



BANKERS COMPLIANCE TASK FORCE

NEWSLETTER

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RULES-BASED CHECK FRAUD SYSTEMS OFFER COMMUNITY BANKS MORE THAN FRAUD SAVINGS

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Sophisticated fraudsters follow a path of least resistance and as large banks have become more adept at check fraud detection and prevention, perpetrators of these crimes are increasingly taking aim at community banks.

In the American Bankers Association's (ABA) latest biennial survey, check fraud ranked only behind identity theft as the leading threat against small banks. The ABA estimated that industry-related check fraud losses totaled \$677 million in 2003, with the number of fraud cases totaling more than 615,000. In 2001 there were just over 600,000 cases.

Even as the number of cases continues to rise, it is important to note that most check fraud activities violate only a handful of rules such as: duplicate serial numbers; serial numbers out of range; missing serial numbers; checks written for unusually large amounts; or an invalid routing transit number.

Today's automated rules-based check fraud detection systems can detect and prevent up to 85 percent of all attempted check fraud.

These rules-based fraud applications detect account "behavior" out of the normal range of historical account behavior and flag these items for further review. Effectively the rules-based application is a tool that indicates to the bank that the "typical" account-type behavior has been broken and the item requires further review.

Though all of the largest banks in the ABA survey used rules-based systems to identify suspicious checks, only eight percent of the smallest banks indicated that they did. Similarly, all of the largest banks use software to screen new-account applications for fraud, but only 14 percent of the smallest banks claimed to use them.

So even though community banks view check fraud as a serious threat and are increasingly vulnerable to such schemes, why have they been so slow to invest in fraud deterring technology? Two of the main reasons that we hear from banks are that "our fraud losses aren't that significant" and "we can't justify the investment in a fraud detection solution".

In addition to significant savings, a rules-based fraud detection system can offer community banks a number of benefits including improved customer service, the ability to customize the system, and

improved operational efficiencies.

This is how one of our community banking clients summed up how his view of fraud has changed over the past few years.

Greg Niemeyer, who is the executive vice president of \$850-million North Dallas Bank, said, "Your first motivation is more like, what if...? Our actual fraud write-offs were not material, but what if somebody did perpetrate a really big fraud on us? How would we catch it? How soon?"

"But now, after a year or so of using a fraud detection solution, I look back and see that we weren't factoring in all the business opportunities we missed because we were worried about risk we couldn't identify. We weren't factoring in the customer gratitude when they receive a call from us that basically says, we're looking out for you and probably saving you a bundle of money and trouble."

"What we bought was a piece of software for detecting check fraud. What we got was a competitive advantage in serving customers, an ever-expanding training tool for our employees, and millions of dollars in avoided losses."

This client saved \$3.5 million in fraud losses in one year.

A victim of check fraud can be put through an overwhelming, unenviable experience of having to make dozens of calls to stores, creditors, the bank, as well as others. A rules-based fraud detection system allows a bank to set customized parameters that will alert the bank personnel to potential fraudulent activities. For example, if a presented check number is out of range or checks with the same serial number are presented multiple times, the software will alert bank personnel early enough so that the customer can be notified in time enough to prevent the problem from becoming completely unmanageable.

Banks can tailor a rules-based fraud detection system to adapt to the varying fraud schemes that they are experiencing or to those that may be more prevalent in their particular market or geographic region.

According to an executive at a regional bank located in the southeastern US, her bank has really benefited from the ability adjust parameters in a rules-based system.

“Our ability to manipulate the parameters in the system is really important in our environment because our geography is very different than a bank on the west coast. We’re able to concentrate on what’s important to our bank and the types of fraud that is hitting us. So we’re able to adjust the parameters accordingly, and as a result, we are witnessing a continual improvement in our saves.”

Rules-based fraud detection systems can dramatically improve a bank’s operational efficiencies, eliminating costly manual processes and allowing the bank to redirect critical resources to other areas of the organization, as was the case with a small bank in the southwest.

The bank’s spokesperson said, “Before we installed our rules-based system we had three analysts, full time equivalent bank staff (FTE’s) that were dedicated to manually prioritizing and checking suspect items. After installation of the system we went from three FTE’s down to one part-time.”

These are just a few examples of how forward-thinking smaller banks are being proactive in their efforts to fight the growing problem of check fraud and realizing benefits other than significant losses avoided. If you’re one of the many community banks that haven’t considered investing in a rules-based check fraud detection system or have the attitude that “our fraud losses aren’t that significant”, it’s probably only a matter of time before the check fraudsters have your bank in their cross hairs.

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