



February 6, 2023

The Honorable Michael J. Hsu
Acting Comptroller
Office of the Comptroller of the Currency
400 7th Street SW
Washington, D.C. 20219

The Honorable Jerome H. Powell
Chairman
Board of Governors of the Federal Reserve
System
20th Street and Constitution Ave, N.W.
Washington, D.C. 20551

The Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Regarding: Fraudulently Altered Returned Items (“Fraudulent Returns”)

Dear Prudential Banking Regulators:

CBAI’s member community banks have been experiencing a pernicious and growing problem with fraudulently altered checks drawn on their customers’ accounts. This is a problem that is recognized by regulators, the United States Postal Service (USPS), and law enforcement. These checks have typically been intercepted by criminals while being transmitted through the USPS, altered, then deposited into accounts, which are later emptied – thus completing the crime cycle.

CBAI is dedicated to exclusively representing the interests of Illinois community banks and thrifts through effective advocacy, outstanding education, and high-quality products. CBAI’s members hold more than \$80 billion in assets, operate 860 locations statewide, and lend to consumers, small businesses, and agriculture. For more information, please visit www.cbai.com.

Our members have been particularly frustrated because these Fraudulent Returns have been deposited into accounts at the nation's largest bank, and the process to determine the liability for the fraud losses and reimbursement is protracted. When this issue has been raised to federal regulators, the responses have been that it is not their responsibility to intervene in bank versus bank disputes. Our members respectfully urge the OCC, Federal Reserve, and the FDIC to reconsider your position regarding Fraudulent Return in light of the information contained in this letter. Our members are asking for your involvement - not in picking the winners and losers, but in getting reasonable closure for the benefit of the banks you regulate for safety and soundness, and compliance purposes.

CBAI Member Survey

CBAI surveyed our members in January 2023 and obtained valuable data on the nature and extent of this problem. The results were even more alarming that we anticipated.

In response to the question - ***Has your community bank experienced problems in being reimbursed for fraudulent returns in the past year?*** 60% of the respondents indicated in the affirmative. If these results are indicative of all community banks under \$10 billion in assets, then this is a problem that confronts approximately 2,800 community banks in the United States. In addition to confirming the widespread nature of this problem, community banks are reporting that it is getting worse.

In response to the question - ***Which banks and/or credit unions have been the most difficult for your community bank to deal with in being reimbursed for fraudulent returns?*** the list includes the following – eight of which are in the top 10 of the largest banks in the country, and the largest credit union.

Names of the offenders (the worst culprits are listed first)

Bank of America
JP Morgan Chase
Wells Fargo
Navy Federal Credit Union
US Bank
PNC Bank

Truist Bank
Capital One
Regions Bank
Citi Bank

These results indicate that this is an undeniable problem that is caused by the largest banks and credit union and harms community banks.

We asked, *As of today, how many items that your bank submitted for reimbursement remain unresolved?* and the response was that on that day an average of five items remained unresolved with a range of between zero and 30. When asked the **total dollar amount** of these items, the answer was an average of \$23,300 which does not include the results of one bank that has over \$1 million in items seeking closure. Once again, extrapolating for all banks under \$10 billion in assets that are experiencing this problem, the current number of items being disputed is estimated to be 19,600, and the total dollar amount is estimated to be approximately \$65 million. By any reasonable measure, these results indicate this is a massive problem that needs the regulators' attention and assistance in resolving.

We inquired about the responsiveness of the largest financial institutions by asking, *Approximately how many months has it taken to get closure for these fraudulent returns?* and the response was an average of five months, with some responding as high as 18 months, and some said there was never closure and they just had to sustain the loss! This data proves that addressing and resolving these items, which are legitimately a costly concern for community banks, is obviously a very low priority for the largest financial institutions.

We asked, *Of the items that remain unresolved, how many of these items have you received no response from the other financial institution?* and the shocking answer was 65%. Clearly, in the majority of cases, these large financial institutions do not even feel the need to extend the bank seeking reimbursement the courtesy of acknowledging the request and when to expect closure. This behavior by the largest financial institutions is completely unacceptable.

When asked about the **percentage of these items that are impacting the community bank's business versus personal accounts**, the response was that the impact is primarily (60%) on business accounts, but that 40% are impacting consumer accounts. CBAI believes that it is highly likely that community banks' business accounts would be defined as "small businesses"

which are the most likely to be negatively impacted by fraud, so it is reasonable to assume that this problem is inflicting more harm on an incredibly important sector of our economy in addition to consumers.

In response to the question, *For 2022, what has been your bank's total amount of losses for fraudulent returns?* the response was an average of over \$30,000. Again, extrapolating for all community banks that have experienced this problem, we estimate their losses from this type of fraud in 2022 to be a staggering \$94 million.

In an open-ended question to our community bank members asking about their experience in trying to resolve these issues with the largest banks and credit union, we received many responses with this common theme.

The big banks' communication and response are nothing if not negligible.

They never call you back.

Trying to locate the "right" person or department is nearly impossible.

Every incident is extremely frustrating and time consuming.

There is no sense of urgency to resolve the case.

No response to several written requests over the past 90 days.

The attitude is – They don't care!

Framing of the Issue and the Responsibility of the Regulators

Our community bank members are sensitive to the regulators' position that it is not their responsibility to get in the middle of arguments between the financial institutions that they regulate. However, our members are not asking the regulators, under normal circumstances, to pick winners and losers. Where we see the responsibility of the regulators is for their ensuring the safety and soundness (and compliance) of the institutions that they supervise and examine, and that there is an intersection between reasonable closure on requests for reimbursement of

Fraudulent Returns and the CAMELS rating system. The failure of the largest banks to reasonably address these reimbursement requests is a clear indication that they are not properly managing this process – the M in CAMELS. Further, the fact that fraudulent accounts are being opened in the first place, through which these fraudulent items are being negotiated, is a clear indication that there is a problem with the large banks managing (the M in CAMELS) their KYC/BSA/CIP compliance responsibilities.

The broader management and KYC/BSA/CIP compliance failures of the largest banks in not resolving Fraudulent Returns is harming the earnings (the E in CAMELS) of community banks and also their capital (the C in CAMELS). In addition, community banks are expending a great deal of time and energy in trying to resolve these returns (i.e., wasted management resources (the M in CAMELS)) that could productively be deployed elsewhere.

Also, and absolutely not to be discounted, community banks have to interface with their customers who are the front-line victims of this fraudulent activity, which undoubtedly shakes the confidence of consumers and small business (i.e., public confidence) in the United States banking system - which the regulators are tasked with ensuring.

Barrier to Resolution

We understand that there are unfortunately no required timeframes for the resolution of Fraudulent Returns. The largest banks are apparently aware of this lack of specific timeframes, they are experiencing an increasing volume of these items and potential losses, and judging by the response of our members they are in absolutely no hurry to resolve them. However, despite the current lack of specific time frames for closure, there should be, at an absolute minimum, a requirement for good business practices, professionalism, and common courtesy to resolve these items in a timely and reasonable manner.

Proposed Resolution

On an interim basis, and until rules and regulations can be changed, we recommend the regulators issue Joint Supervisory Guidance which would clearly identify the current problem and state the regulators' expectations for the largest large banks' good business practices, professionalism, and common courtesy in reasonably attending to, communicating about, and

prompt closure of Fraudulent Return items being submitted to them for reimbursement. In addition, we recommend the regulators go beyond guidance to include rigorous examination and enforcement to ensure the largest banks are complying with current laws, rules, and regulations.

The largest banks are enabling a weak link in this crime chain by permitting fraudulent accounts to be opened in the first place. The fraudulently altered checks are then negotiated through fraudulent accounts and cause subsequent damage to community banks and their customers. The regulators' examination of the largest banks should focus on their apparent failure to adequately comply with KYC/BSA/CIP which permits fraudulent accounts to be opened. In focusing on the largest banks policies, procedures, and practices, and where there are suspicions regarding an account (i.e., red flags), they should not be opening the account until the suspicions have been dispelled. In situations like this community banks place an extended hold on the deposited item(s), or put them through for collection, to increase the likelihood of the fraud being deterred or discovered before a loss is suffered.

Disturbingly, a community banker reported that several times, in the rare instance where she actually found a person to talk to, the person at a large bank acknowledged that there were suspicions noted about the account. While the banker appreciated finding someone to talk to, the response they received begged the question – Why, if there were unresolved suspicions, was the account even opened?

Earlier in this letter we stated that our community bank members are not asking the regulators, under normal circumstances, to pick winners and losers in these types of disputes. That accommodation should disappear in cases where the largest banks have failed in their safety and soundness and compliance responsibilities. These lapses are egregious and should override any large financial institution's defense that the responsibility for the fraud loss belongs to the community bank. In those cases, it is entirely appropriate for the regulators to side with the community banks which were harmed by the failures of the largest financial institutions.

Out of sheer frustration, our members have asked us to provide them with direction in filing written complaints to the offending banks' regulators (i.e., the OCC for the largest banks, the Federal Reserve with its responsibility for the large bank holding companies, and the FDIC as the deposit insurer of these banks). In addition, our members plan to copy their own state and federal regulators to highlight the extent of the problem and their attempts to try to get closure (i.e., that they are operating in a reasonable and responsible manner.) Our community bankers

would reasonably expect that these complaints will receive the prompt attention and high priority that they deserve by the offending large financial institutions' regulators.

In furtherance of our members' plan of action, we request that each of you send us the name and complete contact information for the senior individual in your agency that is responsible for each of the largest banks (listed above) that our members are having the greatest difficulty in being reimbursed for Fraudulent Returns. In addition, they would appreciate knowing the information that would be most helpful to the regulators in the community banks' complaints against the largest banks. They want these written complaints not only to help ensure prompt and reasonable closure but also to enhance the regulators' ability to identify the largest banks' safety and soundness and compliance weaknesses.

Regarding a more permanent solution to this problem, CBAI encourages the regulators to explore policymaking to establish specific timeframes for large financial institutions to confirm receipt and then bring closure to a Fraudulent Return reimbursement request. CBAI would be an enthusiastic participant in this important project.

When asked, CBAI members recommend 15-30 days to confirm receipt of the Fraudulent Return reimbursement request and then 90 days (including the 15 days) to bring the matter to closure. After that, if the largest financial institutions do not successfully bring closure, they should be penalized in some meaningful way – perhaps being required to reimburse the community bank until the matter is finally resolved with an absolute deadline of 180 days after which the matter should be presumed to be decided in favor of the community bank. This process should also include a reasonable way for community banks to appeal the decision of the large financial institutions should the big banks simply choose to deny all liability, where it may exist, in an effort to stay within the required timeframes.

In addition, the Joint Supervisory Guidance and any subsequent policymaking, must include a requirement for the largest financial institutions to provide a contact name, dedicated phone number, dedicated fax number, and email address so community bankers can effectively communicate with the largest banks. This information will provide the necessary proof to the community bank of their initiating the reimbursement request which starts the time clock for the largest financial institutions to comply.

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Conclusion

CBAI and its members believe fraudulently altered return checks are a problem caused by the nation's largest banks (and credit union), harms community banks and their customers, and undermines the public's confidence in the Nation's banking and financial system. We certainly believe regulators have a responsibility to address this issue.

CBAI urges all the regulators, to initiate Joint Supervisory Guidance, to ensure that Fraudulent Returns are being resolved promptly and reasonably by the largest financial institutions. If they are not, then these banks need to be held accountable for their safety and soundness and compliance failures by all of their regulators.

If you have any questions, or need any additional information, please contact David Schroeder at (847) 909-8341 or davids@cbai.com.

We thank you in advance of your timely response to this letter.

Sincerely,

/s/

David G. Schroeder
Senior Vice President
Federal Governmental Relations