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Image Exchange

June 6, 2008

**2008 Payments Conference
Payments Fraud: Perception vs.
Reality**

Federal Reserve Bank of Chicago

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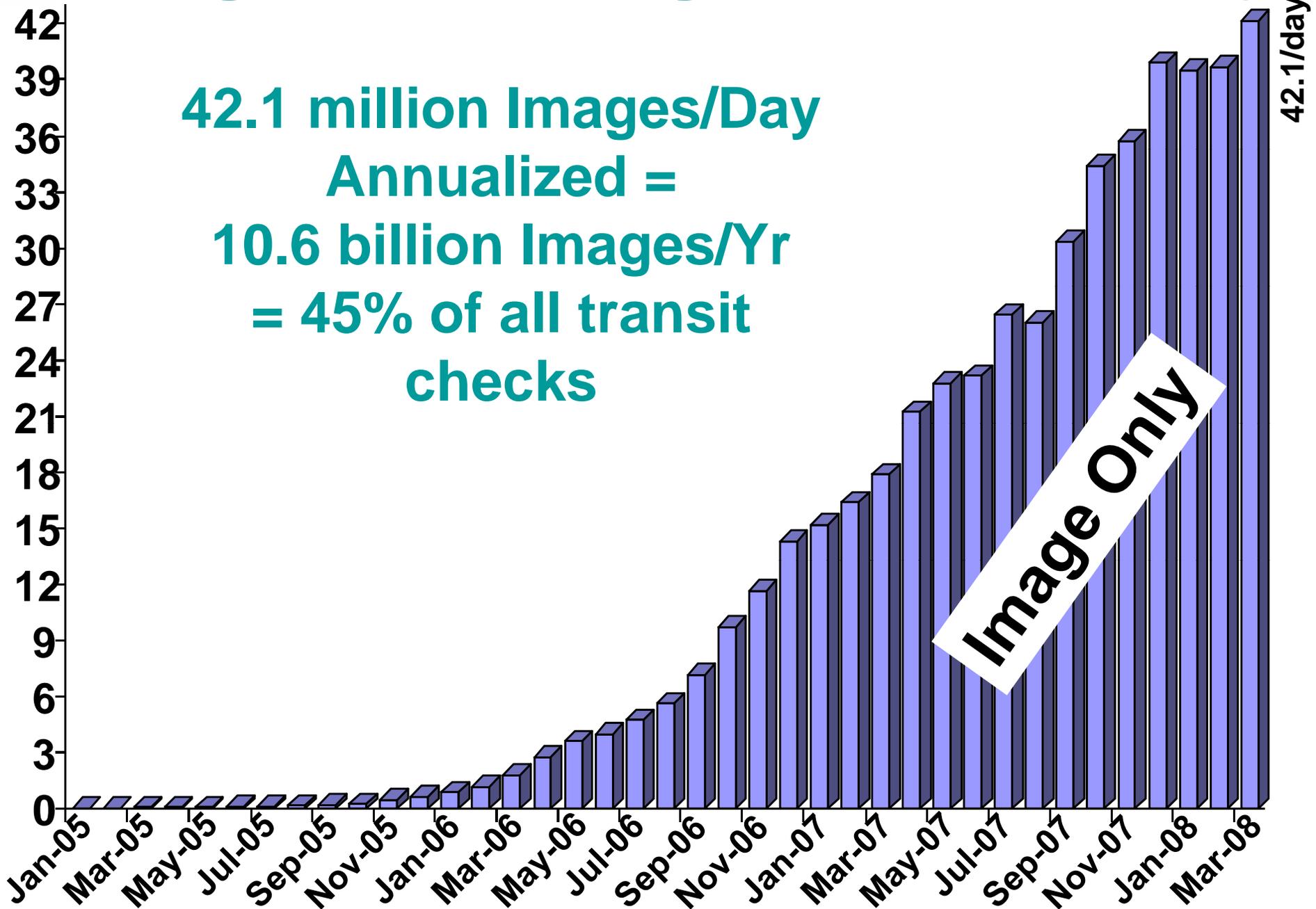
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Industry Trends

***Checks &
Image Exchange***

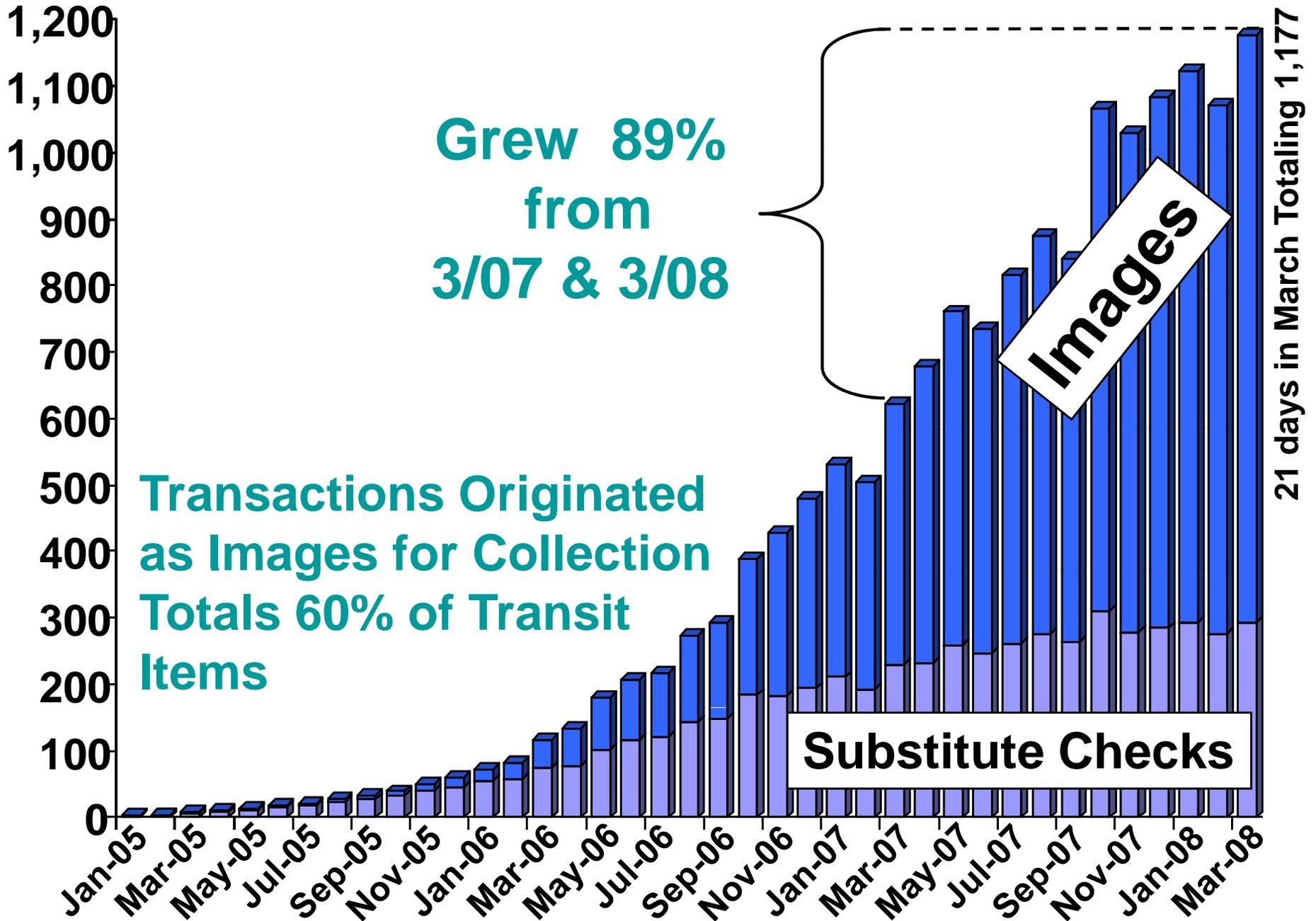
Avg # of Images Rec / Day

Items in Millions



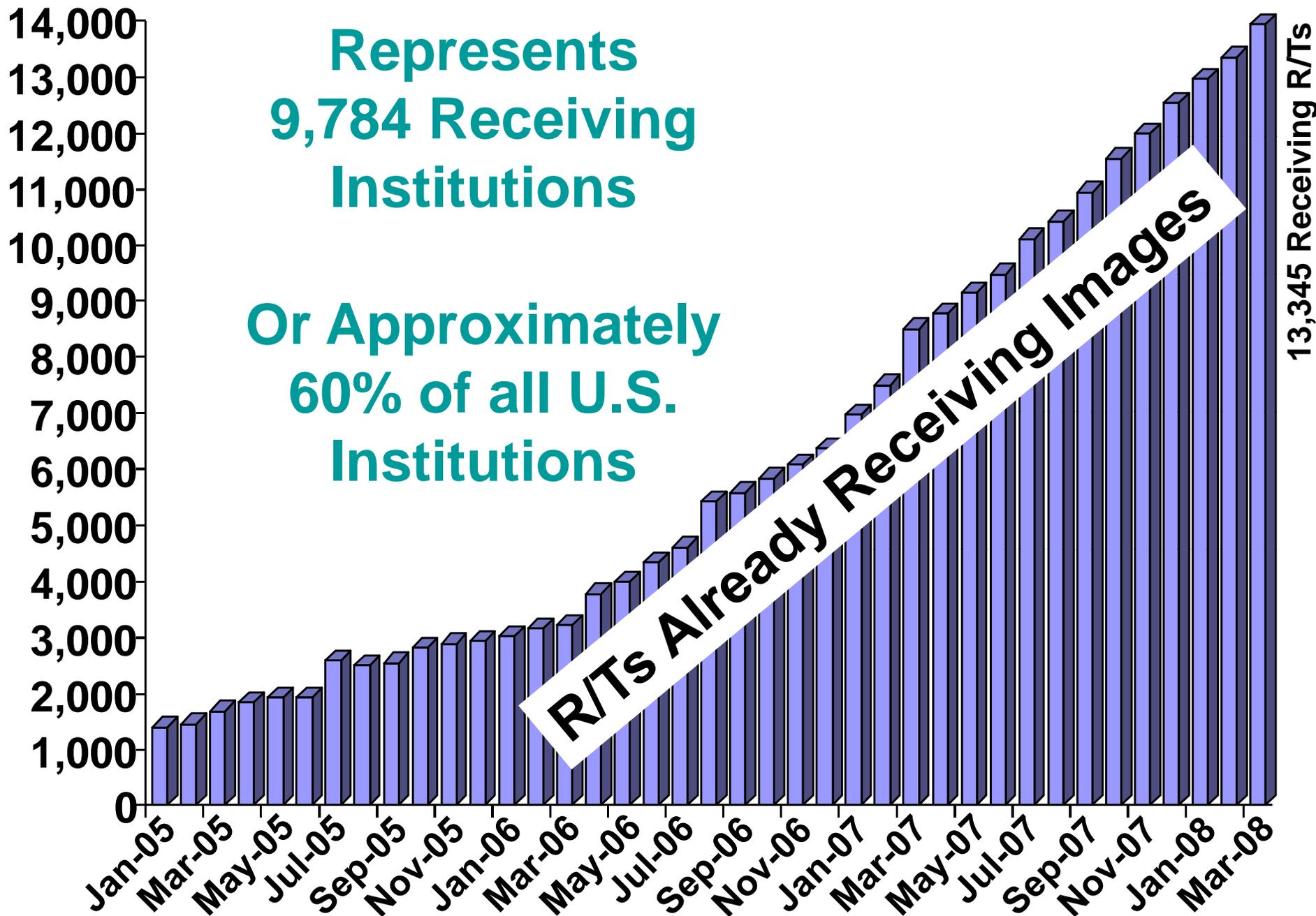
of Image Based Trans.

Items in Millions



of Receiving Institutions

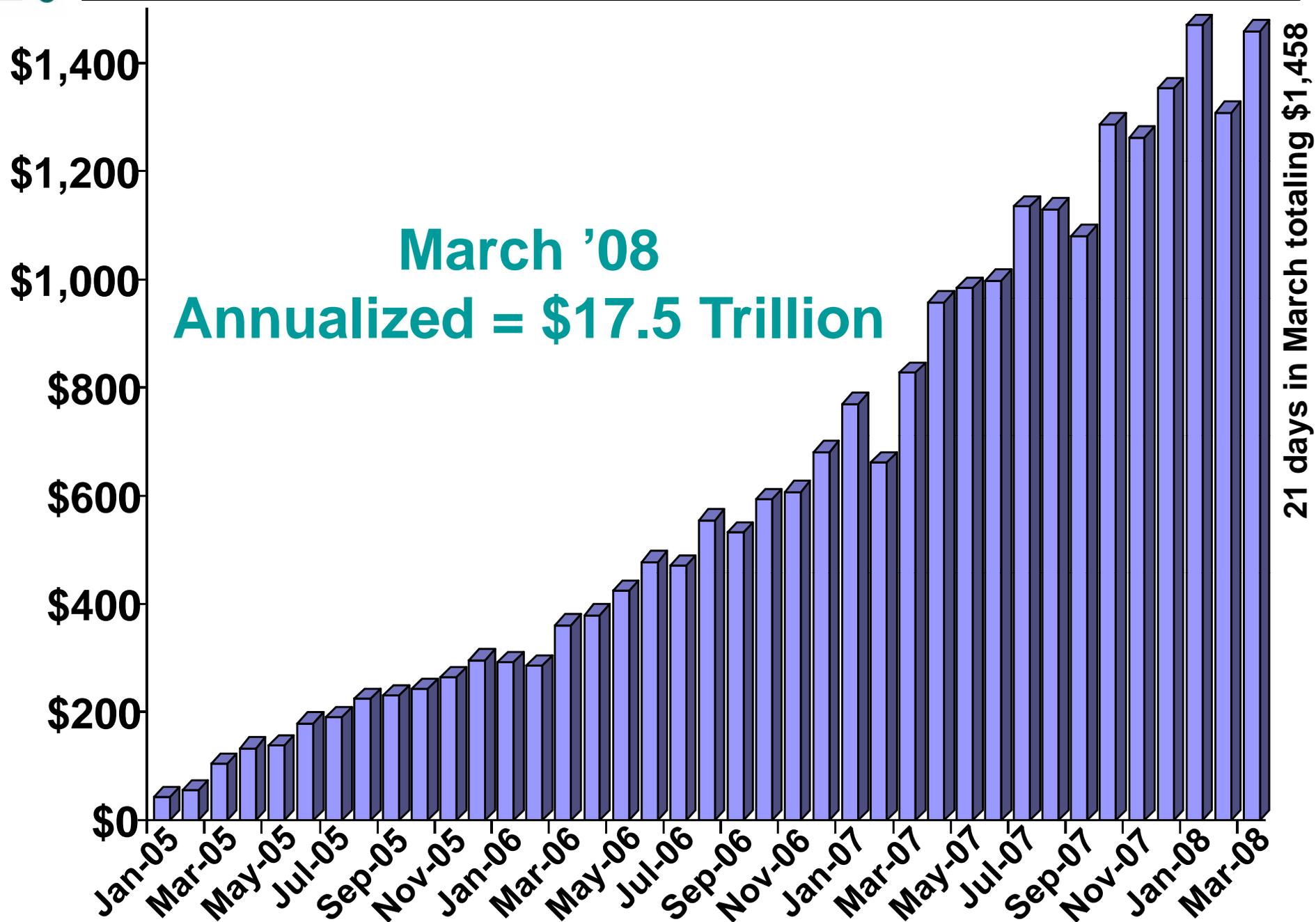
of Receiving R/Ts



Source: Federal Reserve, PaymentsNation, SVPCO and local / regional exchanges

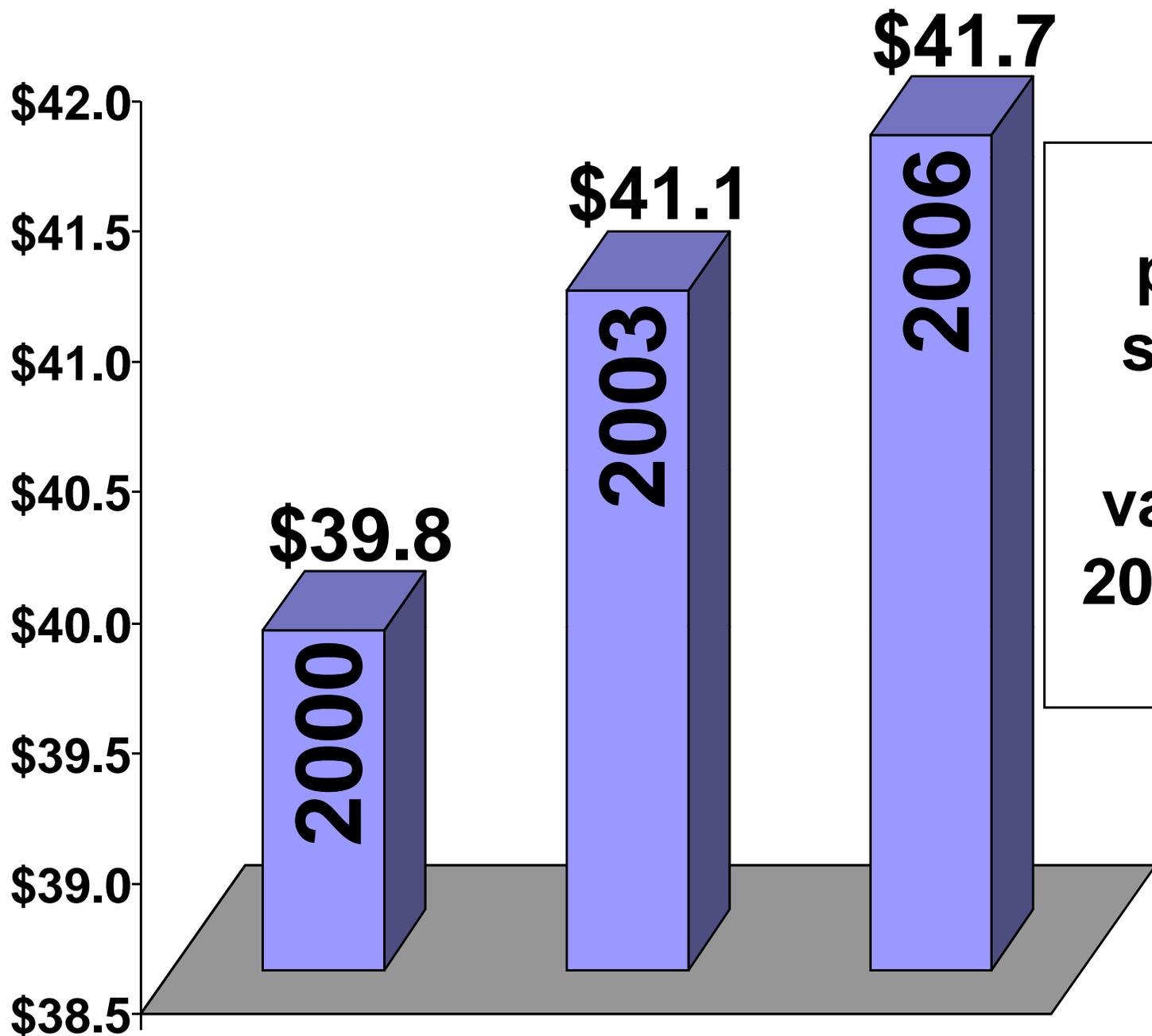
Transaction \$ Amounts

\$ in Billions



Total Check Values

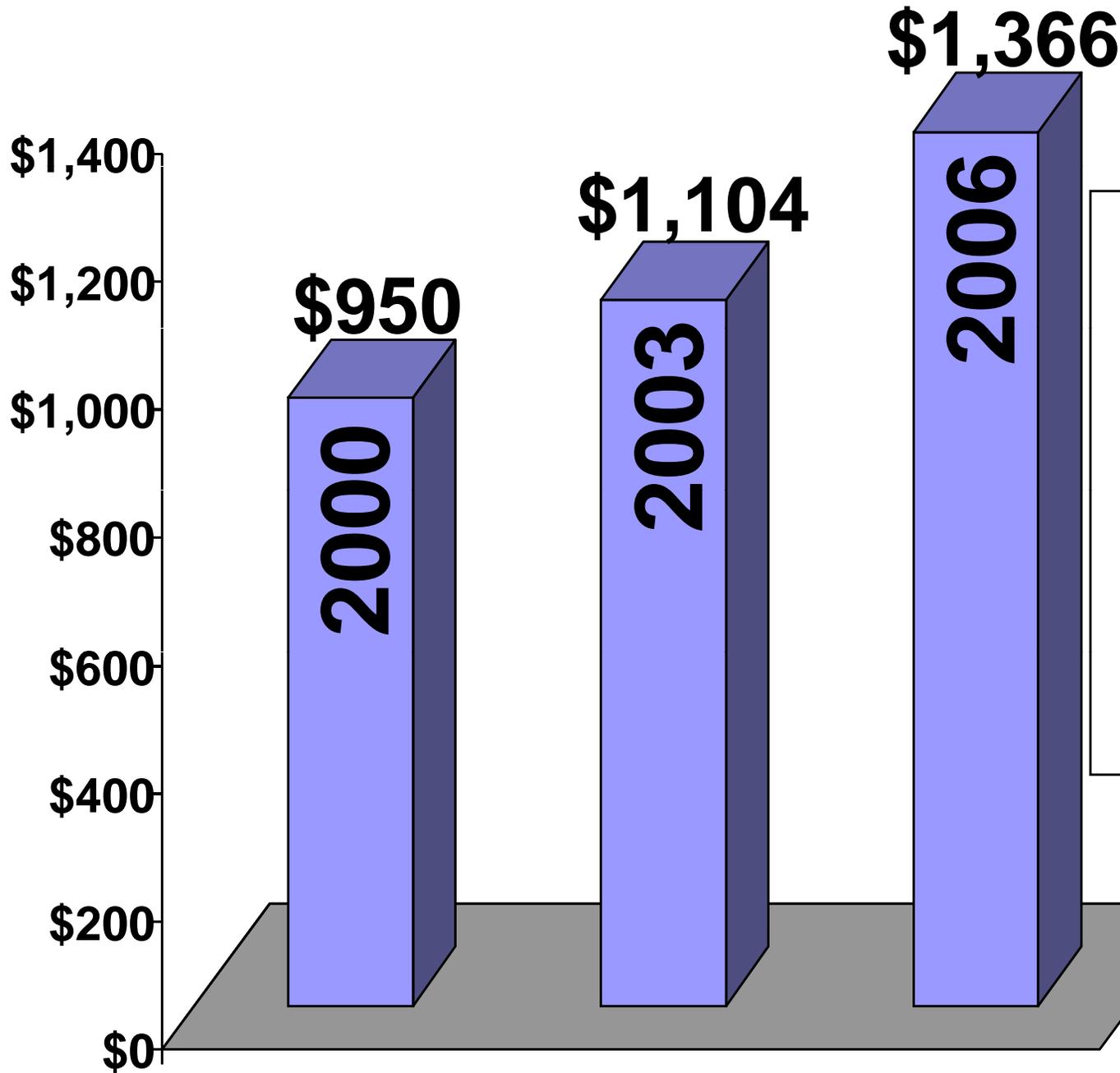
Trillions



Check payment system is more valuable in 2006 than in 2000!

Average Check Value

\$ per Avg Check



Average check payment is more valuable in 2006 than in 2000!



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Fraud Risk

Image Exchange

Traditional Authorization Issues and Fraud Sources Continue

- *Typically, these involve parties outside of the banking collection and return processes*
- *Those same parties continue to participate in the process at the same process points; for example*
 - If a fraudulent signature is placed on a check or if the amount is changed, it will appear on the image as deposited with the bank
 - If a kite is initiated via paper checks and those checks are imaged, the kiting continues

Traditional Authorization Issues and Fraud Sources Continue

- *These frauds are controlled in the traditional ways by the paying bank and its customer*
 - For check images and for substitute checks

New, More Complicated Environment

- *Possible confusion by financial institutions, their customers and vendors*
 - Was the payment authorized?
 - Was the truncation authorized?
 - What is it legally? A check or a non-check?
 - Is it properly payable?
 - Which payment is the duplicate?
 - What is the return deadline?
 - What do you return and to whom?

Complicating Factors

If It Looks Like a Check, Is It a Check?

- *Electronically initiated payments that are formatted to look like checks*
- *Need to know how customers are creating their electronic deposits*
- *Need to have agreements in place to allocate appropriate liabilities between all the parties*
 - *No law to cover check image exchange*

Complicating Factors

If It Looks Like a Check, Is It a Check?



Moo, Moo

Duplicate Images & Substitute Checks

– *Need enhanced controls to:*

- **Prevent the creation/acceptance of duplicates**

- **Testing for duplicates**

 - **Across payments systems**

 - **Across multiple days**

– *Without a more efficient adjustment system it takes too long to unwind interbank-accounting*

• **Non-Conforming Images (NCIs)**

- *Intended to protect paying institutions from receiving poor quality images*
- *Current image quality assessment (IQA) applications are inadequate*
 - **High percentage of NCIs would not impact posting (if presented) verification of signature, customer service, etc.**
 - **Primary impacts are delays in collection of the items and increases in the cost of the collection**

Complicating Factors

Non-Conforming Substitute Checks

– *Mostly conforms except for technical deviations*

- A Shakespearian dilemma:

- *To post or not to post?*

Another Dilemma:

– *To keep or not to keep?*

- Risk of subsequent entry into the payment stream creating duplicates



Loss of Traditional Controls

- *Look and feel of the original paper*
- *Special security features*

Speed of Collection and Return

- *On-demand electronic payments are faster than on-demand paper payments*
- *Later exchange windows for electronics*

More Sophisticated Prevention, Detection and Resolution of Duplicates

More Sophistication in Pay / No Pay Decisions

- *New analysis, new detections*

- **Enhanced Adjustment Processes**

- *To shorten windows of opportunities for would be fraudsters*

- **Image Survivable Security Features**

- *Replaces some of the paper-based features*

Duplicate Detection & Prevention

- *Looking for dups at new places in the process; e.g. BOFD and at the paying bank*
- *Comparisons must be across multiple days and multiple payment channels*

Complication

- *There are some legitimate duplicates*



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Closing Comments

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- **Check Payment System is Growing in Value and Therefore in Importance**

- **Check Image & Substitute Check Fraud**
 - *Same as for paper*

- **New Processes and Changes in Party Participation Create New Complications**
 - *Creates opportunities that could be exploited*

- **New and Different Controls are Emerging**
 - *Should reduce the opportunity for losses generally*
 - *And reduce opportunity for fraud*

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Thank You

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