# FINANCIAL INSTITUTION FRAUD

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## VII. FORGED INSTRUMENTS

*Forged items* are legitimate documents that are obtained via illicit means for committing fraud. A *forged instrument*, for financial institution purposes, is any item bearing the signature of anyone besides an unauthorized party. Forged financial instruments fall into two categories: forged maker and forged endorser. (Because a counterfeit financial document necessarily contains a signature—or some other type of payment authorization—for negotiation, it is also technically considered a forgery.) A *forged maker* instrument is any item bearing an unauthorized *payor* signature. A *forged endorser* instrument is any item bearing an unauthorized *payee* signature. Forged checks can be split deposited (i.e., checks deposited but part of the deposited money is provided back in cash) against the legitimate, established account of a true account holder.

The anonymity and high profitability of counterfeit checks and debit or credit card takeovers afforded by the Internet have led to a decline in check forgeries. Professional criminals are operating a business and, like perceptive business owners, they are going to focus on the activities that provide the highest yield with the lowest risk. The forged maker check scheme offers relatively smaller payouts and the additional risk of conducting a person-to-person transaction.

Additionally, cashing forged checks at the teller window has become more difficult because of instant signature verification. This technology enables tellers to instantly compare check signatures with those on the account record. However, instant signature verification is not a foolproof means of identifying forgeries because individuals' signatures change over time. Individuals sign their names differently based on whether they are alert or tired, sitting or standing, nervous or calm, and many other factors. Despite this, online signature verification significantly increases the risk of identifying forged checks and is a powerful deterrent against check fraud.

Most financial institutions' corporate security departments do not have the staff to investigate and recover small-dollar forgeries; they are considered an acceptable business risk, and banks budget for such losses. Additionally, as financial institutions become more automated—encouraging customers to use full-service ATM kiosks that also cash checks—fewer forgeries are attempted at the teller line. Rather than focusing on small-dollar forgeries, financial institutions are training tellers to look for larger-dollar counterfeit items.

### Forgery Types

Various types of forgeries exist. These include simple forgery, practice forgery, and tracing. Following is an overview of each of these types of forgeries.

### Simple Forgery

The most basic and easiest method of forgery is to sign the account holder's name at the bottom of the check. With this method, no attempt is made to copy a likeness of the true signature. The forger writes out the first and last name of the true signer and hopes there will not be a verification process.

### Practice Forgery

In a practice forgery, the forger obtains a sample of the account holder's signature and practices writing it until the signature reasonably resembles the original. A forger can become so proficient at writing the account holder's signature that he can reproduce it whenever necessary.

### Tracing Forgery

Some forgers use various tracing methods, including the following, to copy a legitimate signature onto a forged check:

- A true copy of the account holder's signature is obtained and placed face up on a well-lighted background. The check to be forged is then placed over the signature and traced onto the stolen check.
- The item to be forged is placed on a flat surface with a piece of carbon paper on top, and then an item containing the true signature is placed on top of the carbon. The true signature is traced, leaving an almost exact copy on the forged item. To avoid having a carbon-type signature on the forged item, the fraudster can trace over the signature with a felt-tip marker. Ink from a felt-tip pen is the most difficult for handwriting experts to verify because it bleeds.
- A check that is directly under a previously signed item in the check ledger is obtained. By lightly moving a pencil back and forth over the impression left by the signed item, the true account signature can be raised.

### Automatic Check-Signing Mechanisms

Companies that issue many checks sometimes use automatic check-signing mechanisms in lieu of signing each check by hand. Automated signatures are produced with manual instruments, such as signature stamps, or they are printed by computer. A fraudster who gains access to an automatic check-signing mechanism will have no trouble forging signatures.

## Forged Maker

The person who signs a check, which makes them responsible for payment, is known as the "maker" of the check, and therefore, a *forged maker scheme* can be defined as a check tampering scheme in which an individual misappropriates a check from an unsuspecting, legitimate customer of a financial institution and forges the signature of an authorized maker on the stolen check. Forgers can then make the checks payable to themselves and cash or deposit them. Financial institutions normally do not verify every signature at the teller line. Most banks do not have the capability to embark on such an endeavor and, even if the technology were made available, the volume of checks presented to tellers daily and the time needed to verify checks would make the option undesirable. These cost- and time-prohibitive drawbacks of preventing forged maker schemes have made this type of fraud a loss that banks are likely to classify as a cost of doing business.

To mitigate the amount of losses from forged maker schemes, financial institutions can establish strict verification limits. Within these limits, tellers, based on their level of expertise, are assigned certain dollar amounts that they can approve for check cashing without needing verification. The major downfall to the establishment of verification limits is that most professional white-collar criminals already know the specific institution's verification limits. They keep the check amount under the known verification limit, thereby limiting the number of eyes viewing the unauthorized instrument and signature.

Forged maker schemes have proven successful for fraudsters cashing forged checks because all that is required by the drawee financial institution is a valid instrument containing a legitimate account number with the proper corresponding account holder information and an acceptable form of identification. The actual presenter of the check does not have to have an established account at the institution where the item is drawn. Financial institutions will honor their specific personal and business payroll checks. Trust on behalf of the check presenter is upheld by the payee institution, negating the necessity for any type of established credit relationship.

Rather than make the stolen checks payable to themselves, fraudsters might make them payable to merchants and present them for payments at retail stores. Most large retailers rely on a computer system for check acceptance so that once a consumer has written one check to the merchant, the information is warehoused and subsequent check verification is done via the computer. If the first check was not returned to the merchant, the likelihood of subsequent checks being accepted increases substantially.

The number of forged maker items, however, has decreased as electronic payment systems have become more popular.

### Red Flags of Forged Maker Schemes

Tellers should be aware of the following items that might indicate a forged check:

- The maker's name is misspelled on the signature line.
- The signature runs off the end of the signature line. This might be an indication that the signer is not used to signing the name and ran out of room.
- There are notations on the memo line. Some forgers believe this gives legitimacy to the check.
- The maker and endorser handwriting matches or is similar. This is an indication that the same person who endorsed the check also wrote the check.

## Forged Endorsement

The *endorsement* is the signature on a check indicating that the signor intends to obtain payment of the instrument, and a forged endorsement occurs when a validly drawn check is fraudulently endorsed. Forged endorser items are cashed by individuals purporting to be the true payee, or are second endorsed and presented by the second endorser. Forged endorsed items are also deposited into fraudulent accounts or, more rarely, negotiated through merchants.

A forged endorsement on a check is different from a forged signature on a check. A forged endorsement involves forging the payee's signature for negotiation. Frequently, a forged endorsed check contains the true signature of the account holder.

Forged endorsed items can be identified as first-, second-, or third-endorsed items. A first-endorsement forgery occurs when the signature of the true payee is forged. A second-endorsed forgery is the forged signature of the true payee with the check made payable to a second party. For a third-endorsement forgery, two subsequent forged signatures accompany the signature of the individual attempting to negotiate the item.

Endorsement issues also occur on checks made payable to more than one payee. A common example of this is when the recipient of an insurance claim and the claimant's insurance company receive a check to split. The insured individual receives the check but is supposed to turn over a portion of it to the insurance company. The individual can sign the check and forge the endorsement of the insurance company. This scenario also occurs with checks made payable to two, three, four, or more payees. Checks that are payable to two parties and are separated with the term *and* require the endorsement of both payees. Checks that are payable to two parties and are separated with the word *or* require the endorsement of either party, but not both.

As with counterfeit checks drawn on specific financial institutions, the drawee institution will honor items drawn against itself. Forged endorsed checks, especially payroll checks, are popular items to steal and negotiate over a forged endorsed signature. Forged endorsements are also used to deposit checks in fraudulent accounts at other financial institutions, which prevents the drawee institution from questioning the validity of the signature.

### Types of Endorsements

When processing checks, it is important to understand the various types of endorsements and their unique qualifications.

### *Basic Endorsement*

The signature of the endorser on the back of a check without identifying the name of any specified person is a basic (or blank) endorsement. A basic endorsement should be signed exactly as the made payable line of the check. Complete first, middle, and last names should be signed. If a middle initial is used in place of a complete middle name, the initial letter becomes part of the complete endorsement.

### *Double Endorsement*

This type of endorsement is for checks made payable to two individuals where the word *and* appears between the two payee names. Both payees must endorse the check in the same manner as with a basic endorsement.

### *Restrictive Endorsement*

A restrictive endorsement sets specific requirements for how the check can be negotiated. Basically, a restrictive endorsement places a limitation on the use of the check. For example, the phrase "for deposit only" written along with the payee's signature on the back of a check is a type of restrictive endorsement. This restrictive endorsement requires that the value of the check be paid to the endorser of the check.

Tellers should not negotiate checks with restrictive endorsements without first obtaining approval from management or the legal department.

### *Special Endorsements*

A special endorsement is a check endorsed by the original payee and identifies the party to whom the negotiable instrument is being transferred. That is, a special endorsement occurs when the endorser puts their signature on the instrument and writes the name of a second person to whom the negotiable instrument is being transferred, and when the endorser makes a special endorsement, it requires the next payee's endorsement for further negotiation. Common wording for special endorsements is, "Pay to [the order of] Name of Subsequent Payee."

### *Conditional Endorsements*

With conditional endorsements, the check issuer establishes specific conditions that must be met before the check is negotiated. For example, a check might provide that, "Pay to Aubrey Ryan upon the satisfactory performance of her contract, (signed) Robert Smith."

Tellers should not negotiate checks with conditional endorsements without first obtaining approval from management or the legal department.

### *Qualified Endorsements*

When a check contains a qualified endorsement, it is negotiated without recourse. The payee of the check does not accept responsibility for the check amount if the drawee financial institution refuses payment of the check.

Tellers should not negotiate checks with qualified endorsements without first obtaining approval from management or the legal department.

### *Missing Endorsements*

How banks of first deposit should handle checks that have no endorsements and are presented through in-clearing is covered in Section 4-205 of the Uniform Commercial Code. According to Section 4-205, the bank is under no obligation to honor the check, and it may return said item to the maker's bank, unpaid, for a missing endorsement. However, acceptance and processing of a check with no endorsement means that the presentment warranty statutes apply. The only exception is if the check were converted by an unauthorized party; in that scenario, an affidavit of forged endorsement would need to be completed by the intended payee.

### Forged Endorser Red Flags

Tellers should be aware of the following "quick look" items that might indicate a forged endorser:

- The check has already been endorsed by an unknown customer.
- The endorser keeps turning the check over to look at the face while endorsing. This might indicate that the signer is not familiar with how to spell the name.
- The endorser makes many stops and starts in signing the signature. This is an indication that they have to think about what the next letter is in the signature.
- The endorser holds their driver's license or other ID at a distance or covers the photo with their thumb. Tellers should request that the ID be removed from the wallet and handed to the teller so that an adequate comparison can be made.
- The endorsement was done in felt-tip pen. This type of ink bleeds into the paper and makes it difficult to make signature comparisons.

## Split Deposit Fraud

A *split deposit* occurs when a customer presents an endorsed check to a financial institution for deposit and receives part of the amount being deposited in cash. Split deposits are susceptible to fraud.

To commit split deposit fraud, a fraudster opens a new account with a financial institution (often with cash) or impersonate a true account holder at the institution. The fraudster then deposits worthless, counterfeit or forged checks and requests cash back.

When a split deposit involves impersonating a true account holder, the fraudster obtains the account information for the checking or savings account of a real bank customer. After obtaining the necessary account numbers, the fraudster might create fake forms of identification in the name of the account holder.

Typically, in such schemes, fraudsters use checks drawn on a financial institution other than the targeted financial institution. The checks can be from either open or closed accounts, or business or personal accounts. The reasoning behind targeting checks at financial institutions other than the drawee institution is so that the targeted institution cannot readily establish the validity of the questioned item.

Here is the typical process used to commit a split deposit fraud. The fraudster makes a check payable to the true account holder at Bank A and drawn on the account of the true account holder at Bank B. The fraudster then deposits the check into the account at Bank A and requests to receive part of the deposit back in cash.

Normally, the fraudster only asks for a small amount in cash compared to the deposited amount, and this often causes banking staff to assume that the transaction is harmless.

Such attacks only last a few days because the payor bank eventually returns the deposited items as unauthorized transactions. Once the deposited items are returned, the bank of first deposit freezes or blocks the deposit account, and the activity will cease.

This type of fraud can be severely curtailed by requiring identification on any cash back transaction, including split deposits.

## Other Forgery Schemes

### Dumpster Diving

Often, fraudsters obtain checks for forgery schemes by dumpster diving. Again, *dumpster diving* is the process of going through trashcans or recycling bins at businesses and residences to look for discarded papers that contain valuable information.

Shredding confidential documents is key to preventing dumpster diving.

### Payroll Forgeries

Payroll schemes occur when an employee fraudulently generates overcompensation on his own behalf, and often, payroll schemes involve forgeries. The most pervasive type of payroll fraud is the ghost employee scheme. A *ghost employee* is a person on an organization's payroll who receives compensation even though he does not work for the organization. In ghost employee schemes, a fraudster causes an organization to generate paychecks to a ghost employee through the falsification of personnel or payroll records. Because the payroll check was not issued or authorized to be paid by the account holder, it is considered a forgery.

To prevent ghost employee schemes, organizations should ensure that the individuals who issue checks are separate from those who reconcile the end-of-month statements.

## Prevention and Detection Measures for Forged Instruments

Again, financial institutions do not verify, or are not required to verify, every signature on checks that are processed. This encourages forged signature activity. Accordingly, financial institution personnel should be aware of the various prevention and detection measures for forged instruments.

### Business Check Verification

Because the names of the account signers on business checks rarely appear on the checks' face, individuals attempting to forge a signature on a business check are at an advantage. The forger might attempt to incorporate a portion of the business account name into the forged signature or simply make up a name to sign on the check.

Accordingly, tellers should verify business checks by verifying the signed name of business checks against the authorized signers on the account that are:

- Provided in the account's signature card
- Listed in a check processing system or account holder database

### Identity Verification

In addition to closely examining the customer's form of identification, tellers should record the document's identification number, issue date, and date of birth on the reverse side of the check. While recording the identification information, they should compare the written endorsement on the check with the signature on the identification. By recording the identification on the front side of the check, tellers are required to flip the check over and conduct a separate verification process. If the check turns out to be fraudulently negotiated, the information recorded on the check may be used to identify the culprit.

Although tellers are not expected to conduct handwriting analysis, they should always compare the signatures on the identification document and the check. It is a quick verification that requires no additional equipment. A side-by-side comparison of the signatures turned upside-down is usually an effective, if rudimentary, means of identifying possible forgeries.

**Writing Lacks Fluidity**

Tellers should examine written signatures for inconsistencies of letter slants and overall fluidity. People develop a natural fluid motion when signing their own names and begin and end with the same character strokes, slants, and overall quality. Individuals attempting to forge a signature lack this constant, fluid motion.

Tellers should also be aware of ink bleeds in the signature. After completing one letter in a series, the forger might stop writing and look at the original. By stopping the pen while it is resting on the paper, the ink leaves small dots. Individuals who are used to signing their own names do so without stopping the pen flow.

**Signatures Do Not Fit End-to-End Signature Lines**

Many people tailor their signatures to fit on the signature line, and therefore, a signature that does not fit the signature line is a red flag of forgery. An authorized signature often begins on the left edge of the line and ends near the right edge. But when forgers sign unfamiliar names, they might run out of room on the line. A forged signature might begin with a natural fluidity and tighten as the forger nears the end of the signature line. Also, the overall height of and spacing between letters might fluctuate throughout the forged signature.

**Carbon-Paper Residue on Checks**

When carbon paper is used to create a forged signature, residue is left on the face of the forged item, resulting in darkened areas around the name. Therefore, tellers should look for evidence of carbon-paper residue.

**Worn and Weathered Checks**

If a check contains a recent date, yet appears to be worn or weathered, this could indicate that the check was stolen months prior, carried by the forger for a time, and finally presented with a forged signature.

**Different Colored Inks on the Check Face**

Checks written in different colored inks are a red flag of forgery.

**Drive-Up Window Deposits**

Often, fraudsters deposit forged checks using a financial institution's drive-up window because it removes face-to-face contact with the teller. Drive-up window tellers have a limited view of the customers, and installed video cameras do not capture quality photos of the individuals negotiating items in their cars.

**Misspelled Name of the Account Holder**

Individuals unfamiliar with signing the account holder's name might misspell it. Tellers should examine the complete name on the signature line to ensure that the signed name matches the account holder's name.

**Felt-Tip Pens**

Tellers should use caution when negotiating checks written with felt-tip pens. Because the ink from felt-tip pens bleed on the check, it is the most difficult ink in which to make a positive handwriting comparison. Felt-tip pens can also be used to mask writing and obliterate previously written information.

Also, it is easier for handwriting experts to perform signature analysis on checks written with ballpoint and fountain pens than it is with checks written with felt-tip pens. This is because felt-tip pens bleed more than ballpoint and fountain pens and because the ink from ballpoint and fountain pens has smooth characteristics.

Likewise, writings made with pencils are smooth and clear, and they do not bleed into the paper, making it possible to complete a handwriting analysis of writings made with pencils.

**Memo Line**

Few check writers use the memo line unless it is to record an account number for a bill payment. However, many check forgers seem to believe that all blank lines on a check face should be filled in and that the information on the memo line makes the forged item more believable.

Tellers should always read the information written on the memo line. Popular memos for forgers include "Birthday Gift" or "Present." While verifying a customer's identity, tellers should determine whether the information located on the memo line can be used to validate the check's authenticity.

**Re-Endorsed Check**

Individuals cashing checks often have endorsed the check before they reach the teller. To ensure the endorsement is legitimate, tellers should have the check presenter re-endorse it in their presence. This process could prevent a thief from presenting a check that was stolen after being endorsed by the true recipient.

### Endorsement Guarantee

Tellers should only process second-endorsed or special-endorsed checks if the drawee institution guarantees the payee's signature. The endorsement guarantee indemnifies the depository institution from any claims made by the true payee in the event of fraud. The endorsement guarantee shows that the true payee signed the check over to a second party in the presence of financial institution personnel.

### Endorsement Verification

If the initial endorsement of the true payee is dubious, the teller should have the check bearer produce the original check payee to endorse the check in the presence of financial institution personnel. Financial institutions are not obligated to honor second- or special-endorsed checks drawn on their specific institution.

### Specific Endorsements

Dual payee checks should contain the signature of both payees as their names appear on the check face. Tellers should not negotiate checks with a restrictive, conditional, or qualified endorsement without first obtaining approval from management or the legal department.

### Verification of True Account Holder

When conducting any type of transaction activity, tellers must always verify the customer's identity. Customer verification is necessary for split deposit transactions, but it is also necessary for straight deposit items.

### Review the Serial Number

When checks are presented through in-clearing and at the teller line, their account histories should be reviewed to determine whether the checks require additional review. The account history provides a list of recently paid checks, including their serial numbers, and an out-of-sequence check is a red flag of a forgery. Thus, the account history is a critical tool for combating check forgeries.

Comparing the serial number of the questioned check with those of recently paid items is one of the most effective methods of reviewing account history. Forged checks are rarely stolen from the front of the checkbook. Accordingly, the fraudster removes a check from the middle or back of the book to avoid detection. However, in doing this, the forgery can be more readily detected by a vigilant item processor or teller. A review of the account history, which should go back at least thirty days, helps identify checks that are out of sequence and require additional investigation.

### Cash Back Is Not a Deposit

Tellers should treat all cash backs as check-cashing transactions. So, if the customer receives any portion of a check in cash, traveler's checks, money orders, or official checks, the teller should treat the transaction as a cashed check. Identification should be reviewed and verified, the validity of account ownership must be established, and identification information should be recorded on the negotiated check.

## Review Questions

1. A forged instrument, for financial institution purposes, is:
   A. A check pre-signed by the true account signer
   B. Any item bearing the signature of anyone besides an authorized party
   C. A check presented where a payee name has been added to the payee line
   D. A check presented with changes made to the issued dollar amount

2. Endorsing a check with which of the following tools offers the greatest opportunity to conceal a forgery?
   A. Ballpoint pen
   B. Fountain pen
   C. Felt-tip pen
   D. Pencil

3. What type of endorsement occurs when a check is made payable to two separate payees and the word *and* appears between the two payee names?
   A. Double endorsement
   B. Conditional endorsement
   C. Restrictive endorsement
   D. Basic or blank endorsement

4. How should tellers at financial institutions treat split deposits?
   A. As noncash transactions
   B. As cashed checks
   C. As deposits
   D. As transactions that do not require identification

5. All of the following are warning signs of forged maker checks EXCEPT:
   A. Misspelled maker's name
   B. Memo line notation
   C. Restrictive endorsement
   D. Signature runs off the signature line

6. Which of the following would be useful in preventing ghost employee schemes?
   A. Ensure that payroll is prepared by personnel responsible for its distribution.
   B. Do not maintain personnel records independently of payroll and timekeeping functions.
   C. Ensure that the individuals who issue checks are separate from those who reconcile the end-of-month statements.
   D. Allow the human resource manager to be responsible for the payment process.

7. When a check is presented at the teller line, the teller should review the account _____ to quickly determine if the presented check requires additional review.
   A. History
   B. Maintenance records
   C. Balance
   D. Number