OCC ADVISORY LETTER

Comptroller of the Currency
Administrator of National Banks

Subject: Check-Kiting, Funds Availability, Wire Transfer Activity

TO: Chief Executive Officers of All National Banks, Department and Division Heads, and all Examining Personnel

PURPOSE

The Office of the Comptroller of the Currency wants to ensure that all national banks prudently manage the risks posed by fraudulent activity involving the use of illegal check-kiting schemes, and to provide useful information to help bank management identify and prevent potential deceptive practices.

BACKGROUND

The OCC has become aware of instances where banks have incurred significant losses through elaborate schemes to draw against uncollected funds. Typically, the banks most susceptible to this type of fraud do not have proper internal controls and reporting systems to monitor this and other suspicious activity, or have failed to properly enforce internal procedures that already exist. In addition, liberal practices regarding funds availability and wire transfer activity further increase the potential for loss.

SUMMARY

Check-kiting may occur in various ways, and involve numerous financial institutions. The underlying premise is the customer's ability to gain access to deposited funds before they are collected from the institution on which they are drawn. Often, exceptions to sound internal controls for approving drawings against uncollected funds, overdrafts, and wire transfers become a routine practice in many institutions. Since these exceptions do not frequently involve fraud or translate to losses, it becomes easy for bank employees and management to overlook the risks involved.

To combat check-kiting, the board and senior management need to ensure the effectiveness of internal controls used to identify suspicious activity and minimize risk. While fraudulent conduct cannot be detected or prevented in every case, there are certain minimal controls that should be implemented to reduce the likelihood that a check kite will go undetected. The types of internal controls which banks should consider include:

- Officer approval on drawings against uncollected funds, overdrafts, and wire transfers. Such authority should be strictly enforced and not exceed an individual's lending authority.

- Daily reports on drawings against uncollected funds, overdrafts, large items, and significant balance changes.

- Designated individual to regularly review internal reports to spot anomalous conduct and to ensure proper investigation when warranted.

- Secondary level of administrative control that is distinct from other lending functions to promote objectivity when granting significant drawings against uncollected funds or overdrafts.

- Regular overdraft activity reports to the board or an approved committee thereof.

- Periodic review through an independent audit function to assess and report on the adequacy of all established internal controls in this area.

In addition, although banks are required to adhere to the time frames on availability of funds established by Regulation CC, 12 CFR Part 229, bank management should also be aware of the regulation's exceptions to the normal availability schedules and use those exceptions as circumstances require. *See* 12 CFR 229.13 and related commentary at Part 229, Appendix E.

With proper controls, banks will increase their ability to flag suspicious activity. Although not all questionable conduct is the result of fraud, the board and senior management should recognize potential warning signs and monitor such conduct to help identify possible illegal activity. Examples of suspicious circumstances which may indicate a check-kiting scheme include:

- Several accounts with similar names, owned or controlled by the same individuals.

- Regular or excessive drawings against uncollected funds.

- Frequent daily negative ending balances or overdrafts that eventually clear or are covered in a short time frame.

Identifiable patterns of transactions such as deposits, transfers between accounts, withdrawals, and wire transfers, often with similar or increasing amounts.

- Deposits of large checks drawn on out-of-area banks or foreign banks.

- Frequent requests by the customer for account balances, collected items, or cleared items.

- Frequent, large deposits drawn on the same institution.

- Deposits drawn on other institutions by the same maker or signer.

- Large debits and credits of even dollar amounts.

- Frequent check withdrawals to the same institution, with the maker listed as payee.

- A low average daily balance in relation to deposit activity.

- A low collected fund balance in relation to the book balance.

- A volume of activity or large debits and credits inappropriate in relation to the nature of the business of the account holder involved.

There is no absolute safeguard against check-kiting or any other type of bank fraud, but there are account activities which can signal the need for greater scrutiny. Establishing adequate controls to identify such activity and periodic review and assessment of those controls is fundamental to minimizing the bank's potential risk of loss.

Any bank that becomes aware of activity that suggests the existence of a check-kiting scheme, or is otherwise suspicious, should file a suspicious activity report (SAR) in accordance with 12 CFR 21.11. *See* OCC Bulletin 96-19, March 15, 1996, and its attachment.

Questions concerning this advisory may be directed to the portfolio manager responsible for your bank or the OCC's Enforcement & Compliance Division at (202) 874-4800.

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