

Fighting Cheque Fraud in the 21st Century:
Cheque Fraud Detection in the New Clearing Model

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Introduction

Cheque volumes are reducing by around 14% per annum but cheques remain an important and indeed essential payment method for various segments of society, with more than one million issued every day in the UK. Critically, you do not need the beneficiary bank account details to make a payment, just the beneficiary's name, and if posted, then their address. Cheques are the only payment type that is protected by legislation as detailed in the Bills of Exchange Act 1882, the Cheques Acts 1957 and 1992 and a wide range of case law.

We are currently in the midst of the UK banking industry's commitment to digitise the paper cheque with the roll-out of the Cheque Imaging Clearing System (ICS), thereby reducing clearing times to the next working day following the cheque being banked on Day 1. New methods for paying cheques into your bank account are being introduced, such as capture on your smartphone and remote deposit for businesses using desktop cheque scanners. Subsequently, there is a faster clearing period with value credited and certainty of fate known by the end of Day 2, whilst you are now no longer required to visit your bank or pay in at your local Post Office. The cheque is now finally coming into the 21st century technology revolution.

Decline in Cheque Fraud

Identification of fraud on a paper instrument has been developed and refined over the years with greater use of technology, and bank staff checking for fraud have honed their skills in identifying fraud – counterfeit, forgery and fraudulently altered. The Cheque Printer Accreditation Scheme (CPAS) has also played an important role since its inception

in the mid-90s in ensuring that cheque printing production meets strict standards and regulations, the design and ink coverage enables good quality images when captured, and all paper meets minimum fraud prevention requirements.

Fraud losses peaked in 2008 and during the past 10 years they have reduced by more than 85%, far in excess of the decline in cheque volumes over the same period.

Fraud – The Figures

Cheque fraud is at its lowest level ever and currently stands at 1.33% of overall payment fraud, as reported by the UK Finance Fraud the Facts 2017 Publication. Cheque usage may be unfashionable but from these fraud figures, it is currently the safest payment method (notwithstanding coin and paper cash usage).

In 2017, overall payments fraud decreased by 5% compared to the previous year and totalled £731.8m. The cheque fraud figure declined to £9.8m, representing an annual reduction of 28% with case volumes also down by 48%.

2017 Cheque Fraud Losses		
Fraud type	Loss	Annual Percentage
Counterfeit <i>A cheque printed on non-bank paper to look exactly like a genuine cheque and drawn by a fraudster on a genuine customer account.</i>	£2.7m	46% down
Forged		

<i>A genuine cheque that has been stolen from a customer and used by a fraudster with a forged signature.</i>	£4.3m	22% down
Fraudulently Altered <i>A genuine cheque that has been issued by a customer but has been changed by a criminal before it is paid in, e.g. by altering the beneficiary's name or the amount.</i>	£2.8m	10% down
Total	£9.8m	28% down
Fraud Cases	1,745	48% down

Source of information: UK Finance Fraud the Facts 2017 Publication.

For the period January to June 2018, the reported figure is a £3.2m fraud loss, a decline of 41% on the same period in 2017, with prevented fraud for the same half year being £74.3m – equivalent to £9.59 in every £10.00 attempted.

The Challenges with Imaging

Once the front and back of the cheque has been imaged in readiness for submission into the Image Clearing System it becomes the legal payment instrument and the original paper cheque then has no value.

The ICS automatically undertakes a validation check for file size that includes the images and data. If this validation check fails then the file is rejected, and it is for the collecting

bank to correct and represent their submission. An Image Quality Analysis (IQA) check on both the front and rear images of each cheque against the ICS Image Standards is also undertaken following successful validation. Such checks cover readability – not too light or too dark, sizing of image – not too large or too small, skewing, tears and folds. The paying bank is advised for each item whether IQA has failed or passed and it is then for that bank to accept or reject the image.

The paying bank has to be able to read the images, not only to undertake technical checks i.e. words and figures match, within date and correctly signed but also for their fraud detection image analysis to work. Should the paying bank be unable to read the image then the cheque will not be paid with the need for the beneficiary bank to liaise with the collecting bank (usually the same bank) to recapture the image from the original paper and to represent both the front and rear images together with new data. As the cheque has not been paid due to the poor image capture then there is an unwanted and unwelcome delay for the beneficiary to be credited with the funds. Accordingly, the standard of image collection is important and a pre-submission check should be deployed at the point of capture to reduce exceptions within the ICS and to avoid elongated payment decisions. Rework is time consuming and expensive and can easily be avoided. If the collecting bank chooses not to undertake IQA at capture, they do so at their risk that submitted images may be flagged as non-compliant and unusable with potential reputational damage to both the Scheme and that bank.

With a faster clearing timescale cheque fraud detection has, by necessity, got to become more agile and it is essential for all banks involved in the transaction to diligently undertake their checks to combat fraud, particularly as the paying bank will no longer be able to physically examine the paper cheque issued by their customer.

Normally, the customer will pay cheques into their account at their own bank and hence that bank has to assume duties as both the collecting and beneficiary banks.

The collecting bank has to undertake some legal obligations in their checking process e.g. the payee name is identical to the account name to be credited – cheques in sole name can go into a joint account but a cheque in joint names should not be credited to a sole account. If that is being sought - then investigate. Be aware of any additions to the payee line e.g. *T/A (trading as) or For* (with another name added), as they may be fraudulently altered.

The collecting bank has the only opportunity in the Image Clearing System to check the security features on the paper cheque e.g. alterations to words or figures and the payee line by checking there have been no changes to UV design – this can be automated with a UV scanner - and to do a ‘wet finger test’ to ensure that the ink smudges as part of the check for counterfeit items.

As the paper cheque is retained by the collecting bank or beneficiary customer at the point of deposit then it is essential for the beneficiary bank to “know their customer” - is the amount to be credited and frequency the norm? Does it fit the profile advised by the customer?

Where the beneficiary bank is not the same as the collecting bank then the ICS can send the beneficiary bank an early notification message providing details of the item being processed and thereby enabling them to be aware and to commence their checks.

When the paying bank receives the image of the cheque then “know your customer” and account profiling are paramount. Is the amount and frequency of cheques issued the norm? If not, check with the customer (e.g. telephone, text, fax message). Have there been previous incidences of fraud? Other checks include the need to ensure that the cheque number is consecutive and the presentation is not duplicated. Handwriting analysis together with cheque layout and design analysis have proved effective in detecting fraudulent changes and counterfeit cheques.

The central Image Clearing System automatically checks for the presentation of duplicate items and issues a warning message to the paying bank to check the item and their data records.

Image Survivable Features

The addition of Image Survivable Features onto the face of the cheque can greatly help with fraud prevention and 'ISFs' are becoming more readily available and prevalent. Such features enable the cheque data to be captured and encrypted within a unique coded number or barcode that can be applied to the original paper cheque, thereby ensuring the validation of the item when the image is scanned. Counterfeit items and fraudulently altered items can then be readily identified.

Future Development

A New Payments Architecture is being progressed by Pay. UK with the aim of undertaking an end-to-end data analysis across all transactional retail payments - faster payments, bacs and cheques - thereby improving data sharing and analysis to fight financial crime.

As payments become near real-time then real-time data analysis is essential to create a rich and varied database to achieve fraud detection and to further strengthen the fight against fraud.

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