WORKING TOGETHER TO FIGHT

CHEQUE FRAUD

The third white paper written by the TALL Group of Companies

FRAUD: A CHANGING LANDSCAPE

In terms of recent history, cheque fraud losses peaked in 2008 and during the following 10 years they reduced by more than 85%, far in excess of the decline in cheque volumes over the same period. However, the latest statistics published earlier this year have revealed that cheque fraud losses have increased throughout 2018.

According to "UK Finance Fraud the Facts 2019*, cheque fraud losses increased to £20.6 million last year - the first rise in cheque fraud reported in seven years. The volume of fraudulent cheques increased by only a limited amount, indicating that a small number of high-value fraudulent transactions led to the rise in losses last year, rather than any change to the longer-term trend.

A total of £218.2 million of cheque fraud was prevented in 2018, up by 3% on 2017. This is equivalent to £9.14 in every £10 of attempted cheque fraud being stopped before a loss occurs. This remains the highest proportion of attempted fraud prevented across all types of payment fraud.

There are three main types of cheque fraud:

- Counterfeit – a cheque that has been created on non-bank paper to look genuine. It relates to a genuine account, but has actually been created and written by a fraudster for the purposes of committing fraud.

- Forgery – a genuine cheque, however the signature is not that of the account holder. The fraudster has forged the signature by signing the cheque themselves.

- Fraudulently altered – a genuine cheque made out by the genuine customer but it has been altered by a fraudster before it has been paid in (e.g. by altering the recipient's name on the cheque or the amount. It is no longer a genuine cheque).

Of the total £20.6 million lost to cheque fraud in 2018, counterfeit cheques accounted for £15.9 million, forged items resulted in a £3.4 million loss, and fraudulently altered accounted for £1.2m.

As expected, fundamental change to the cheque clearing system – the introduction of the Image Clearing System (ICS) in October 2017 - has inevitably attracted more attempts of fraud, as criminals pro-actively look for any weak links in the new cheque image clearing system.

THE IMPLEMENTATION OF ICS

Whilst cheque volumes continue to decline in the UK – at around 15% per annum – the payment method still plays an important role for many sectors, organisations and individuals alike, with more than one million issued every day.

As detailed in our first white paper of 2019, ["Fighting Cheque Fraud in the 21st Century: Cheque Fraud Detection in the New Clearing Model"](), the UK banking industry has been delivering the digitisation of the paper cheque and the roll-out of the ICS has recently been completed. All cheques now benefit by reduced 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 has finally become part of the 21st century technology revolution.

Commenting in October 2017, at the launch of ICS, Martin Ruda, Group Managing Director at the TALL Group of Companies, had said: "The digitisation of cheques has proven to be very effective across numerous countries for many years, and the long-awaited introduction of ICS is a significant event as the UK follows suit. With an emphasis on speed and convenience, we encourage banks and building societies to fully embrace the modernisation of the cheque clearing process, which will lead to increased efficiencies for the financial organisations as well as their valued customers."

Fraud liability model and secondary legislation
Currently, in the event of losses, direct participants are bound by the ICS Rules for compensation in cases of fraud with the paying bank typically compensating the customer for the loss albeit the payee's bank, or the collecting bank (if different to the

payee's bank) can compensate the customer depending upon the circumstances surrounding the loss.

Last year, the government introduced secondary legislation to provide a safety net in respect of compensation for losses suffered by users of cheques to ensure the innocent customer, particularly the payer of the cheque, should not be left out of pocket.

Where a cheque is lost or stolen from a payer and collected by a fraudster, the banker who has provided the facilities for the image to be captured from the original cheque, normally the payee bank, is deemed the responsible banker, and is liable to make full compensation to the payer or paying bank, irrespective of fault. Compensation is excluded in those cases where the payer has been grossly negligent or been knowingly involved in fraudulent activity.

This 're-balancing' of the fraud liability model is recognized as a fair and reasonable step to mitigate risk and is a further change to ensure all parties to the cheque image clearing process contribute to its integrity and reliability.

DEVELOPMENTS IN TECHNOLOGY

Innovative anti-fraudulent solutions

The introduction of ICS has given the wider industry the opportunity to innovate and develop new and highly sophisticated Image Survivable Features (ISFs) to help

combat fraudsters, many of which were discussed in-depth within our second white paper, *"Cheque Image Clearing System: An Innovative Approach To Defeating Cheque Fraud".* These solutions have been designed to protect financial organisations and their customers from any attempted fraudulent activity as they adapt to the new processes that form part of the new clearing model.

The introduction of scanner-based features at the point of collection, including the use of ultraviolet (UV) image capture and alteration detection, and the application of Image Quality Assessment (IQA) routines, can flag items that are not imaging correctly, or which may have fraudulent history (wrong size, shape, information). This will prevent the collecting bank from submitting fraudulent and non-standard items into the central clearing system.

This is being supplemented by the use and gradual adoption by banks and their customers of the new and enhanced ISFs - which include UCN and UCN Plus® to very specifically trap counterfeit, tampered and fraudulently altered items. In particular, UCN Plus® enables the original variable data applied to the cheque – Payee Name, Amount, Date – to be automatically matched against the actual content which appears on the image once the cheque has been deposited, and before the funds are cleared.

Impacting figures

Encouragingly, these solutions are also having a positive effect on the level of fraud being detected. For instance, modern technology has now evolved to identify

alterations, counterfeits and forgery, in addition to the traditional security features on the cheque, which has reduced the reliance on human eye-balling. Whilst ISFs are becoming increasingly important to confirm the cheque payment details, these sophisticated solutions are underpinning the strong and well-established fraud prevention measures used within the industry for many years.

COLLABORATION IS KEY

In order to fight fraud in the most proficient manner, it is vital for all participants involved in the transaction process (collecting bank, the payee bank and the paying bank) have to accept they have a duty of care to check for poor image quality and to identify fraud. Similarly, indirect participants (agencies) also have that obligation where they assume any of the roles within the transaction.

With the introduction of ICS, the collection participant is now the only one that has sight of and can feel the paper and check the paper security features, and it is most important that this task is fulfilled in the most effective manner.

The image, once captured, must be clearly readable thereby enabling the paying participant to undertake their own specific checks. If that particular organisation is unable to read the image clearly, then the paying participant will not pay the cheque, resulting in the item being represented. This will lead to all parties having to undertake additional work, frustrating delays to the beneficiary in receiving the funds, as well as negatively impacting the reputation of ICS.

With the completion of cheque imaging in the UK, the transfer of the paper document from one bank to another has now become a thing of the past, and now the UK cheque industry looks to its technology service providers for innovation, quality assurance and protection from fraud. Early evidence suggests it will not be disappointed.

ENDS

Sources:

- UK Finance: Fraud The Facts 2019