

CREDIT FRAUD IN RETAIL BANKING

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A definition of credit fraud may be found in article 250a of the Penal Code 58/2000 Coll. as amended. Article 250a(1) states: "Anyone who obtains a loan or a loan guarantee from another person in such a way as to mislead that person about the fulfilment of the conditions under which the loan is provided, and who, as a result, causes that person appreciable damage or profits himself to an appreciable extent, shall be punished with a custodial sentence of up to three years, or an injunction to refrain from an activity, or a financial penalty." Paragraph (2) continues: "A punishment the same as that mentioned in paragraph (1) shall be imposed on anyone who, as an employee, member, or representative of the lender, or as another person authorised to act on the lender's behalf, enables the loan to be obtained by someone who he or she knows does not fulfil the conditions under which the loan is provided." The Penal Code's definition comprehensively covers credit fraud from the view of its source, including fraud that is external (paragraph 1) and internal (paragraph 2). In practice, however, this definition is seen to be insufficient and open to ambiguous interpretation. This concerns cases where the loan is not provided for a specific purpose and where it is found that the data contained in the loan application or attached documents is not authentic. In that case, it is a matter of attempted fraud. The law, however, only refers to people who actually cause damage. This loophole should be removed and the procedures of the responsible bodies should be unified.

A far simpler definition of fraud is used by economists. Fraud is understood to be a deliberate act carried out with the intention of obtaining a financial benefit or other advantage by means of inauthentic data. Such a widely framed definition also covers the definition of credit fraud, and it distinguishes between fraud, on the one hand, and negligence, error, fault, or system failure, on the other. Fraud is understood as an intentional act of someone seeking personal gain.

Identifying fraud

All high-quality fraud risk management is based on a Fraud MIS – Management Information System –

which systematically protects a loan portfolio against fraud and is able to automatically identify signs of fraud entered in databases. The basic signs of fraud which are necessary to look out for include:

- a negative record in the client's history,
- problems in recovering debts from the client,
- a criminal record or criminal caution,
- frequent or large changes in payments, or the cancellation of these payments,
- large irregular expenditures - living beyond means,
- financial problems,
- frequent changes of address, employment, telephone numbers,
- incorrect accounting, badly recorded wages, for example, no mention of holidays taken,
- low interest in the control of accounts, employees,
- frequent start-ups, or maintenance of a large number of small enterprises,
- large and unusual year-end transactions resulting in profit for the enterprise and others.

Types of credit fraud

Credit fraud is basically classified according to the perpetrator of the fraud. Therefore we distinguish between external fraud and internal fraud. In the case of external fraud, the fraudster is always outside the bank and no bank employee is complicit in the fraud. If there were any assistance from an employee, the fraud would be classified as internal. A fraud is likewise classified as internal in the case that an employee is deliberately negligent with the intention of assisting an external fraud.

A second classification of credit fraud relates to the impact on the bank, whether the fraud is at the attempt stage or committed after the loan has been drawn. The bank should aim to catch all fraud while it is still at the attempt stage, and also to keep the number of frauds to a minimum since any fraud results in a loss for the bank. Even attempted credit fraud incurs costs: the wages of people employed to identify fraud, lawyers, the creation of an MIS, and so on. The additional costs pertaining to drawn loans include the costs of recovery (although the recoverability is, in this case, minimal) as well as the principal, charges and interest.

The third most common classification of credit fraud is based on the type of loan product used in the fraud. This is an important classification since the attention paid to products must differ according to the different risk they carry. The least risky are loans secured by financial assets. These low-risk loans include mortgage loans, mainly due to the high-quality security. Since banks are now waiving notarial deeds, blank bills, and guarantors, they are reducing the security and increasing the risk exposure. Also among the less risky loans are consumer loans secured by moveable or immovable property and by a guarantor. There is a greater risk with unsecured consumer loans, so-called fast loans, and with credit cards, current accounts, and authorised overdrafts.

Credit fraud may also be classified according to the falsified document. Among the most risky is ID fraud, which involves the fraudster presenting false identity documentation. The most common, however, is the falsification of employment documentation, and documents on amount of income, property or other assets. A no less important group consists of documents showing the address or other contact information of the client, in particular those used for debt recovery.

Effective countermeasures

The most important instrument is information exchange, the provision of information on potential risk and fraud groups. Most suitable in this regard would be collaboration between banks and the police, with the police regularly informing banks about potential threats. Since the introduction of the credit register, banks have been able to protect themselves more effectively against persons seeking to defraud them.

Another effective countermeasure is the launch of electronic registers, by means of which it is possible to verify immediately whether data is registered and authentic. Particularly helpful in this respect are the register of lost documents maintained by the Interior Ministry, the online Commercial Register of the Slovak Republic (ORSR), the Register of Entrepreneurs in the Slovak Republic (ŽRSR), and the web site of the Notarial Chamber. On the other hand, there is lacking an online facility to search for telephone owners according to telephone number, a common standard in developed countries.

The instrument most frequently employed by banks is in-depth analysis and verification of provided data. The verification must come from a disinterested source and it is both time-consuming and costly. Since it creates mistrust between the bank and client, it must be handled with utmost care and discretion.

Fraud Risk Management

The most effective way to minimise the occurrence of fraud is to introduce high-quality Fraud Risk Management. This plays an important role in retail banking, especially at a time when ever more risky products are being introduced. Banks facing strong competition are forced to waive security, require fewer documents for approving a loan, and cut the time required for approval. Banks are therefore courting a segment which is more risky and more prone to delinquency. This is opening the door not only to notorious fraudsters, but also to "opportunists", fraudsters who enter the market when they see an opportunity or possibility to get money. Since fraudsters are after "easy money", the greatest threat lies in active trades in retail banking. One way for the banks to respond to the situation emerging on the market is to implement Fraud Risk Management.

Fraud Risk Management represents the management of fraud-related risk regardless of whether the fraud is external or internal. The task of Fraud Risk Management is to reduce fraud-related delinquency, to protect the bank against loss arising from fraudulent transactions and activities, and to recover proceeds from fraudulent loans.

The current trend in lending forces banks to decide quickly whether or not to provide a loan. The other significant trend is to make access to loans easier, not only from the view of time, but in particular by lowering the documentary requirements. In principle, it is true that the fewer documents required, the easier it is to commit fraud. By not requiring guarantor certificates, notarial deeds, blank bills, etc., the bank is undertaking greater risk with regard to its security against a loan that cannot be paid back. It is the same in the case of fraud, except that this does not concern inability to repay the loan but rather unwillingness, even the deliberate intention not to do so. Subsequent recovery of the receivable has little chance of success. These factors require the introduction of quality Fraud Risk Management

Fraud Risk Management comprises four basic components, the first and most important of which is the prevention of fraudulent activities before they occur. The prevention of fraudulent activities relies above all on identifying the signs of fraud and introducing countermeasures essential to the protection of the retail loan portfolio.

If the bank ensures that the portfolio does not include fraudulent loans, then the following steps are not necessary. Of course, that is an ideal situation and achievable only with difficulty. The bank must, however, strive to minimise the number and volume of



fraudulent loans. To this end, it is crucial to reveal fraudulent loans when the application for the loan is being made, at the stage when the loan fraud is being attempted. The aim is to minimise losses and, by identifying signs of fraud, to prevent similar cases happening in future.

The third component covers the recovering of proceeds lost through fraudulent activities. The bank may use all legal means available to recover the loans.

The fourth and by no means least important component of Fraud Risk Management is to discourage fraudsters from attempting to defraud the bank. Per-

haps most important in this regard is the quality tracking of signs of fraud and the detection of fraud, which may lead to criminal prosecution. Quality Fraud Risk Management serves as a deterrent to fraudulent activities and the fourth part fully supports the initial part, that is, the prevention of fraud.

Quality Fraud Risk Management is only able to function as whole, when each of its parts supports the other. The result must be to reduce losses from fraudulent activities, thereby reducing the risk premiums on loan interest rates and improving the reputation of the bank.