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Compliance Corner

FEDERAL RESERVE BANK OF PHILADELPHIA

How Banks Can Respond to Counterfeit Cashier's Checks and Money Order Fraud

by Kenneth J. Benton, Consumer Regulations Specialist

It has become an all-too-familiar story for many banks: a customer receives a counterfeit cashier's check or money order from a third party and deposits it into their bank account. In accordance with the Expedited Funds Availability Act (EFAA) and Regulation CC, its implementing regulation, the bank makes the deposit available to the customer by the next business day.[1] After confirming that the deposit is available, the customer delivers the goods to the third party, believing the check has cleared. Later, however, when the counterfeit cashier's check or money order is detected and returned unpaid to the depository bank, the bank deducts the amount of the check from the customer's account or demands repayment if the customer has insufficient funds in the account.

While banks are not legally responsible for the unpaid checks a customer deposits, they can sustain losses if a customer lacks funds to repay the amount of the cashier's check or money order. There is also increased reputational risk from angry customers who were defrauded. This article discusses the increasing level of fraudulent activity related to cashier's checks and money orders and responsive measures banks can adopt to help combat this growing problem. While there are no simple solutions to prevent this type of fraud, banks can help reduce the risk by educating their customers and employees.

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[1] The full text of Regulation CC, *Availability of Funds and Collection of Checks*, is available on the Board of Governors' website at <www.federalreserve.gov/regulations/default.htm#cc>. The full text of the Expedited Funds Availability Act is available online at <www.law.cornell.edu/uscode/html/uscode12/usc_sup_01_12_10_41.html>.

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FEDERAL RESERVE BANK OF PHILADELPHIA

Understanding Unfair or Deceptive Acts and Practices Prohibited Under Regulation AA and §5(a) of the Federal Trade Commission Act

by Kenneth J. Benton, Consumer Regulations Specialist

"Financial education is a critical component of a robust and effective financial marketplace, but it is not a panacea. Clear disclosures, wise regulation, and vigorous enforcement are also essential to ensuring that financial service providers do not engage in unfair or deceptive practices. Even the most financially savvy consumer may fall victim to fraud or deception." Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, testifying before the Committee on Banking, Housing, and Urban Affairs of the United States Senate May 23, 2006.

This article provides an overview of unfair or deceptive acts and practices both in the context of Regulation AA, *Unfair or Deceptive Acts or Practices,*[1] which identifies specific credit practices that the Board of Governors of the Federal Reserve System (Board) has prohibited for all banks[2] because they are unfair or deceptive and in the broader context of section 5(a) of the Federal Trade Commission Act [(section 5(a)],[3] which also applies to banks, where Congress created a broader, more general prohibition against "unfair or deceptive acts or practices in or affecting commerce."

While the Federal Trade Commission (FTC) is the primary regulator for combating unfair or deceptive acts and practices, Congress excluded banks, savings and loans, and national credit unions from the scope of the FTC's section 5(a) jurisdiction. Instead, the federal banking agencies—the Board, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA)—verify compliance with section 5(a) for the institutions they supervise.[4]

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[1] The full text of Regulation A, *Unfair or Deceptive Acts or Practices*, is available on the Board of Governors' website at <www.federalreserve.gov/regulations/default.htm#aa>.

[2] While the Board is the primary regulator for state-charted banks that are members of the Federal Reserve System, Congress directed the Board in section 18(f)(1) of the FTC Act to define prohibited unfair or deceptive acts and practices for all banks. 15 U.S.C. § 57a(f).

[3] The full text of section 5(a) of the Federal Trade Commission Act is available online at <www.law.cornell.edu/uscode/html/uscode15/usc_sec_15_00000045----000-.html>.

Regulation AA

The Board enacted Regulation AA to identify specific prohibited acts or practices for banks (12 C.F.R. 227.11 -.227.16). These prohibitions are set forth in the credit practices rule (the rule), which identifies certain remedies that banks are prohibited from using to enforce consumer credit obligations.[5] Before discussing the prohibited practices, it is helpful to understand the rule's scope. The rule applies to extensions of credit to consumers (natural persons seeking to acquire goods or services for personal, family, or household use). The rule also defines household goods and identifies what is *excluded* from the definition. A Board publication, *Staff Guidelines on the Credit Practice Rule*, provides a helpful, extended discussion of the definitions and exclusions.[6]

For example, the rule only applies to credit extensions for consumer purposes, but the difference between consumer and business purposes is not always clear. The guidelines provide some examples to illustrate the distinctions between consumer and business purposes and advise that the extensive discussion of this issue in section 3a of the Official Staff Commentary for Regulation Z can be used for Regulation AA purposes. The guidelines also clarify that loans to acquire real estate are excluded from the scope of the credit practices rule.

Unfair credit contract remedies. This section of Regulation AA prohibits creditors from including certain remedies in credit contracts that are always considered unfair or deceptive. The prohibited remedies are: confession of judgment, waiver of exemption, wage assignment, and security interest in household goods, which are discussed in more detail below.

- Confession of Judgment—This is a powerful legal tool for creditors that enables them to file a lawsuit and obtain a judgment against the borrower the very same day, without a trial or any pre-trial proceedings. It is typically used for loans and other credit extensions. The rationale for confession of judgment is that if a borrower has defaulted on a loan, it is not necessary to conduct a lengthy, full-blown trial to obtain a judgment. But consumers, who typically are not represented by counsel in credit transactions, are unlikely to understand the serious potential consequences of a confession of judgment clause. Consequently, it is prohibited in consumer credit transactions.
- Waiver of Exemption—This occurs when a creditor asks a debtor to waive his right under state law to exempt certain property from execution on a judgment. For example, section 8124 of Pennsylvania's judicial code contains a list of exempt properties (42 Pa.C.S. §8124). A waiver of exemption clause would allow a creditor to execute a judgment against property that would normally

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[4] The Board also has rulemaking authority under the Home Ownership and Equity Protection Act (HOEPA), a law enacted to combat predatory lending, to enact rules prohibiting unfair or deceptive practices in the mortgage loan market. 15 U.S.C. § 1639(L)(2). To date, the Board has not exercised that authority. However, on May 3, 2007, the Board announced that it will be holding a hearing on June 14, 2007, to determine whether to use its HOEPA rulemaking authority to enact rules to combat abusive practices in the lending market, particularly the subprime market. The notice is available at <www.federalreserve.gov/boarddocs/press/bcreg/2007/20070503/default.htm>.

[5] The FTC first banned these practices in a rulemaking in March 1984. See 16 C.F.R. 444 et seq. Under section 18(f) of the FTC Act, whenever the FTC identifies by rule a practice that is unfair or deceptive, within 60 days the Board must adopt a substantially similar rule that applies to banks.

[6] *Staff Guidelines on the Credit Practice Rule* is available on the Board of Governors' website at <www.federalreserve.gov/Regulations/cg/crdtpracrul.htm>.

be exempt under state law. Waiver of exemption is prohibited for the same reason as confession of judgment—it is a complex concept that most consumers would not understand. Moreover, state legislators created exemptions to ensure that a debtor would not be totally destitute when creditors are trying to execute on a judgment. A waiver of exemption would defeat that purpose.

- Wage Assignment—This allows a creditor to be repaid on an extension of credit directly from the debtor's employer. It is prohibited because it is considered oppressive. However, if the following specific conditions are adhered to, the practice is permitted: 1) the debtor can revoke the assignment at any time, 2) the assignment is a payroll deduction or preauthorized payment plan that is established as a method of making payments (as opposed to being used for collections if the debtor defaults), and 3) the assignment only applies to earnings already earned at the time of the assignment (i.e., it does not apply to future earnings).
- Security Interest in Household Goods—This provision prohibits creditors from obtaining a non-possessory security interest in household goods. This means a creditor can take a security interest in an item it sells to the consumer, but it cannot take a security interest in the debtor's other property that was not part of the transaction involving the credit extension.

Unfair practices involving cosigners. This rule applies to credit transactions involving a cosigner. A cosigner agrees to be legally responsible for a debt in the event the creditor cannot collect from the primary obligor. This is different from a co-obligor, where two or more people are benefiting from the credit extension and are jointly liable for it. A cosigner does not directly benefit from the credit extension but agrees to be a guarantor to encourage the creditor to extend credit. The cosigner rule does not prohibit cosigners, but it requires that creditors do not misrepresent the nature and extent of the cosigner's liability. The rule also requires the creditor to provide a standard disclosure notice to ensure that the cosigner understands the nature of the transaction and the liability. In the case of open-end credit, the rule requires that the notice be provided before the debtor becomes obligated for fees or transactions on the account.

The cosigner rule does not prohibit cosigners, but it requires that creditors do not misrepresent the nature and extent of the cosigner's liability.

Unfair late charges. This rule applies to debt collection arising from an extension of credit. The prohibited practice at issue here is known as pyramiding of late fees. This occurs when a creditor imposes a late fee, and the debtor fails to remit the late fee when the next installment payment is made. If the creditor first applies the new payment toward the outstanding late fee, the current installment is not paid in full. If the creditor then assesses a new late charge, this creates a fee pyramid. The creditor can continue to treat the late fee as unpaid, but cannot impose a new late fee if the debtor submitted payment in full and on time.

Board's authority to cite state member banks for other unfair and deceptive practices. While Regulation AA addresses unfair or deceptive practices that the Board has specifically identified and prohibited, it is important to recognize that the Board has the legal authority to cite the banks it supervises for *any* practice that would constitute an unfair or deceptive act or practice under section 5(a) of the FTC Act. This authority derives from section 8 of the Federal Deposit Insurance Act, 12 U.S.C. § 1818, which empowers the federal banking agencies, in section 8(b)(1), to issue cease-and-desist orders to the banks they regulate for directly or indirectly violating *any* law or regulation.

Section 5(a) of the FTC Act

To provide guidance to the financial institutions they supervise, the Board and the FDIC in March 2004 jointly published guidelines they use in evaluating banking practices for compliance with section 5(a).[7] The guidelines use a three-pronged approach to determine: (1) whether the practice causes or is likely to cause substantial injury to consumers, (2) whether it cannot be reasonably avoided by consumers, and (3) whether it is not outweighed by countervailing benefits to consumers or to competition.

The substantial injury prong focuses on monetary harm. If a practice only causes a small amount of harm, but does it to a large number of people, it can be considered to cause substantial injury. The unavoidable prong focuses on whether the consumer can reasonably avoid the practice. As an example, the joint guidelines cite withholding material price information until after the consumer has committed to purchasing the product or service or subjecting the consumer to undue influence or coercion when purchasing unwanted products or services.

The Board can consider whether a practice is illegal or specifically allowed under state law. But public policy alone will not render a practice "unfair."

The final prong examines whether the practice has any benefits that, on balance, offset the harm the practice causes. In other words, what is the *net* effect of the practice on consumers? The guidelines also mention that public policy can be considered. For example, the Board can consider whether a practice is illegal or specifically allowed under state law. But public policy alone will not render a practice "unfair."

Deceptive practices. A three-pronged test is also used to determine whether a representation, omission, or practice is deceptive: 1) whether it misleads or is likely to mislead from the consumer's perspective; 2) whether the consumer's interpretation is reasonable under the circumstances; and 3) whether the representation, omission, or practice is material. These elements, all of which must be established for a practice to be deemed deceptive, are discussed in more detail below.

The "misleads or likely to mislead" test applies to representations of express or implied claims or promises and can be written or oral. An express claim refers to a direct representation about the benefit of a product or service, such as: "Our bank offers the highest-yielding money market account in the country." An implied claim, by contrast, does not directly make a representation about the product or service, but one is necessarily suggested.

For omissions, the focus is on whether the omitted information is necessary to prevent a consumer from being misled. The guidelines note that the statement, representation, or omission is not evaluated in isolation but in the context of the entire advertisement, transaction, or course of dealing to determine whether it is deceptive.

The guidelines cite the following examples of practices that are potentially deceptive: making misleading cost or price claims; using bait-and-switch techniques; offering to provide a product or service that is not, in fact, available; omitting material limitations or conditions from an offer; selling a product unfit for the purposes for which it is sold; and failing to provide promised services.

The next prong focuses on whether the consumer's expectations are reasonable relative to the claims made. If a specific audience is targeted with a product, service, or practice, such as the elderly or the financially unsophisticated, the reasonable expectations of *that* group are used to evaluate the claim.

The guidelines also note that even if a consumer's

[7] CA Letter 04-2, *Unfair or Deceptive Acts or Practices by State-Chartered Banks*, is available on the Board of Governors' website at <www.federalreserve.gov/boarddocs/caletters/2004/0402/caltr0402.htm>.

interpretation is not shared by a majority of the consumers in the relevant class, it can still be deemed deceptive if a significant minority of such consumers are misled, and that if a representation conveys two or more meanings to reasonable consumers, and one is misleading, the representation can be considered deceptive.

If a statement or representation is misleading, but written disclosures are made to correct it, the disclosure may still be insufficient to correct the misleading aspect, especially when the consumer is directed away from the qualifying disclosure or is counseled that reading the disclosures is unnecessary. Similarly, oral disclosures or fine print may be insufficient to cure a misleading headline or prominent written representation.

The final element for evaluating deceptive representations, omissions, or practices is materiality, which evaluates the significance of the representation or omission. This is another way of saying "no harm, no foul." If a bank misrepresents an aspect of one of its services, but that aspect is trivial and unimportant, it is not considered deceptive.

The guidelines also clarify that information about costs, benefits, or restrictions on the use or availability of a product or service are *always* considered material, and that when express claims are made with respect to a financial product or service, they will also be presumed to be material. Similarly, materiality will be presumed for an implied claim if it is demonstrated that the institution intended for the consumer to draw certain conclusions from the claim.

Finally, when an institution knowingly makes a false claim, or knew or should have known that the consumer needed the omitted information to evaluate the product or service, it will be presumed to be material.

In summary, it is important for banks to remember that consumer compliance is not limited to the specific requirements of familiar consumer regulations like Regulation Z (Truth in Lending), Regulation CC (Expedited Funds Availability), or Regulation E (Electronic Funds Transfer). Banks are also subject to section 5(a) of the FTC Act, which broadly prohibits unfair or deceptive acts and practices. As the Providian Bank case demonstrates, the penalties for violations can be substantial, especially if they are pervasive and affect a large number of customers.

If you have any questions about this article, please contact Consumer Regulations Specialist Kenneth J. Benton (kenneth.j.benton@phil.frb.org) or Supervising Examiner John D. Fields through the Regulations Assistance Line at (215) 574-6568. ☐

Revised Consumer Handbook on Adjustable-Rate Mortgages Available

The Federal Reserve Board and the Office of Thrift Supervision have announced the availability of a revised Consumer Handbook on Adjustable-Rate Mortgages (CHARM), which provides information about the features and risks of these mortgage products. The original CHARM was released in 1987 to help educate consumers about adjustable-rate mortgages, and it has received periodic updates over the years. To address the growing popularity of nontraditional mortgage products, information on "interest-only" and "payment option" mortgages are included in this most recent update.

Under Regulation Z, creditors must provide a copy of the CHARM, or a suitable substitute, to consumers with every application for an adjustable rate mortgage. Creditors may begin providing the recently updated version of the CHARM (December 2006), or they may continue to distribute their existing supply of handbooks until October 1, 2007, when the updated version must be provided to consumers. For more information or to order publications, please visit www.federalreserve.gov/pubs/brochure.htm.

Unfair or Deceptive Case Study: Providian Bank

In June 2000, the Office of the Comptroller of the Currency (OCC) and the San Francisco District Attorney's Office announced a $300 million dollar settlement against Providian Bank because of egregious unfair or deceptive acts and practices in violation of section 5(a) of the FTC Act and violations of other consumer regulations with respect to Providian's credit card operations.[1]

The overwhelming size of the penalty is powerful evidence of the potential risks banks face for violating the prohibition against unfair or deceptive acts and practices. While Providian's conduct, and the size of the penalty, do not represent a typical unfair and deceptive practices case, the enforcement action nonetheless offers insights and lessons for banks.[2] The key points of the case are discussed in the following paragraphs.

Providian offered a "Guaranteed Savings Rate" program, in which it encouraged consumers to transfer credit card balances by telling them that Providian guaranteed a lower credit card rate than they were currently paying. Providian's telemarketers used terms like "great savings" and "maximum savings," but were instructed to not answer questions about how great the savings would be.

But the telemarketers, as instructed by the bank, never disclosed that the maximum savings over the rate the consumer had been paying was 0.7 percent in one rollout and 0.3 percent in another. In addition, after the account was transferred, customers dissatisfied with Providian's rate reduction had to pay a three percent "balance transfer fee" to move their account to another institution. To be eligible for the lower rate, customers also had to prove the interest rate of the credit card account whose balance they were transferring within 90 days. If Providian was not satisfied with the proof, it charged the highest rate permitted under its account agreement, which was often 21.99 percent. This was usually a higher rate than the one the customer was paying on the transferred account. Providian also waited until the 70th day to notify the customer that it was dissatisfied with the customer's proof of the prior rate, which allowed little time to send additional satisfactory proof.

Providian's marketing of credit protection was also cited as unfair and deceptive. Credit protection was marketed as a great way to avoid having to make credit card payments when hospitalized or out of work for up to 18 months, with no interest charged during that period and no adverse credit reports filed with the credit bureaus. But Providian failed to disclose significant restrictions on credit protection coverage, including that:

- It was limited to the number of months that the consumer paid premiums, even if that was less than the 18 months touted by the telemarketers.
- It was unavailable with regard to involuntary unemployment unless the consumer had paid in three months of premiums.
- It was unavailable with regard to involuntary unemployment if the consumer was self-employed.
- It was unavailable with regard to hospitalization, sickness, or disability caused by a pre-existing condition unless the consumer had paid in six months of premiums.
- Benefits could be denied if the consumer's account was not current or was over the limit, or if the consumer paid more than the minimum to another credit card account or accessed credit from another credit card beside Providian's.

No annual fee credit cards. Providian marketed a card with no annual fee, but did not adequately disclose that the consumer had to purchase credit protection at $156 a year. If the consumers complained, they were informed that the only alternative was to pay an annual fee.

Real Check program. Providian marketed a Real Check program that promised a reward of up to $100 or $200 for transferring a credit card balance, but failed to disclose adequately that customers had to transfer a minimum balance to obtain the full reward. For the $200 reward, the balance transfer was a minimum of $10,000.

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[1] The OCC's news release discussing the settlement is available at <www.occ.treas.gov/ftp/release/2000-49.txt>.

[2] The discussion here pertains to the OCC's enforcement action against Providian, but Providian's conduct also resulted in a private class-action settlement of $105 million dollars in 2000 for other unfair and deceptive practices.

How Banks Can Respond to Counterfeit Cashier's Checks and Money Order Fraud *...continued from page CC1*

In recent years, fraudulent activity involving counterfeit cashier's checks and money orders has increased significantly. Bank regulators are reporting new cases of this fraud on a daily basis. In just the first three months of 2007, Bankers On-Line reported 99 alerts from bank regulators involving new cases of counterfeit cashier's checks. Similarly, in April 2005, the *New York Times* reported on the surge in counterfeit postal money orders.[2]

The sharp increase in this type of fraud can be attributed, in large part, to sophisticated, low-cost desktop publishing tools that are widely available today. In addition, because each bank designs its cashier's checks with different papers and security features, neither consumers nor bank tellers have uniform expectations of how cashier's checks should look and feel, which makes it harder to detect counterfeits.

The sharp increase in this type of fraud can be attributed, in large part, to sophisticated, low-cost desktop publishing tools that are widely available today.

Additionally, fraudsters are exploiting a discrepancy between the deadlines federal law imposes on banks for making deposits available to customers and the actual time it takes to clear checks and money orders. Under section 4002(A)(2)(F) of the Expedited Funds Availability Act (EFAA) and section 229.10(c)(1)(v) of Regulation CC, the implementing regulation for EFAA, banks generally must make a deposit available, up to the first $5,000, by the next business day for the following checks: cashier's, Treasury, money order, Federal Reserve Bank, Federal Home Loan Bank, and state or local government. However, it often takes significantly longer for a counterfeit check or money order to be rejected and returned to the depository bank.

For example, the postal service reserves the right to examine money orders submitted for payment and deny payment if the money order is counterfeit, but it does not specify a deadline, stating only that it has a "reasonable time" to make an examination. Even after the postal service pays a money order, it retains the right to demand repayment within a reasonable time of discovering that it is counterfeit or otherwise defective. The Uniform Commercial Code's (UCC) short deadlines for clearing checks do not apply to U.S. Treasury checks or postal money orders.[3] This discrepancy between funds availability and the long period for rejection provides a significant window of opportunity for fraud to occur.

Similarly, for cashier's checks, the deadline for dishonoring a check is governed by the check collection provisions of Articles 3 and 4 of the UCC. In particular, a payor bank is liable for the full amount of a check presented unless it returns the item unpaid by midnight on the next banking day (after the banking day on which it receives the check). While a depository bank is waiting to learn whether a check has been rejected by the midnight deadline, it must still provide

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[2] Tom Zeller, Jr., "A Common Currency for Online Fraud, Forgers of U.S. Postal Money Orders Grow in Numbers and Skill," *New York Times*, April 26, 2005. Available on the United States Postal Service (USPS) website at <http://www.usps.com/postalinspectors/mofeatur.htm>.

[3] The UCC's rules in article 3 only apply to a "bank," which is defined as "a person engaged in the business of banking, including a savings bank, savings and loan association, credit union, or trust company," UCC 4-105(1). In addition, section 42 of Regulation CC specifically states that the "expeditious-return (§§229.30(a) and 229.31(a)), notice-of-nonpayment (§229.33), and same-day settlement (§229.36(f)) requirements of this subpart do not apply to a check drawn upon the United States Treasury, to a U.S. Postal Service money order, or to a check drawn on a state or a unit of general local government that is not payable through or at a bank," 12 C.F.R. 229.42.

provisional credit to the customer the next day after deposit. Moreover, some sophisticated fraud scams use altered routing numbers to intentionally slow the clearing processing.

The law does provide some protection to the depository bank. If the payor bank fails to dishonor a counterfeit cashier's check prior to its midnight deadline, it can be held liable to the depository bank. For example, in the leading case of *Northern Trust Co. v. Chase Manhattan Bank*, 582 F. Supp. 1380 (S.D.N.Y. 1983), *aff'd*, 748 F.2d 803 (2d Cir.1984), Northern Trust Co. (Northern Trust) made payment to Chase Manhattan Bank (Chase) on a counterfeit cashier's check in the amount of $473,272.22 drawn on Northern Trust. Two months later, Northern Trust notified Chase that the check was counterfeit and sought to be repaid the amount of the check. When Chase refused to reimburse Northern Trust for its loss, Northern Trust sued. The court rejected Northern Trust's legal theories because it had already made payment on the check to Chase.

If the payor bank fails to dishonor a counterfeit cashier's check prior to its midnight deadline, it can be held liable to the depository bank.

As a practical matter, however, it is often difficult for a bank to justify the cost and burden of litigation against the payor bank when only a few thousand dollars are at stake. Moreover, the depository bank's customer is the party primarily responsible if a cashier's check is returned unpaid. The bank will only suffer a loss if the customer cannot cover the amount of the deposited check after it is returned.

However, customers who are victims of fraud are often left angry and confused. Why did the bank mislead them into believing the check cleared by making the funds available without explaining that it was provisional credit subject to collection from the paying bank? Why didn't the bank warn of the possible delay in rejecting the deposit or of the current problem involving counterfeit cashier's checks and money orders? Why should the customer be responsible since the bank misled them by making the amount of the deposit available?

For all of these reasons, it makes good business sense for banks to focus their efforts proactively on preventing fraud scams from succeeding. Educating customers and employees are two steps banks can take to help mitigate the risk of fraud.

Educating Customers

Educating bank customers is the single most important response banks can initiate. Counterfeit cashier's check scams have been successful primarily for two reasons. First, consumers often assume that a cashier's check cannot bounce. Prior to the revolution in desktop publishing, this was a safe assumption. Because cashier's checks are an obligation of the issuing bank, and bank failures are rare, banks historically did not suffer losses on cashier's checks. Indeed, this is precisely the reason Congress specified in the EFAA that a cashier's check must be made available by the next business day.

But now that it has become relatively easy to create a counterfeit cashier's check or money order, customers must be made aware of the risk from these forms of payment and the steps they can take to protect against this risk. This is admittedly a delicate task because banks want to inform their customers of the risks without alarming them.

One method of educating customers is to have bank tellers discuss the risks or provide a brochure when a customer deposits a cashier's check, money order, or similar item. For example, the Federal Trade Commission has created a brochure for banks to provide to their customers, entitled *Giving the Bounce to Counterfeit Check Scams*.[4] Important tips for customers include the following:

- Understand the difference between provisional credit for deposits that banks are required to provide and the actual time it can take for banks to clear checks.
- Examine cashier's checks or money orders carefully for any irregularities. The United States Postal Service has a webpage that describes characteristics of authentic money orders.[5]
- Contact banks issuing cashier's checks and money orders to verify whether they have cleared and were issued in the amount stated. Customers are advised to obtain the bank's phone number from an independent source.
- Use caution when getting a cashier's check or money order from a third party with which the customer has no prior relationship. For example, a buyer who sends a payment in excess of the seller's asking price in a legitimate classified sale and then asks to have the overpayment wired back is a red flag of fraud. In addition, because it is more costly to ship abroad, and because a buyer has fewer remedies when dealing with a seller in a foreign country, sellers should use extra caution when selling to persons outside the United States.
- Remit payment through a payment service when selling items on the Internet. After the payment has been received through the payment service, the customer can safely deliver the goods purchased.
- Banks can also post advisories on their websites about counterfeit check scams and alert customers to red flags of suspicious transactions.

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Educating Employees

It is also important for banks to educate their employees, and it is especially important to educate tellers. Tellers should be advised when to discuss the risks with customers. The Federal Reserve has issued a booklet entitled *Check Fraud*, which discusses check fraud issues and adopting electronic check presentment.[6]

The bank's wire department should also be included in any educational campaign. It is important for wire department staff to be trained to recognize suspicious transactions in which bank customers are at high risk for counterfeit check scams. Typically, these scams involve some or all of the following characteristics: a deposit made within a few weeks of the requested wire transfer with a certified form of payment (cashier's check, money order, etc.), a customer who rarely makes wire transfers, and a wire transfer recipient outside the United States. When customers are apprised of the risks, they can take appropriate action to protect themselves, and by giving additional attention to wire transfer requests, banks can target the higher risk transactions.

Conclusion

When EFAA was enacted, counterfeit cashier's checks and money orders did not present a significant risk, but now that technology has enabled individu-

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[4] *Giving the Bounce to Counterfeit Check Scams* is available online at <www.ftc.gov/bcp/edu/pubs/consumer/credit/cre40.pdf>.

[5] Please see the USPS website at <www.usps.com/missingmoneyorders/security.htm>.

[6] The Federal Reserve's booklet, *Check Fraud,* is available online at <www.frbservices.org/Retail/pdf/CheckFraud.pdf>.

als to create sophisticated counterfeits inexpensively, shorter hold periods under EFAA present a challenge for banks and consumers. At the recent March 8, 2007, Consumer Advisory Council meeting at the Board of Governors, check holding guidelines and practices were discussed, with a focus on fraudulent official checks, counterfeit cashier's checks, and money orders. Ultimately, the full adoption of Check 21 and electronic payment systems will greatly reduce the use of checks for payment. But in the meantime, banks should focus on educating their customers and training their employees to mitigate the financial impact of these scams.

If you have any questions about this article, please contact Consumer Regulations Specialist Kenneth J. Benton (kenneth.j.benton@phil.frb.org) or Supervising Examiner John D. Fields through the Regulations Assistance Line at (215) 574-6568. ☐

The Federal Reserve Board's Consumer Advisory Council

In 1976, Congress directed the Board of Governors of the Federal Reserve System (Board) to establish an advisory committee on consumer issues. In response, the Board established the Consumer Advisory Council. The Council is composed of 30 members from across the country, representing consumers, communities, and the financial services industry. The Board appoints members, who serve staggered three-year terms.

The council meets three times a year in Washington, D.C., and the meetings are open to the public. Several members of the Board of Governors typically attend the meeting along with the director and staff of the Board's Division of Consumer and Community Affairs (DCCA), which develops policies and activities that address financial services industry issues related to consumer protection, financial education, and access to banking services.

The Council provides for regular discussion and debate on consumer issues from the perspective of consumers, regulators, and the financial services industry. As Sandra Braunstein, the director of DCCA, commented at the October 26, 2006, meeting:

"One of the things that the Board members and the staff—that we like so much about the Council—is the diversity of opinion. We have often felt that the purpose of this group was not necessarily to reach consensus on an issue, but it was to air all the views on an issue, because that does help us as we go forward with rulemaking and developing policy and guidelines and other kinds of issues that we are dealing with."*

Several weeks after each meeting, the Board provides a full transcript of the Council's deliberations, along with the meeting's agenda, at: <www.federalreserve.gov/generalinfo/adviscoun/cac/default.htm>.

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* The full text of the October 26, 2006 Consumer Advisory Council meeting is available at <www.federalreserve.gov/generalinfo/adviscoun/cac/transcripts/2006/200610/0ct06transcript.pdf>.

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