasing, the frequency of fraudsters stealing and modifying checks from mailboxes is increasing each year.
- Fraud risk remains for consumers' personal checks; check fraud also occurs through business accounts, as well as insurance and investment vehicles.

Check fraud is anticipated to increase

**+50%** from 2018 to 2023, reaching \$24b in 2023.<sup>2</sup>

Reports of check fraud filed by banks nearly doubled from 350,000 to

**680,000** from 2021 to 2022.<sup>3</sup>

The U.S. Postal Inspection Service received over

**299,000** complaints of mail theft from March 2020 through February 2021.<sup>4</sup>

Attempted check fraud total value saw an increase of

**171%** from 2021 to 2022.<sup>5</sup>

<sup>1</sup> "The Federal Reserve Payments Study: 2022 Triennial Initial Data Release," [federalreserve.gov](https://www.federalreserve.gov), accessed June 2023.

<sup>2</sup> Ibid.

<sup>3</sup> "Banks on High Alert as Check Fraud Threatens New Deposits," [pymnts.com](https://pymnts.com), accessed June 2023.

<sup>4</sup> "FinCEN Alert on Nationwide Surge in Mail Theft-Related Check Fraud Schemes Targeting the U.S. Mail," [fincen.gov](https://www.fincen.gov), accessed June 2023.

<sup>5</sup> Rob Rendell, "Check Fraud Running Rampant in 2023," [niceactimize.com](https://niceactimize.com), accessed August 2023.

# Real-world scenarios

Fraudsters have many ways they can facilitate check fraud, each with a severe financial impact on financial institutions. Below are a few real-world scenarios where check kiting was used to perpetuate a fraud scheme.

## Consumer

### Consumer check-kiting scheme – ATM cash-out <sup>1</sup>

- Fraudster, his wife and other family members in San Fernando Valley defrauded major banks out of more than \$1.7m through a check-kiting fraud ring.
- Over two years, the fraud ring obtained genuine Armenian or counterfeit Ukrainian and Belarusian passports, altered the documentation to include photos of themselves, and leveraged them to obtain additional identity documents to open bank accounts at the victim banks.
- The fraud ring leveraged the fraudulently opened accounts to write bad checks to other fraudulently opened accounts, then immediately withdrew funds from ATMs at Las Vegas casinos before the checks would bounce.
- The outcome of this scheme was the fraud ring forging over 300 passports to unlawfully obtain funds from multiple major banks by exploiting bank rules that allowed them to transfer funds from one account to another.

## Business

### Business check-kiting scheme – artificial account inflation <sup>2</sup>

- A fraudster orchestrated a large-scale check-kiting scheme that caused \$8.8m in losses across three banks in New Jersey.
- The fraudster was the principal of several business entities and maintained and controlled numerous business checking accounts across three separate banks.
- Over a year and a half, the fraudster created artificial balances across his business checking accounts by writing checks with full knowledge there were insufficient funds to cover said checks. To successfully commit the check-kiting scheme, the fraudster deposited checks into other accounts to artificially inflate his balances.
- Over the duration of the scheme, the fraudster deposited millions of dollars into his entity's accounts, far exceeding their annual revenues.
- This fraud resulted in \$3.7m in losses to Bank A, \$3.0m to Bank B and \$2.1m to Bank C.

<sup>1</sup> "Burlington County Man Charged with Bank Fraud for Running Multi-Million-Dollar Check-Kiting Scheme," *fbi.gov*, 24 June 2014.

<sup>2</sup> "San Fernando Valley Man Sentenced to More Than 6 Years in Prison for Masterminding Check-Kiting Scheme that Defrauded Major Banks," *justice.gov*, 20 September 2023.

# Common types of checks in fraud

Fraudsters have many ways they can facilitate check fraud, each obtainable from various sources. Below are some of the most common types of checks used to perpetrate check fraud.

## Stolen check

Legitimate checks of all types, commonly stolen from the mail or inadvertently left in a purse or vehicle where theft may occur

## Altered or check washing

Often a legitimate check that the fraudster stole or received and went to lengths to change the dollar amount or payee

## Payroll check

Commonly identified as a form of internal payroll fraud, impacting companies using paper checks where an employee in processing will take them to be cashed or sold to a third party

## Cashier's, official, certified check

Checks that may be sent for investment proceeds, commonly counterfeited, could be in the form of false promotional marketing checks that appear legitimate but ultimately bounce from the account

## Convenience check

Checks issued by lenders (e.g., credit card company, loans) to legitimate customers that are intercepted by fraudsters for their use

## Counterfeit check

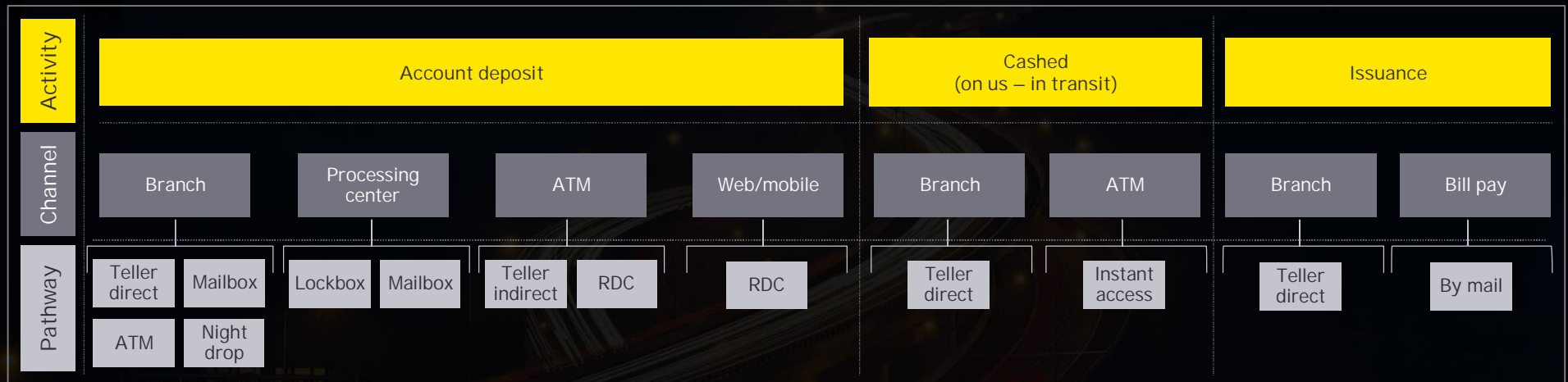
Fictitious checks that may represent a payroll check, lottery winning, promotional check, etc.

\* A check-kiting scheme also facilitates theft by check, and without adherence to Regulation CC, banks are susceptible to fraud losses.



# Where is your check fraud?

Check fraud can occur across various channels and pathways, making it essential for financial institutions to understand their check channels and processes before determining a control strategy.



What is your control strategy?

## Prevention

Examples of prevention may include:

- Training and education
- Biometric authentication
- Multifactor authentication
- Enhanced customer identity

## Detection

Examples of detection may include:

- Link analysis
- Step-up authentication
- Risk-scoring optimization
- Model optimization

## Recovery

Examples of recovery may include:

- Right of offset
- Account recourse
- Collections
- Workout loans

# Targeted roadmap methodology

## Risk and control landscape assessment

Conduct an assessment of fraud risk at the institution and their corresponding controls to identify potential enhancements to existing anti-fraud mechanisms or establish new ones

*If a fraud risk assessment was already completed, firms may begin at the Root cause and discovery phase*

## Customer journey mapping

This analysis focuses on understanding potential touchpoints and vulnerabilities where customers might encounter fraud risk and friction related to check usage

## Root cause and discovery

Once a Fraud Risk Assessment (FRA) has been completed, firms should focus on the root cause of their check fraud risk. The goal is to recognize points of vulnerability across check offerings and identify opportunities for the most impactful changes

## Fraud control roadmap

Finally, once all the information is available, institutions can outline a strategic plan that guides an organization's deliverables to proactively prevent, detect and respond to fraudulent check risk exposure.

## EY Differentiators

1

### Deep knowledge across all facets of fraud

We provide industry knowledge. Our industry perspective can influence actionable change, outline requirements for a robust fraud program and strengthen the control environment.

2

### Strong industry partnership and alliances

EY professionals and our alliance relationships create customer value to help each client rapidly and digitally transform. We help to be more agile and better equipped to respond to disruptive changes in fraud risk management space.

3

### Customer-centric approach

We leverage a customer-centric EY methodology for designing the customer authentication journeys that allows key stakeholders and influencers to define the desired experience while simultaneously identifying and mitigating key risks across fraud and balancing for customer friction.

4

### Advanced artificial intelligence (AI)/machine learning (ML) models

Advanced EY models provide insights from data to continually learn and make better decisions over time. Our flexible deployment approaches include rapid-deployment cloud-based models that require minimal technology investment by the organization.

# Our recommended approach

To adequately address check fraud, we suggest a multilayered approach to conduct the initial phases to understand the risk landscape and root of the issue, map controls that may be impacted by changes, and understand points of friction along the customer journey to make informed decisions for solutions.



# Risk and control assessment approach



## Risk management methodology definition

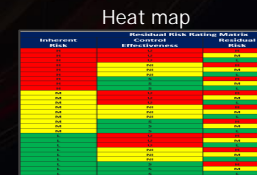
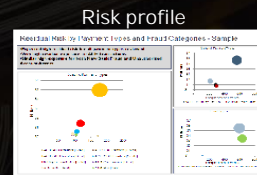
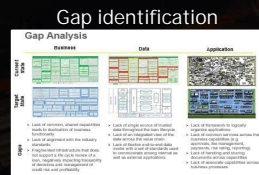
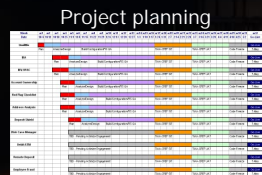
A comprehensive fraud risk assessment is performed to identify specific fraud schemes and risks, their likelihood and impact, and existing fraud control activities. Key components of the risk assessment methodology are leveraged with existing standards, approaches and controls currently in place. Mitigation plans to manage residual fraud risks are implemented to an acceptable level.



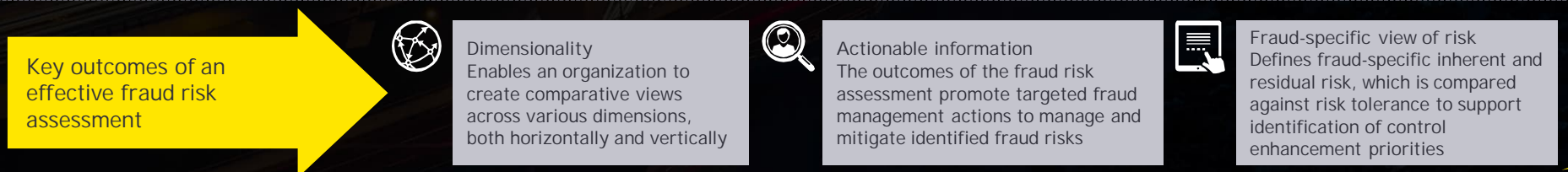
## Check fraud points of focus:

- Analyze internal and external factors that can impact the organization's potential achievement of its objectives and goals
- Evaluate the drivers of check fraud risk within the processes, products, channels and customer segments associated with fraudsters circumventing controls, allowing them to access customer accounts, including potential data analytic techniques to improve the risk assessment process
- Assess the override of controls that can cause catastrophic and/or reputational brand damage

## Illustrative outputs of fraud risk assessment



## Risk assessment methodology

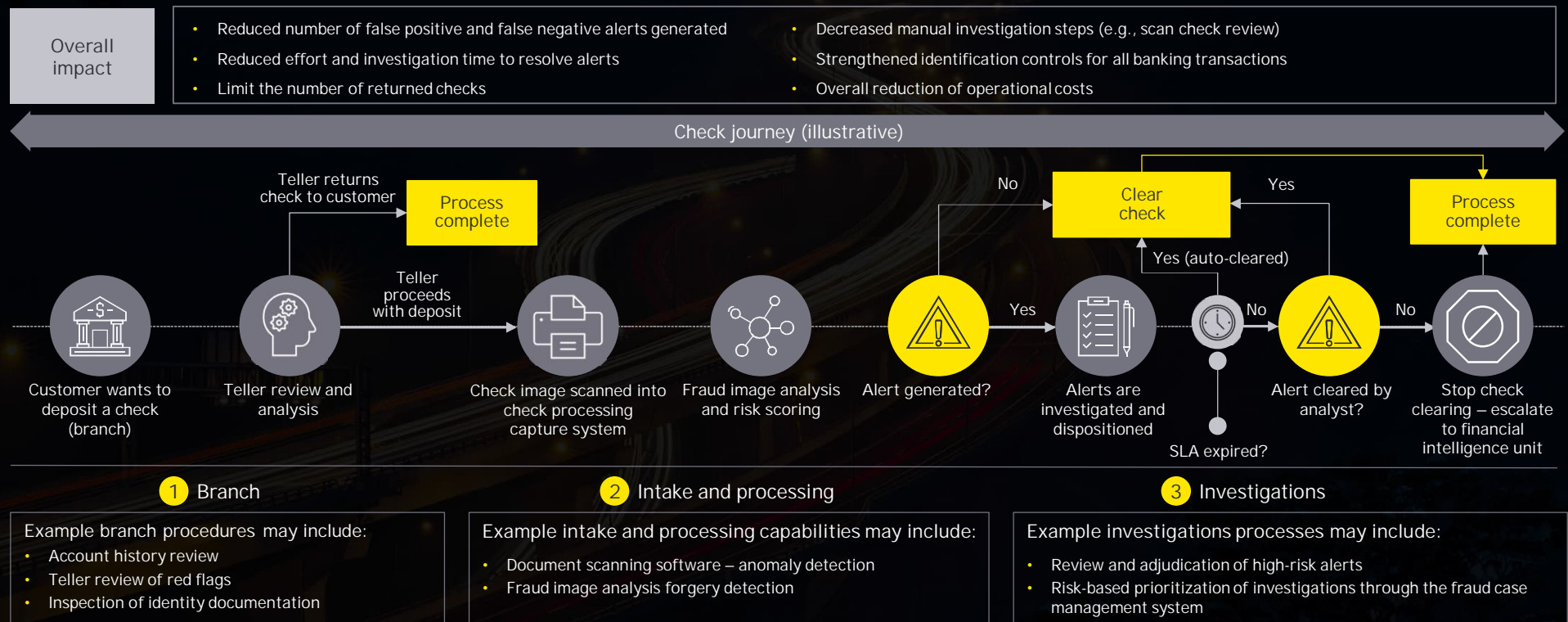




# Check fraud process flow – root cause and discovery



Check processing involves multiple stages where fraud may occur. The illustrative diagram below shows that there are opportunities for control gaps, operational inefficiencies and process failures at various points along the check journey. By conducting an end-to-end root cause analysis, your financial institution (FI) may identify points of vulnerability for check fraud and opportunities for the most impactful changes.



# Check fraud process flow – customer journey mapping

Risk and control assessment

Root cause and discovery

Customer journey mapping

Fraud control roadmap

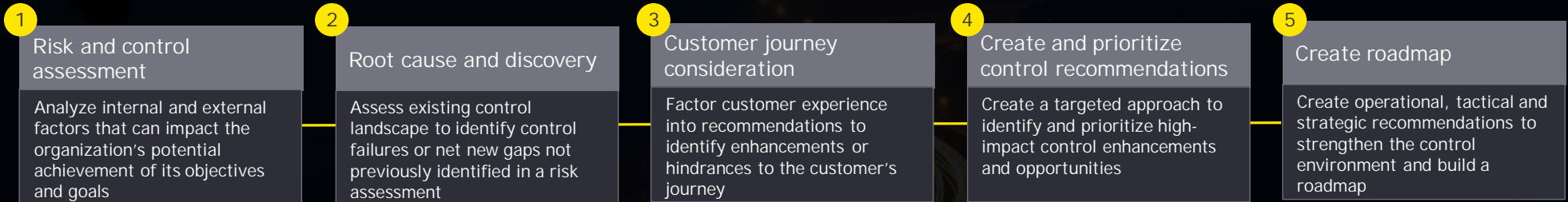
From the customer's perspective, depositing a check consists of a few simple steps followed by a response by the FI that either leads to the funds being deposited in the customer's account or having to repeat previous steps. The illustrative flow below shows the loop that can arise in the check journey, demonstrating the potential gains in customer experience for getting it right the first time.



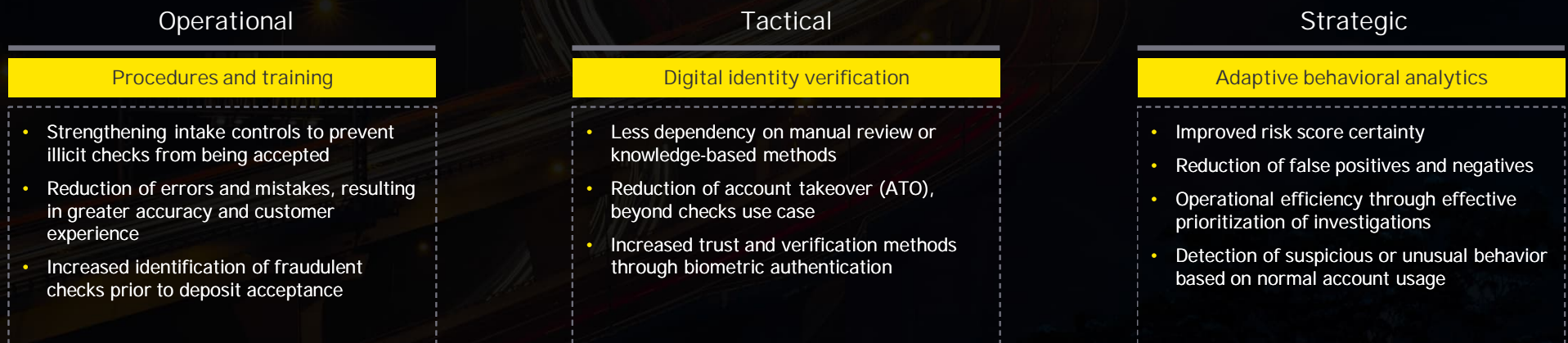
# Targeted roadmap methodology



By understanding the risk and control landscape across your financial institution, the methodology below highlights the steps taken to create a prioritized roadmap targeting the underlying risks to prioritize highly impactful control enhancements while limiting any negative impact on the customer experience.



## Potential roadmap prioritization (illustrative)



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