

mRDC Fraud – Any Recourse Against Losses??



April 20, 2017

**Greg Litster, President
SAFEChecks**

Mobile Banking and Deposit Fraud



Mobile Banking Fraud – the newest twist on check fraud....

Mobile remote check deposit has become one of the most desirable mobile banking applications. Almost all banks now offer or plan to offer mobile Remote Deposit Capture (mRDC) for mobile phones.

Cases of double depositing of checks and other forms of mobile deposit fraud are growing.

**Mobile Remote Deposit Capture (mRDC)
has been adopted by criminals.**

**The methods of deceit vary and
are increasing, and losses are mounting.**



A report on banking fraud released by American Bankers Association highlights the impact mobile banking fraud is having on institutions of all sizes, with 100% of the largest financial institutions reporting RDC fraud and a 400% growth in losses reported over two years across financial institutions of all sizes.

thepayers.com April 2016

72% of all fraud cases involving mobile banking apps included mobile Remote Deposit Capture (mRDC).

mRDC fraud is the latest example of fraudsters merging the old and the new – classic social engineering and check fraud over modern banking channels and technology.

Guardian Analytics Mobile Fraud Trends Report, April 2016

Guardian Analytics` Mobile Fraud Trends research identifies two schemes dominating mobile RDC fraud: the `sweetheart scam` in which fraudsters foster relationships online and then manipulate their victims into cashing fraudulent checks, and...

Guardian Analytics Mobile Fraud Trends Report, April 2016

...`fake online payday lenders`, where cyber criminals trick prospective borrowers into unwittingly depositing fraudulent checks through RDC and then cashing them out as a part of a fake loan approval process.

Guardian Analytics Mobile Fraud Trends Report, April 2016

Mobile Banking Fraud:

Double Deposits



Mobile Banking Deposit Fraud

Scenario: A check is mailed to Dishonest Don

- Don uses a smart phone app to deposit check
 - Takes pix of front of check
 - Endorses the back of a different check
 - Uploads check; is paid at drawer's bank
- 3 days later, Don cashes the same check at a check cashing store
 - ✓ 2nd check hits the drawer's bank account
(check is presented for payment twice)

Mobile Banking Fraud: Another variation.....

Scenario: A title insurance company gives John Doe a check at closing. John Doe deposits the check via a mobile app,

then comes back to office and returns the check, asking that it be made payable to John Doe or Jane Doe.

**The company doesn't think to place a
Stop Payment on the first check
because they have the check in hand!**

1. If a physical check is returned for a replacement, place a stop payment on the returned check. It may have been deposited remotely.
2. Recipient **MUST** sign an affidavit stating the check was not "deposited."
3. An Affidavit does not provide protection, only a right to sue and collect legal fees.

**Who Takes The Loss
on Double Deposits??**

The answer is found in the Rules governing

Check 21

AND

The Uniform Commercial Code (UCC):

Holder In Due Course

Mobile Banking & Check 21

1. Mobile depositing is another form of Remote Deposit Capture
2. Remote Deposit Capture is part of Check 21
3. Check 21 has specific rules that govern Remote Deposit Capture (including mRDC)
4. The Rules determine who takes the loss

Check 21 Rules

Two Warranties:

- ✓ Image of check is clean; everything is legible; substitute check is properly created
- ✓ Check is presented for payment only one time; **no double presentments.**

Check 21 Rules

Two Warranties:

- ✓ Image of check is clean; everything is legible; substitute check is properly created
- ✓ Check is presented for payment only one time; **no double presentments.**

The Fed did not envision Remote Deposit Capture desktop scanners or mobile banking smart phone apps in 2004!

§ 229.52 Substitute check warranties

- A bank that transfers, presents, or returns a substitute check (or a paper or electronic representation of a substitute check)... warrants... that—

§ 229.52 Substitute check warranties

- (2) No depository bank, drawee, drawer, or indorser will receive presentment or return of, or otherwise be charged for, the substitute check, the original check, or a paper or electronic representation of the substitute check or original check such that that person will be asked to make a payment based on a check that it already has paid.

§ 229.52 Substitute check warranties

- (b) Warranty recipients. A bank makes the warranties... to the person to which the bank transfers, presents, or returns the substitute check or a paper or electronic representation of such substitute check and to any subsequent recipient, which could include a collecting or returning bank, the depository bank, the drawer, the drawee, the payee, the depositor, and any indorser. These parties receive the warranties regardless of whether they received the substitute check or a paper or electronic representation of a substitute check.

§ 229.56 Liability

- (c) Jurisdiction. A person may bring an action to enforce a claim... in any United States district court or in any other court of competent jurisdiction. Such claim shall be brought within one year of the date on which the person's cause of action accrues... a cause of action accrues as of the date on which the injured person first learns...of the facts and circumstances giving rise to the cause of action, including the identity of the warranting or indemnifying bank against which the action is brought.

Under the § 229.56 Warranty...

Bank of First Deposit (BOFD) can charge the loss against its customer's account.

Liability for the loss falls on the bank that allowed its customer to use the smart phone app.

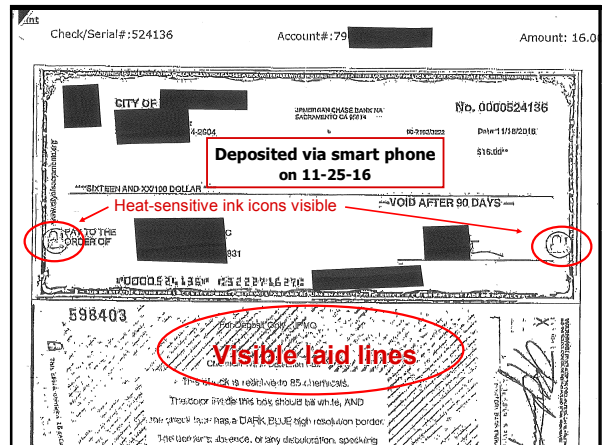
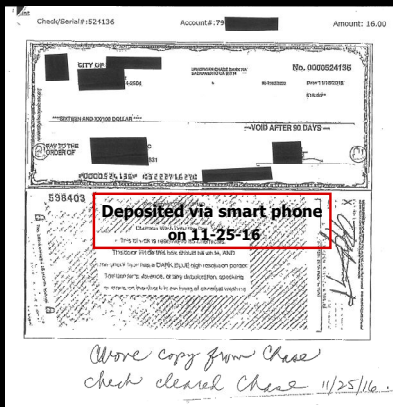
Warranty Claims

A Breach of Warranty claim can be filed within one year from the cause of action.

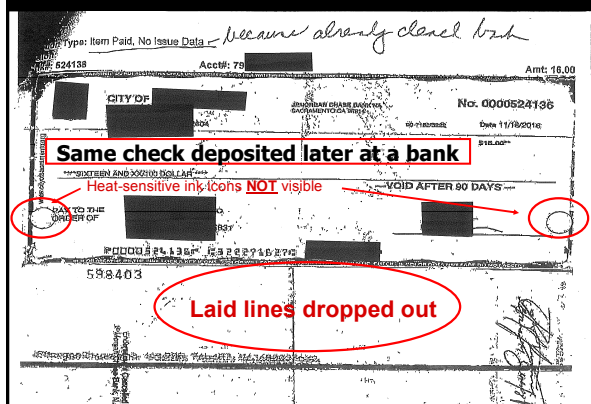
- Cause of action begins to run the date the injured party first learns of the loss.
- Claims must be made within 30 days after the person has reason to know or further losses cannot be claimed.
- Comparative negligence applies.

Recent examples of Fraud Attempts

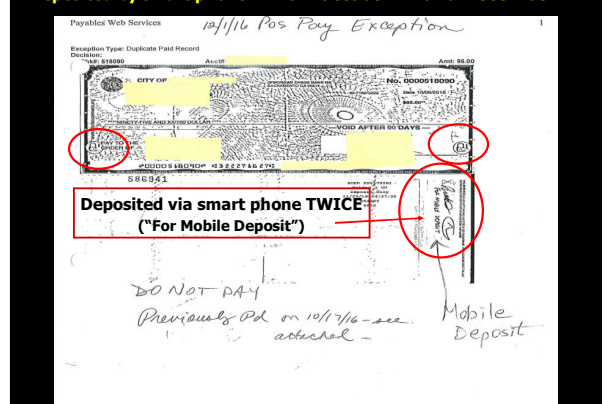
Deposited by smart phone November 25, 2016

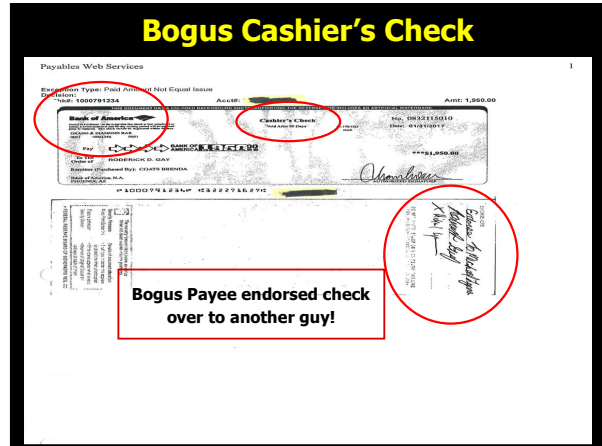
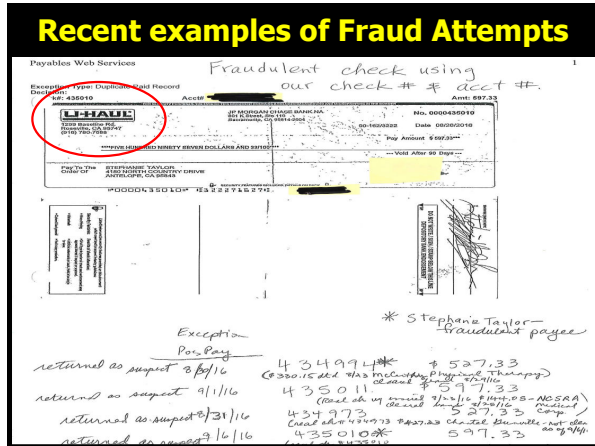


Deposited later at a bank...



Deposited by smart phone TWICE: October 17 and December 1





Good and Bad Examples of Different Banks' Remote Deposit Capture Agreements (Desktop Scanners)

A Large Regional Bank Remote Deposit Capture Agreement:

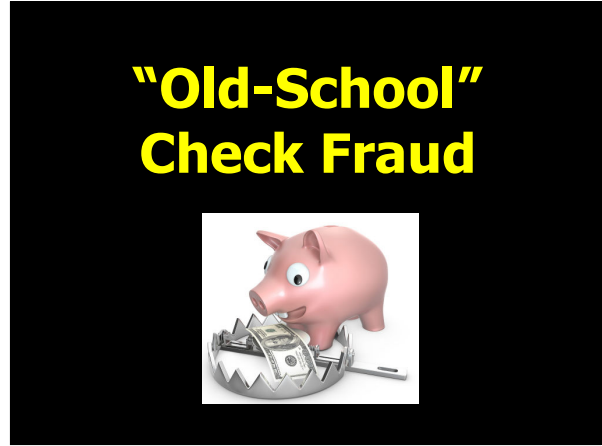
"... you will be liable to us to the same extent that we are liable under federal and state law regulation... including... damages, to the maker/drawer of the original check that you imaged and sent to us electronically... if: ... (c) the maker/drawer of a check you imaged and transmit to us suffered a loss that could have been prevented had the original item been presented for clearing and payment. By way of example only... if the dollar amount of the original check was \$10 but was altered to read \$100 before you imaged it and the maker's account was debited for \$100... You will have liability... if (i) the check in its altered state were presented in its original form (not imaged) and (ii) the alteration would have been detected."

(Nothing about counterfeit checks or 1-year minimum timeframe.)

A Small California Bank Remote Deposit Capture Agreement:

14. Customer Indemnification.
"Customer will indemnify and hold Bank harmless for liability and other losses that result from: ... (v) any claim by any recipient of a Substitute Check corresponding to an item processed by Customer... that such recipient incurred a loss due to the receipt of the Substitute Check instead of the Original Check."

16. Bank's Liability.
"Bank will not be liable to Customer for any of the following... (iv) any refusal of a Payor Financial Institution to pay the Item or Substitute Check that was allegedly unauthorized, was a counterfeit, had been altered, or had a forged signature." **(Very clear and thorough)**



Check Fraud

Produces more \$ Losses
than all other types of payment fraud!

AFP 2015 Payments Fraud Survey

“Checks remain the most targeted payment method by those committing fraud attacks.

Check fraud also accounts for the largest dollar amount of financial loss due to fraud.”

AFP 2016 Payments Fraud Survey

Check fraud still accounts for the largest dollar amount of financial loss due to fraud.

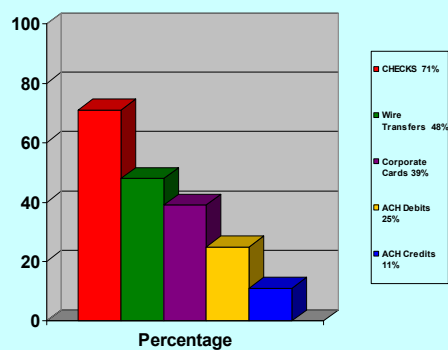
AFP 2016 Payments Fraud Survey

50% of large organizations
(plus millions of smaller companies)
still issue checks

Check fraud is not going away!

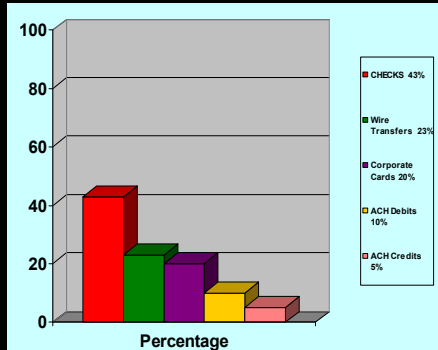
Fraudulent Payments by Method

(Respondents were hit multiple ways; total > 100%)



Fraud Losses by Method

(How Dollars were actually lost)



QUIZ: True or False?

- 1) Placing a Stop Payment on a check ends your legal responsibility to pay the check.
- 2) Positive Pay will catch all check fraud attempts.
- 3) **Payee** Positive Pay will catch all check fraud attempts, including altered/added payee names.
- 4) I'm using Payee Positive Pay. The quality of my check stock doesn't matter.
- 5) In a Check 21 world, check security features don't matter.

QUIZ: True or False?

- 6) In a Check 21 world, check security features don't matter **if you're using Payee Positive Pay.**
- 7) Your payables are processed by a third party (your bank) that uses Payee Positive Pay. The quality of the check stock they use doesn't matter to you. If there's fraud loss, they'll take the hit.
- 8) If you have a great relationship with your bank, you'll never be held liable for a check fraud loss

- 1) Placing a Stop Payment on a check ends your legal responsibility to pay the check

FALSE – Holder in due course (UCC) trumps Stop Payments & Positive Pay

- 2) Positive Pay will catch all check fraud attempts

FALSE – Altered Payee Names and counterfeit checks

- 3) **Payee** Positive Pay will catch all altered or added payee names

FALSE – Added Payee name placed 2 lines above the original name pass right through Payee Pos Pay

- 4) I'm using Payee Positive Pay. The quality of my check stock doesn't matter.

FALSE – Check 21 Indemnity Provision, & HIDC and counterfeit checks that looked "genuine"...

(Triffin vs. Somerset Valley Bank and Hauser Contracting Co. vs. ADP)

5) In a Check 21 world, check security features don't matter

FALSE – Check 21's Indemnity Provision

6) In a Check 21 world, check security features don't matter **if you're using Payee Positive Pay**

FALSE – Check 21's Indemnity Provision and Holder in due course

7) Your payables are processed by a third party (your bank) that uses Payee Positive Pay. The quality of the check stock they use doesn't matter to you. If there's fraud loss, they'll take the hit.

Probably FALSE. It depends on:

- Whose bank account the checks are drawn on.
- What the contract says about losses.
If the contract is silent, YOU have the liability.
- The dollar amount of the loss.

(I've never heard of a bank or other payables service provider volunteering by contract to accept check fraud losses.)

8) If you have a great relationship with your bank, you'll never be held liable for a check fraud loss

FALSE

- Florida Power & Light v. NationsBank
- Cincinnati Insurance Co. v. Wachovia Bank
- Healthcare Insurance company in the South

Today's generation:

What once was "old" is NEW





"...Gangs traditionally associated with drugs and violent crimes are increasingly committing financial frauds.

Gangs are getting into crimes like check fraud and identity theft because they are more lucrative, harder to detect, and carry lighter prison sentences...."

Wall Street Journal, March 8, 2016

"We think of gang members being knuckleheads, but these guys are using a sophisticated thought process and getting involved in stuff that requires technology and an understanding of the banking system."

Wall Street Journal, March 8, 2016

When federal agents arrested a group of Outlaw Gangsta Crips last summer in Brooklyn, N.Y., the 38-page indictment included robbery, attempted murder and cocaine distribution. But it also included an atypical charge for a street gang case: bank fraud.

Wall Street Journal, March 8, 2016

Check fraud has become especially popular...fraudsters are familiar with checks and so are able to commit check fraud with relative ease with the help of sophisticated equipment."

Wall Street Journal, March 8, 2016

What has changed are the size and scale of the operations. "The sums of money involved are staggering...the potential amount of money involved and damage to people's financial accounts is greatly out of proportion to other gang crimes...."

Wall Street Journal, March 8, 2016

“Prosecutors said the gang members **created and deposited fake checks**, and then quickly withdrew money from the accounts before the banks could identify the checks as fake.


The alleged scheme reaped more than **\$500,000 for the group....”**

Wall Street Journal, March 8, 2016

Twelve members of a group known as the **Van Dyke Money Gang** were accused last summer of bilking banks out of more than **\$1.5 million**.

Manhattan federal prosecutors say the gang, **mostly men in their 20s living in Brooklyn**, fraudulently obtained money orders and cashed them at bank accounts along the East Coast.

Wall Street Journal, March 8, 2016



Frank Abagnale
Catch Me If You Can
Technology is making Frank Abagnale's "gift" achievable by mere mortals



June 2008
Volume 6, Number 6

Prepared by
Southeast Consulting, Inc.

Bank Fraud & IT Security
REPORT

Check Fraud Liability
by Frank Abagnale, Secure Document Consultant

Holder in Due Course (HIDC) is part of the Uniform Commercial Code (UCC) that significantly impacts an organization's liability for check fraud from the checks it issues. After learning about HIDC, prudent companies are often motivated to use high security

Also in this Issue:

- The Role of the Independent Auditor in Detecting Bank Fraud
- How Much of Your Bank's Data is in the Wild?

Editorial Board:

Arkwright Mutual Insurance v. Nationsbank

Issue: Facsimile Signatures May Invite Fraud Losses

In another victory for banks, the Florida 11th Circuit Court of Appeals upheld NationsBank's, now Bank of America, interpretation of its carefully worded Deposit Agreement. This agreement effectively shifted the burden of responsibility from the bank to its customer in cases of forgery. The phrase "purporting to bear the facsimile signature" saved NationsBank over \$4 million in losses resulting from forged checks.

Florida Power and Light (FP&L), a customer of NationsBank, used a facsimile machine to sign most of its corporate checks. FP&L's check volume totaled nearly 20,000 each month. Unfortunately, in the mid-1990s, 27 fake checks were cashed over a two month period totaling **\$4,387,057**. These counterfeit checks bore exact replicas of the FP&L facsimile signature and used actual serial numbers from real FP&L checks that had been voided or cancelled.

\$4,387,057

signatures. The fake checks appeared authentic and signatures were identical to the signature card, and therefore were paid *in good faith*. When FP&L discovered the counterfeits, they contacted NationsBank, which in turn contacted its upstream collecting banks. However, because the 24-hour rescission period had long since passed, NationsBank was denied its request for reimbursement. It therefore refused to credit FP&L for the loss.

signatures. The fake checks appeared authentic and signatures were identical to the signature card, and therefore were paid *in good faith*. When FP&L discovered the counterfeits, they contacted NationsBank, which in turn contacted its upstream collecting banks. However, because the 24-hour rescission period had long since passed, NationsBank was denied its request for reimbursement. It therefore refused to credit FP&L for the loss.

Arkwright Mutual Insurance, who insured FP&L against commercial crime, reimbursed the company. It then sued NationsBank. Arkwright claimed that the checks were not *properly payable* because nothing in the contracts between the two had authorized NationsBank to pay checks with forged facsimile signatures.

Arkwright Mutual Insurance, who insured FP&L against ~~commercial~~ crime, reimbursed ~~the company~~. It then sued NationsBank. Arkwright claimed that the checks were not *properly payable* because nothing in the contracts between the two had authorized NationsBank to pay checks with forged facsimile signatures.

NationsBank disputed this, pointing out that FP&L had agreed to a provision in its Deposit Agreement that said, "If your items are signed using any facsimile signature or non-manual form of signature, you acknowledge that it is solely for your benefit and convenience. You accept sole responsibility for maintaining security over any device affixing the signature. Such signature will be effective as your signature regardless of whether the person affixing it was authorized to do so."

NationsBank disputed this, pointing out that FP&L had agreed to a provision in its Deposit Agreement that said, "If your items are signed using any facsimile signature or non-manual form of signature, you acknowledge that it is solely for your benefit and convenience. You accept sole responsibility for ~~maintaining security over any device~~ affixing the signature. Such signature will be effective as your signature regardless of whether the person affixing it was authorized to do so."

As part of the Deposit Agreement contract, FP&L had passed a resolution authorizing NationsBank to pay checks for \$500,000 or less when bearing or purporting to bear selected facsimile signatures.

As part of the Deposit Agreement contract, FP&L had passed a resolution authorizing NationsBank to pay checks for \$500,000 or less when bearing or purporting to bear selected facsimile signatures.

This is extremely significant. Banks are bound by the regulations of the Uniform Commercial Code, which has historically placed the responsibility for detecting forgery on the bank. However, the UCC also specifically allows a bank and its customers to alter, through contractual agreement, the liability for fraud losses.

The Florida court granted summary judgment to NationsBank, agreeing that these two contractual agreements shifted the liability for the forged checks to Florida Power and Light.



Don't Write Checks!

- Use Commercial Purchase Cards
- Pay electronically (ACH)

But, if you are going to write checks...

Positive Pay

Positive Pay...

...a powerful tool!

PositivePay.net

High Security Checks

Effective check fraud prevention strategies begin with a high security check.

Do check security features still matter in a Check 21 world?

Do check security features still matter in a Check 21 world?

YES!!

Why?

Check 21's Indemnity Provision

Check 21

Indemnity Provision:

- ✓ Converting bank (company/person) is liable for any loss that is directly related to the paying bank receiving a substitute check in place of the original check

Federal Reserve Board "Final Rule"

A bank "that transfers, presents, or returns a substitute check...shall indemnify the recipient and any subsequent recipient...for any loss incurred by any recipient of a substitute check if that loss occurred due to the receipt of a substitute check instead of the original check."

Indemnity Claims

An Indemnity claim can be filed within one year from the cause of action.

- ✓ Cause of action begins to run the date the injured party first learns of the loss.

Indemnity Claims

An Indemnity claim can be filed within one year from the cause of action.

- ✓ Cause of action begins to run the date the injured party first learns of the loss.
- ✓ Claims must be made within 30 days after the person has reason to know or further losses cannot be claimed.

Indemnity Claims

An Indemnity claim can be filed within one year from the cause of action.

- ✓ Cause of action begins to run the date the injured party first learns of the loss.
- ✓ Claims must be made within 30 days after the person has reason to know or further losses cannot be claimed.
- ✓ Comparative negligence applies.

Which security features are most useful?

1. Controlled check stock

Controlled check stock are checks that are not sold entirely blank to anyone, unless the entire face has been uniquely customized for that company.

Who Sells Blank, Uncontrolled Checks?

- Virtually ALL accounting / check writing Software Vendors
- Virtually ALL check printers
 1. Large, national printers
 2. Small print brokers buy from wholesalers

Uncontrolled Checks

Home > Business Checks & Banking Products > Business Checks > Laser Business Checks

BLANK LASER CHECKS, TOP FORMAT

Printer: DLT831 Size: 8 1/2 x 11"

QUANTITY	500	1000	2000	2500
DLT831-1-Part/Original	\$78.99	\$120.99	\$107.99	\$251.99
DLT831-2-Part/Duplicate	\$165.99	\$240.99	\$408.99	\$481.99
DLT831-3-Part/Triplicate	\$202.99	\$338.99	\$576.99	\$901.99

We recommend this quantity.

1. Quantity: 1000
2. Part: Select
3. Color: Select

ADD TO CART

Uncontrolled Checks

Home > Business Checks & Banking Products > Business Checks > Laser Business Checks

HIGH SECURITY LASER TOP CHECK

Item#: S5LT104 Size: 8 1/2 x 11"

QUANTITY	50	100	500	1000	2000
S5LT104-1-Part/Original	\$97.99	\$140.99	\$258.99	\$289.99	\$444.99
S5LT104-2-Part/Duplicate	\$188.99	\$248.99	\$324.99	\$400.99	\$719.99
S5LT104-3-Part/Triplicate	\$223.99	\$285.99	\$438.99	\$601.99	\$1,243.99

We recommend this quantity.

1. Quantity: 500
2. Part: Select
3. Add Matching Companion Envelopes: Save time and money with these perfectly matched envelopes. See shopping cart for product details and pricing.

CUSTOMIZE NOW

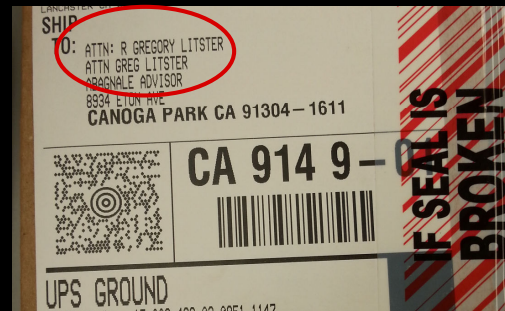
"The increasing number of counterfeit cashier's checks flooding the country continues to cause major problems for both banks and consumers. The FDIC is routinely issuing special alerts on 15 to 40 banks per month that report counterfeit checks bearing their name. Counterfeit cashier's checks represent a major risk to consumers who can be held liable by their bank for the full amount of a deposited counterfeit check."

Problem Bank List, March 15, 2016

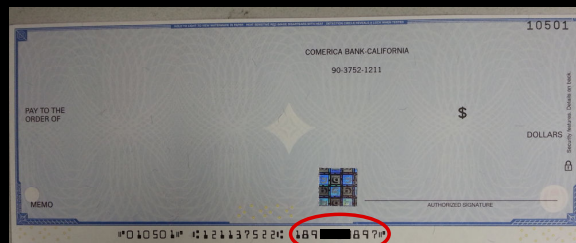
**I bought high-security checks from
XXXXX...**

**I bought high-security checks from
XXXXX...**

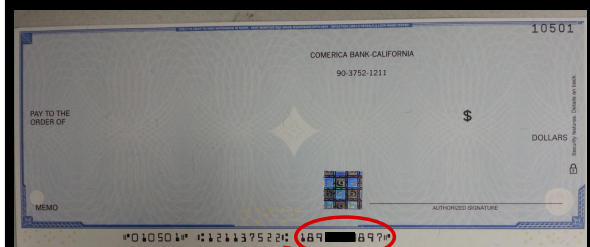
**...using the account number of a
closed account!**



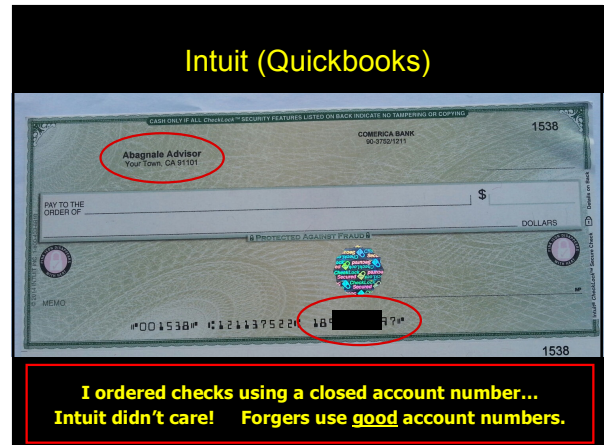
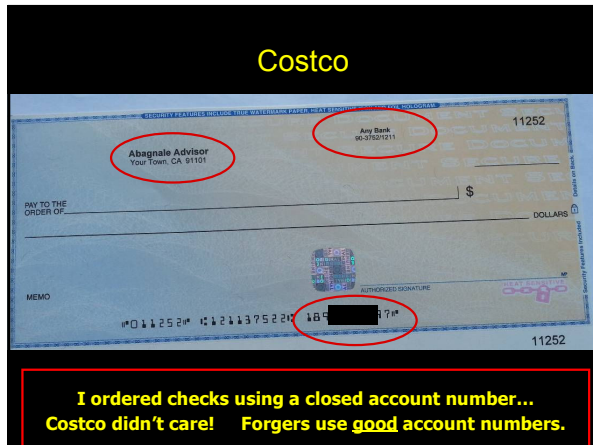
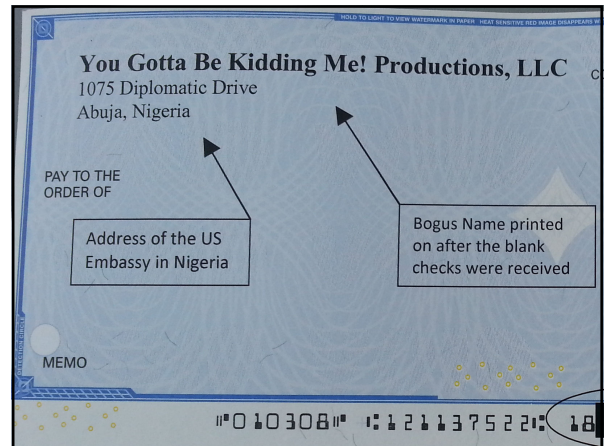
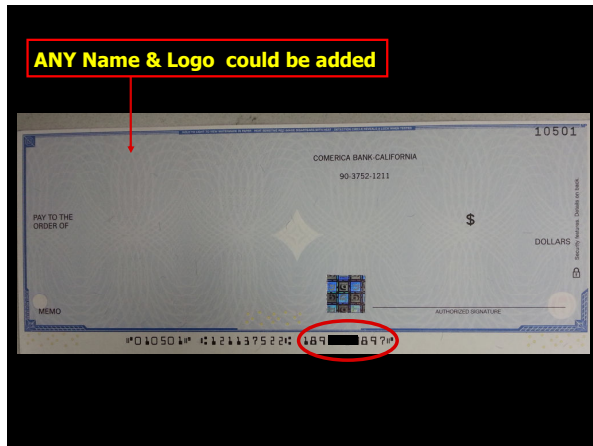
Failure to Verify Name/Account #/ Address



**I used this CLOSED ACCOUNT NUMBER
and ordered "high-security" checks!**



Any ACTIVE account number could be used when ordering!!



- Additional Security Features**
1. Controlled check stock.
Dual-tone True watermark
Thermochromatic ink
Correctly worded warning banners
Toner anchorage
Copy void pantograph
Chemical sensitivity
Chemical wash detection box
Inventory control numbers

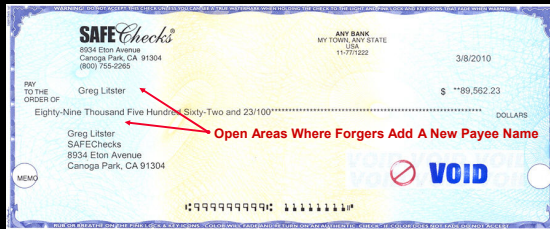
Payee Positive Pay provides

NO PROTECTION

Against

Added Payee Names!

Typical Check Layout



Fix it: Use a Secure Name Font

Secure Name Font printed above original payee name helps eliminate Added Payee Name Risk



Leaves No Room for Adding Bogus Payee

Secure Name Font printed above original payee name helps eliminate Added Payee Name Risk



Deterrence: Add **WARNINGS** to the Check



Deterrence: Encrypted barcode



Barcode contains:

1. Drawer
2. Payee Name
3. Dollar Amount
4. Issue Date
5. Check Number
6. Account Number
7. Routing/Transit Number
8. Date and Time Check was printed
9. Laser Printer used
10. The employee that printed the check

Barcode is created by a
Printer Driver

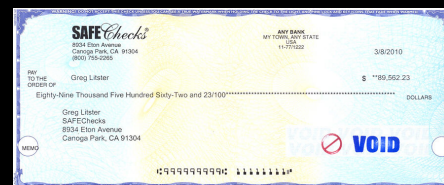
Barcode is created by a
Printer Driver

Requires NO Technical Skills
to create Positive Pay file

Printer driver can:

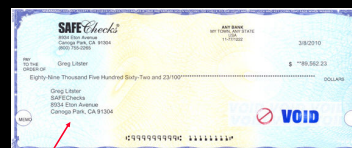
1. Accumulate check data for Positive Pay
2. Change Font size
3. Add Barcode, Secure Name & Number fonts
4. Be configured to send Pos Pay files to the bank automatically

Identical data is printed on both checks.
Which check would forgers prefer to attack?



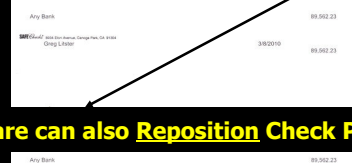
Typical Check Layout –
Check is on top and shows thru window envelope

Printer Driver can Reposition the Check

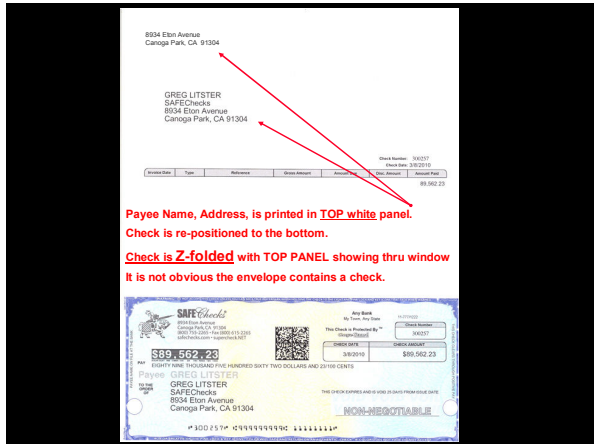


Typical Check Layout –
Check is on top and shows thru window envelope

Printer Driver can Reposition the Check



Software can also Reposition Check Placement



Official Comments to the Funds Transfers provisions of the UCC:

The purpose of having a security procedure deemed to be commercially reasonable is to encourage banks to institute reasonable safeguards against fraud but not to make them insurers against fraud.

A security procedure is not commercially unreasonable simply because another procedure might have been better or because the judge deciding the question would have opted for a more stringent procedure. The standard is not whether the security procedure is the best available.

Official Comments to the Funds Transfers provisions of the UCC:

Sometimes an informed customer refuses a security procedure that is commercially reasonable and suitable for that customer and insists on using a higher-risk procedure because it is more convenient or cheaper. In that case, under the last sentence of subsection (c), the customer has voluntarily assumed the risk of failure of the procedure and cannot shift the loss to the bank.



Greg Litster, President
SAFEChecks
(800) 949-BANK
(818) 383-5996 cell
greg@safechecks.com
GLITSTER@aol.com