DALLASFED

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Financial Insights

FIRM • FINANCIAL INSTITUTION RELATIONSHIP MANAGEMENT

CALENDAR OF EVENTS

September 13–14
Economic Roundtable
Abilene, TX

September 18
Economic Roundtable
Junction, TX

September 25
Dialogue with the Dallas Fed
Howard Payne University

October 9
Corporate Payments Council Meeting
Dallas, TX

October 16
Community Depository Institutions Advisory Council Meeting
Dallas, TX

October 23–24
Economic Roundtable
Waco, TX

November 1
CEO Forum with Richard Fisher
Houston, TX

November 7
Economic Insights: Conversations with the Dallas Fed
Webcast

November 8
Dialogue with the Dallas Fed
University of Texas at Tyler

November 15
Dialogue with the Dallas Fed
University of Texas at Permian Basin

November 15–16
Economic Roundtable
Midland, TX

For more information about these events, email FIRM at Dallas_Fed_Firm@dal.frb.org.

Payments Fraud: A Clear and Present Danger

by Matt Davies

How concerned are organizations about risks related to payments fraud? Which payment methods have the highest concentration of fraud attempts and losses? What are the most effective controls and procedures used to mitigate payments fraud risk? And what are the main barriers to further reducing payments fraud?

To answer these and other questions, the Federal Reserve Bank of Dallas conducted a survey in April 2012 on payments-related fraud experienced by organizations in the Eleventh Federal Reserve District (Texas, northern Louisiana and southern New Mexico). This essay briefly describes our survey methodology and previews some of the research results derived from survey respondents. (The full "2012 Payments Fraud Survey Summary of Results" is available at **www.dallasfed.org**.)

Overall, we found that payments-related fraud remains a major concern for financial institutions (both banks and credit unions) and corporations of all sizes. Most problematic is fraud that affects checks and debit cards because these are the payment types that were most often attacked by fraud schemes and that sustained the highest losses. While actual losses reported due to payments fraud are relatively small, they are still undesirable and require implementation of new internal controls, as well as organizational actions to mitigate payments fraud risk. Many fraud prevention efforts can be expensive and time consuming; respondents reported that the lack of staff resources is the primary barrier to new payments fraud mitigation efforts.

Financial institutions and non-financial services organizations were asked to respond to an online survey about payments fraud experiences and methods used to reduce fraud risk. In addition to a list of financial institution contacts maintained by the Financial Institution Relationship Management (FIRM) Department at the Dallas Fed, the following organizations also sent the survey to their members: SWACHA—The Electronic Payments Resource; the Austin, Dallas and Fort Worth Associations for Financial Professionals (AFP); and the Houston and San Antonio Treasury Management Associations (TMA).

The survey covered transactions involving cash, check, debit and credit cards, automated clearinghouse (ACH) and wire transfers. We received 139 responses to the survey in the Eleventh Federal Reserve District, with 120 (86 percent) in the financial services industry—almost all of them financial institutions (FIs)—and 19 (14 percent) non-financial institution organizations or corporations headquartered in the Eleventh Federal Reserve District.[1]

Only two of the FI respondents (1.7 percent) reported no payments fraud attempts for 2011; that figure was four for all other organizations (20 percent). Respondents were asked to choose up to three payment types that had the highest number of fraud attempts. As shown in Chart 1, of FI respondents, 83.6 percent chose signature debit card as having the highest number of fraud attempts, followed by check (49.1 percent) and PIN debit (45.7 percent). Check fraud attempts were the highest among non-FI organizations at 65 percent, with credit card attempts second at 35 percent.

DALLAS FED RESOURCES

Economic Updates

Regional—"Regional Economic Growth Decelerates"

National—"Recent Weakness Sets Pace For Uncertain Second Half"

International—"Global Growth Prospects Lower on Continued Euro-Area Uncertainty"

Southwest Economy

"Oil Boom in Eagle Ford Shale Brings New Wealth to South Texas"

e-Perspectives

"At a Crossroads: Finding a Path to Affordable Small-Dollar Lending in Texas"

Economic Letter

"China's Slowdown May Be Worse Than Official Data Suggest"

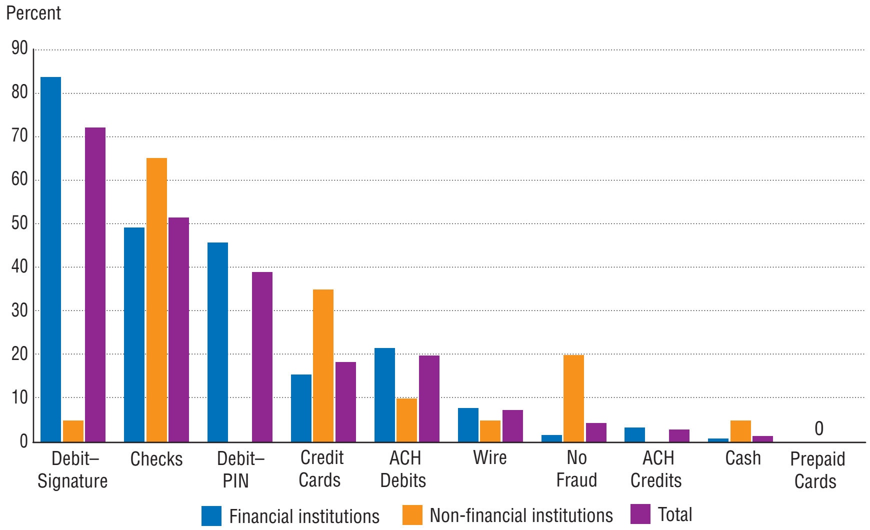
Financial Insights

"2012 Payments Fraud Survey Summary of Results"

"Branding the Great Recession"

Find other resources on the Dallas Fed website at www.dallasfed.org.

Chart 1
Payment Types with Highest Number of Fraud Attempts
(percent of respondents)



Nearly 45 percent of respondents experienced increased fraud losses in 2011 over 2010, while approximately 38 percent indicated their financial losses due to fraud had stayed the same, and nearly 17 percent reported that they had decreased.

For the organizations that experienced fraud losses, over 74 percent estimated losses at 0.5 percent or less of their annual revenue. Nearly 63 percent of all respondents selected the lowest range of loss, or less than 0.3 percent of annual revenues. These data suggest that losses due to payments fraud are relatively small and well controlled.

The survey also solicited information regarding payments fraud mitigation. Respondents were asked about their use of—and the effectiveness of—various fraud mitigation methods and tools. Questions were asked regarding authentication methods, transaction screening and risk management approaches, internal controls and use of risk mitigation services offered by FIs. Chart 2 summarizes the response data on risk mitigation services offered by FIs, and Chart 3 summarizes their use by non-FI respondents.

As shown in the charts, a large majority of FI respondents are offering services such as online statements to their corporate customers and have implemented multifactor authentication requirements for the initiation of payments—many of the latter likely the result of the Federal Financial Institution Examination Council's (FFIEC) guidance and supplemental guidance on multifactor authentication. However, as one moves down the list of service offerings to more complex products, such as positive pay/reverse positive pay and payee positive pay (for both check and ACH), the percentage of financial institution respondents offering those services decreases significantly. This may be indicative of the fact that many FIs either cannot or do not offer these more sophisticated services or do not have a commercial customer base that has yet expressed a need for them (for example, banks with smaller commercial clients, or credit unions).

The survey also asked respondents to report on barriers to further reduction of payments fraud. Most identified a version of "cost," citing the lack of staff resources, implementation costs and lack of compelling business case as the main barriers.

Finally, as far as regulatory changes are concerned, most respondents indicated that they would like to see increased penalties and prosecutions for fraud. Topping the list for FI respondents was placing more responsibility for fraud mitigation with—and shifting liability for fraudulent card payments to—the entity that initially accepts the card payment.

Chart 2 Percentage of FI Respondents Offering Risk Mitigation Services

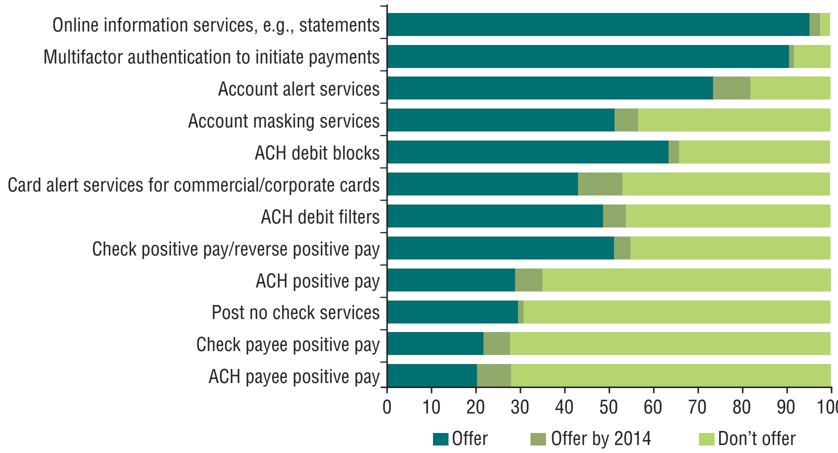
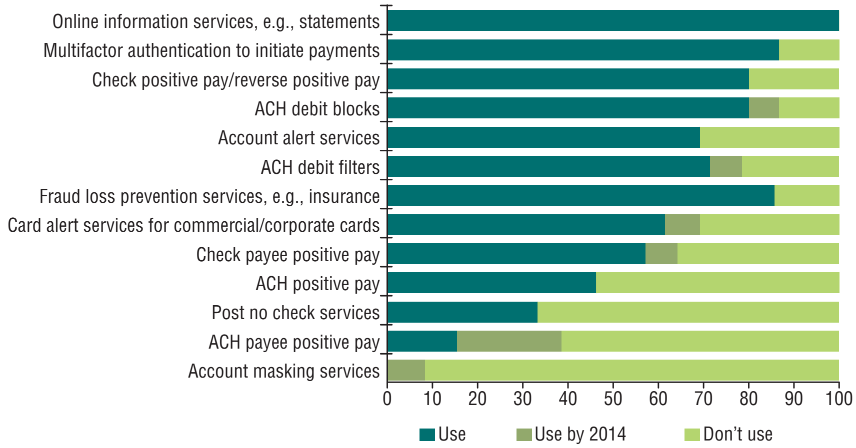


Chart 3 Percentage of Non-FIs Using Risk Mitigation Services Offered by FIs



This survey was conducted jointly with the Federal Reserve Banks of Boston, Minneapolis, and Richmond, and the Independent Community Bankers of America (ICBA). In general, the results for the Eleventh Federal Reserve District were in line with those for other participating entities. As payments-related fraud remains an ongoing concern, we intend to repeat this survey biennially. This will allow us to analyze trend data on payments fraud and better understand which payments fraud mitigation efforts and regulatory changes might be most effective in reducing losses due to payments fraud.

Davies is the director of payments outreach in the Financial Institution Relationship Management Department at the Federal Reserve Bank of Dallas. Send comments or questions about this article to the author at matt.davies@dal.frb.org.

NOTE

[1] Survey questions varied depending on whether a respondent indicated his or her organization was an FI or a non-FI. While the number of non-FI respondents to our survey this year is small, it is hoped that number can be increased in the next survey to provide even more meaningful results.

ABOUT *FINANCIAL INSIGHTS* AND FIRM

Financial Insights is published periodically by FIRM – Financial Institution Relationship Management – to share timely economic topics of interest with financial institutions.

FIRM was organized in 2007 by the Federal Reserve Bank of Dallas as an outreach function to maintain mutually beneficial relationships with all financial institutions throughout the Eleventh Federal Reserve District. FIRM's primary purpose is to improve information sharing with district financial institutions so that the Dallas Fed is better able to accomplish its mission. FIRM also maintains the Dallas Fed's institutional knowledge of payments, engaging with the industry to understand market dynamics and advances in payment processing.

FIRM outreach includes hosting economic roundtable briefings, moderating CEO forums hosted by Dallas Fed senior management, leading the Dallas Fed's Community Depository Institution Advisory Council (CDIAC) and Corporate Payments Council (CPC), as well as creating relevant webcast presentations and this publication. In addition, the group supports its constituents by remaining active with financial trade associations and through individual meetings with financial institutions.

Contact us at Dallas_Fed_FIRM@dal.frb.org.

Noteworthy Items

Richard Fisher's speech before the Australian American Leadership Dialogue
In this speech, Dallas Fed President Richard Fisher shares his American story: from homeless to Harvard in one generation.

www.dallasfed.org/news/speeches/fisher/2012/fs120709.cfm

Economic Insights: Conversations with the Dallas Fed webcast on "Celebrating Friedman: Why Freedom Matters"
Robert Lawson, economics professor at Southern Methodist University, and Thomas Siems, senior economist and director of economic outreach at the Dallas Fed, reflect on the legacy of Nobel-prize-winning economist Milton Friedman in making the case for freedom and why freedom matters to people everywhere.

www.dallasfed.org/publications.cfm?tab=1#dallastabs

Chairman Bernanke's speech to U.S. educators on financial education
In this speech, Federal Reserve Chairman Ben Bernanke encourages teachers to help students achieve greater financial literacy, not only for their own well-being but also for the economic health of our nation.

www.federalreserve.gov/newsevents/speech/bernanke20120807a.htm

Federal Reserve simplifies reserves administration
The Federal Reserve is implementing changes to the policies, internal processes and technologies that support the administration of reserve requirements effective Jan. 24, 2013. The new application to view information for reserve management is Reserves Central—Reserve Account Administration. All current ReserveCalc subscribers will automatically be granted access to the new application. Organizations currently without access to the ReserveCalc application are encouraged to complete the Reserves Central—Reserve Account Administration access request by Oct. 15, 2012.

www.frbservices.org/centralbank/reservescentral/reserves_administration_resource_center.html

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