Cheque Fraud – International Scenario & Countermeasures

1. Cheque Fraud[1]: An Overview.

We all know the risks, losses and frustration associated with credit card fraud and identity theft. However, the likelihood of being affected by cheque fraud dwarfs these risks, and criminals also have a higher likelihood of success.

15 years ago a person would have to understand the printing processes and have a printing press available to be able to commit cheque fraud. Today, with desktop publishing programs, scanners, copiers and printers, any PC user is capable of committing high-quality cheque fraud.

Adding to the trouble is the speed at which banks process cheques. Banks process over 64 billion[2] cheques a year. They are processing cheques at 2,500[3] cheques per minute. Banks cannot possibly review all of these cheques thoroughly enough to consistently identify every fraudulent cheque. With the cheque truncation process, which will enable banks to convert cheques to electronic images and use these images as substitutes for the real thing, the speed of processing of cheques is set to increase significantly over time. Conversion also increases the likelihood of cheque fraud by truncating the security information that may exist on a real cheque from the point in time when the cheque is scanned in the clearing process.

To protect ourselves against cheque fraud we must start with a basic axiom, "trust no one." Remember that even a attorney, judge, doctor, employee, friend or relative can commit fraud. Anyone is capable of committing fraud.

2. Cheque fraud statistics.

Here are some facts and statistics about cheque fraud compiled from various sources:

- According to Ernst & Young more than 500 million cheques are forged annually, with losses totaling more than $10 billion.

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[1] Content taken from report title: Check Fraud – A guide to avoiding losses issued by Check Fraud Working Group based in US.
[2] Source www.ebanklink.com
[3] Source www.ebanklink.com

- According to a report issued by the American Banker, an industry bankers magazine, estimates of losses from cheque fraud will grow by 2.5% annually in the coming years.

- According to the Create-A-Cheque website, in 1997 there were about 496 million fraudulent cheques written for a total of approximately $9.9 billion. This means that an average of 1.4 million fraudulent cheques was written daily worth $27.3 million.

- According to the National Cheque Fraud Center, cheque fraud and counterfeiting are among the fastest-growing problems affecting the nation's financial system, producing estimated annual losses of $10 billion and losses continue to rise at an alarming rate annually.

- As per report[4] available in website
  - Small businesses are the most vulnerable to fraud and abuse. The average scheme in a small business causes $127,500 in losses. The average scheme in the largest companies costs $97,000.
  - The typical occupational fraud perpetrator is a first-time offender. Only 7% of occupational fraudsters in this study were known to have prior convictions for fraud-related offenses.
  - Frauds committed by employees cause median losses of $60,000, while frauds committed by managers or executives cause median losses of $250,000. When managers and employees conspire in a fraud scheme, the median loss rises to $500,000.
  - Losses caused by perpetrators older than 60 are 27 times higher than losses caused by employees 25 and younger.
  - The average fraud scheme lasts 18 months before it is detected.

3. Why is cheque fraud growing?

The unfailing popularity of paper cheques is one reason cheque fraud is booming. Banks have been working hard to transition customers from using paper cheques. However, bank customers continue to use cheques in very high number. Banks have discovered that many customers prefer paper cheques to debit cards, automatic bill payments, electronic banking, and other alternatives intended to reduce the volume of paper cheques. One reason for the ongoing popularity of paper cheques is the benefit provided by the float period that provides additional time for bank customers to deposit funds or

[4] Source www.stopcheckfraud.com

earn interest on account balances. Customers also value paper cheques as a tangible record of cash disbursements.

Another reason for rising cheque fraud is the availability of low-cost, professional desktop publishing and copying technology. Using color copiers, laser printers, scanners and publishing software, counterfeiters can easily create excellent-quality duplicate, forged, or amount-altered cheques.

4. Types of cheque fraud[5].

Fraud schemes involving cheques take many forms. Cheques may be

- Altered, either as to the payee or the amount.
- Counterfeited.
- Forged, either as to signature or endorsement.
- Drawn on closed accounts.
- Used in a variety of schemes.

5. Countermeasures for cheque fraud[6].

The most common method for detecting fraud is through tips from employees, customers, vendors and anonymous sources. The second most common method of discovery is by accident.

Various countermeasure adopted by financial institution like:

- General Internal controls.
- Internal Controls to Prevent Cheque Fraud by Insiders.
- Education ,Training & Guidelines.
- Teller Training etc

has not met the expectation in reducing the frauds. The Banks on his own couldn't prevent or decrease the cheque fraud alone. The Bank in coordination or in partnership with customer can reduce the probability and chance of cheque fraud.

[5]Content taken from report title: Check Fraud – A guide to avoiding losses issued by Check Fraud Working Group based in US.
[6] Content taken from report title: Check Fraud – A guide to avoiding losses issued by Check Fraud Working Group based in US.

The Bank – customer coordination in preventing fraud has been well established in combating the fraud. Various Banks have implemented the following two countermeasures for cheque fraud:

1. Positive Pay
2. Reverse Positive Pay.

The use of technology and in partnership with customer, banks are now able to provide an effective solution to combat cheque fraud.

1. How it works?

A) Positive Pay.

Positive Pay is an efficient cheque verification services designed to reduce fraud for organisation. The service can also include payee verification on high value cheques.

Positive pay allows a company and its bank to work together to detect cheque fraud by identifying items presented for payment that the company did not issue. In the usual case, the company transmits electronically to the bank a list of all cheques it issued on a particular day. The bank verifies cheques received for payment against that list and pays only those on the list. The bank rejects:

- Cheques not on the company's list.
- Cheques that exceed a specific amount.
- Cheques that carry dates long past due (stale cheques).

The banks investigates rejected cheques to find out if the items are fraudulent or in error. The bank pays only exception items approved by the company.

B) Reverse Positive Pay.

Reverse positive pay is similar to positive pay, but the process is reversed. This is prevalent in the US. The company, not the banks, maintains the list of cheques issued. When cheques are presented for payment and clear through the Federal Reserve System, the Federal Reserve prepares a file of the cheques' account numbers, serial numbers, and dollar amounts, and sends it to the banks. In reverse positive pay, the bank sends the file to the company. The company compares the information with its internal records. The company lets the banks know which cheques match its internal information. The banks pay those items. The banks then researches the cheques that do not match, corrects any misreading or encoding errors, and determines if any items are fraudulent. The banks pay only the "true" exceptions, that is, those that can be reconciled with the company's files.

6. Banks that have implemented Positive Pay service.

Various Bank had implemented "Positive Pay " and "Reverse Positive Pay" as countermeasures to prevent cheque Fraud. Some of the Banks are:

- ABN Amro Bank
- Bank of America
- Bank of New York
- CitiBank
- Bank One
- HSBC
- Imperial Bank
- JP Morgan Chase
- Mellon Bank
- Scotia Bank
- Well Fargo
- Wachovia
- US Bank

7. Success stories of using "Positive Pay" services.

A) Scotia Bank [7], fraud prevented of USD 70,000.

Ford Credit based at Canada has implemented "Positive Pay " service of Scotia Bank. Since the implementation, the Bank were able to intercepted fraudulent cheques totaling USD 70,000.

B) Wachovia Bank[8], fraud prevented of USD 8,000.

Selective Insurance Group has implemented " Positive Pay " service of Wachovia Bank. Since the implementation, the Bank were able to intercepted fraudulent cheques totaling USD 8,000.

Disclaimers : The views mentioned are the personal views. Any reference should be at your own risk. The author is not any way responsible for any action taken based on the content of the article.

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[7] As published in Scotia Bank website.
[8] As published in Wachovia Bank website.