

Check Fraud: The Community Bank Perspective

The Independent Community Bankers of America, representing community banks across the nation with nearly 50,000 locations, appreciates the opportunity to provide this statement for the record for today’s hearing: “Examining Scams and Fraud in the Banking System and Their Impact on Consumers.” ICBA would like to use this opportunity to highlight the recent surge in check fraud and its impact on community bank customers.

At the outset, ICBA would like to acknowledge the important work of one of our state affiliate associations, the Community Bankers Association of Illinois (CBAI), who was early in identifying and documenting the increasing occurrences of check fraud and its resulting impact on CBAI members and their customers. In January of 2023, CBAI surveyed its members and found that the scope and cost of the problem to community banks is significant and growing.¹

When a customer falls victim to fraud, a community bank’s primary goal is to make the customer whole through recovery of funds. Additionally, community banks conduct thorough investigations on such incidences to ensure the fraud does not continue. Community banks assist law enforcement to identify and understand specific crimes and trends with the hope of protecting all consumers from similar incidents.

Fraud Rooted in Rampant Mail Theft

Check fraud occurs when checks are stolen and the payee and possibly the amount are altered, using advanced “check washing” techniques. The check is cashed or deposited, typically into a fraudulent account created for this purpose. Funds are withdrawn or transferred before the fraud is discovered, and the criminals escape with the proceeds.

Check fraud has become highly sophisticated in recent years with large scale operations, sale of stolen checks and mailbox keys on the dark web, and the recruitment and training of “walkers” who are paid to deposit or cash washed checks using false identification. According to FinCEN, Suspicious Activity Reports (SARs) related to check fraud increased from 350,000 in 2021 to more than 680,000 in 2022.²

By far the biggest source of stolen checks is the United States Postal Service. Checks are stolen from consumer mailboxes as well as from USPS facilities. During the Covid pandemic, USPS became a rich source of checks for criminals as government benefits were distributed through the mail. Effective mail security is a critical, though not exclusive, part of the solution to the problem of check fraud. With better security, check fraud would be significantly reduced.

¹ According to a CBAI survey of its members, 60 percent of respondents said that they had experienced problems obtaining reimbursement for fraudulent returns in the past year. An extrapolation of these results nationwide would suggest that some 2,800 community banks are experiencing this problem. The CBAI respondents further indicated that large banks and credit unions were the source of the problem. On average, respondents had five unresolved checks awaiting reimbursement for an average of \$23,000 each, and these checks had been outstanding for an average of five months. A nationwide extrapolation would suggest that 19,600 are unresolved with an estimated total value of \$65 million. 65 percent of respondents said they had had no response from the large banks of first deposit in their efforts to obtain reimbursement. Respondents’ losses averaged \$30,000 in 2022. Extrapolation would suggest that nationwide community bank losses are approximately \$94 million.

² <https://www.fincen.gov/news/news-releases/fincen-alert-nationwide-surge-mail-theft-related-check-fraud-schemes-targeting>

Bank Cooperation Is Critical to Consumer Reimbursement

Check fraud typically involves two banks: the drawee bank on which the check is issued and at which the customer's funds ultimately reside, and the "bank of first deposit" at which the criminal deposits or cashes the fraudulent check. Following deposit, the bank of first deposit requests a transfer of funds from the drawee bank to cover the deposit.

The fraud is usually discovered when the owner of the stolen check, be it a consumer or a business, flags the check as fraudulent and requests reimbursement. The drawee bank reimburses its customer and seeks reimbursement from the bank of first deposit, where liability for the fraud resides.

The Uniform Commercial Code (UCC) provides that the bank of first deposit is liable. This makes sense because that bank is the entry point of the fraud and is in the best position to prevent it by screening out the deposit, or better yet, deterring the creation of a fraudulent account to accept a deposit. Liability creates an incentive for the party that is best positioned to prevent the fraud to do so. Though liability is unambiguous, there is no effective enforcement mechanism outside of costly litigation. Resolution depends on willing cooperation between the banks.

Community banks are frustrated because large banks or credit unions of first deposit are often nonresponsive when fraud is discovered by a community bank. Coordination between banks is an important step for quickly understanding and resolving instances of check fraud. Any lack of consistent and timely cooperation slows the investigation and can lead to additional instances of fraud.

Opening of Fraudulent Accounts Deserves More Scrutiny

Check fraud is frequently enabled by fraudulent accounts opened at large banks and credit unions with stolen credentials. These accounts are used for the deposit of fraudulent or altered checks. Account opening at all financial institutions is subject to the Bank Secrecy Act's (BSA) Know Your Customer (KYC), and Customer Identification Program (CIP) rules, which are expressly designed to prevent the use of assumed identities to open accounts. Because community banks exercise due diligence and do not rely on generic and anonymous account opening processes that are easily manipulated by fraudsters, they are less vulnerable to account opening fraud.

Community Banks Are Part of the Solution

Community banks are uniquely positioned to prevent, detect, and mitigate customer fraud. They take this role very seriously. As relationship bankers, community banks know their customers in real and meaningful ways. These relationships promote access to services, prevent fraud on the front lines, and give customers a personal resource when they fall victim to fraud or scams.

Recently, a community bank member told us of a customer that had been tricked into wiring a significant amount of money to a fraudster. Upon realizing they were scammed, the customer contacted the community bank for help. The community bank, which employs former police officers with expertise in financial crime, acted immediately and was able to recover the money for the customer. This could only have been achieved by a financial institution that knows its customers, prioritizes needs, and is willing to act rapidly.

Customer education, whether in person, at branches, or online is a critical component of fraud prevention and mitigation. The most vulnerable customers benefit the most from the face-to-face interactions they find in a community bank. When fraud occurs, preexisting relationships allow for an immediate response.

Under certain circumstances, a community bank may take steps to make defrauded customers whole before the bank of first deposit has reimbursed the customer for the loss. Community banks often choose to absorb these costs because they prioritize long-term customer relationships.

While community banks are a critical part of the solution, they cannot do it alone. USPS must do more to prevent mail theft. Cooperation among financial institutions is needed to prevent the opening of fraudulent accounts, mitigate fraud, and promptly reimburse victims, and the largest institutions of first deposit must take steps to promptly respond and be held accountable.

ICBA Supports and Partners with Community Banks and other Stakeholders

ICBA leads an industry fraud work group comprised of regulators, law enforcement, trade associations, and other government stakeholders such as the U.S. Postal Inspection Service to share information, identify best practices, and discuss emerging approaches to combatting check and other types of fraud. This group has built a considerable record of success in creating cooperation among entities.

ICBA continues to engage with its members to explore different mechanisms for collaborating to prevent, detect, and mitigate fraud. ICBA also values its ongoing work and relationships with members of Congress and federal agencies. We will continue to partner with these important stakeholders as we collectively work to reduce the burden of check fraud.

Thank you for convening today's hearing to examine fraud in the banking system and its impact on consumers. We appreciate the opportunity to provide community bank perspectives and hope to provide ongoing input as solutions are developed.