

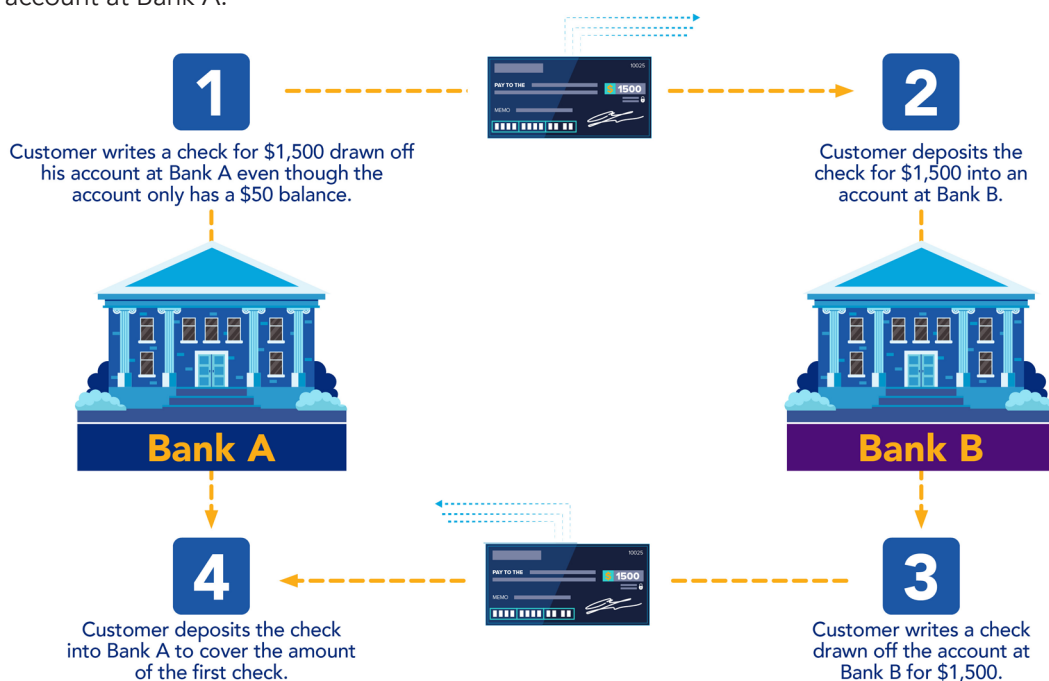
THE ANATOMY OF CHECK KITING

Check kiting — also known as floating, paper hanging or drawing on uncollected funds — is an illegal scheme where a customer deliberately writes a check for more than is available in his account and then, deposits the check into another account to falsely inflate the balance. This scheme may be perpetrated by an individual — or a combination of individuals working together — using personal or business deposit accounts. It can result in significant losses for financial institutions if the check deposits used to build up the fake balance bounce because of insufficient funds.

HOW DOES CHECK KITING WORK?

This scheme relies on making deposits and withdrawing funds across multiple accounts, often with different financial institutions. At a high level, check kiting generally follows a pattern where:

1. A customer writes a check to himself drawn off his account at Bank A, even though the account does not have sufficient funds available to pay the check.
2. The customer quickly deposits the check into his account at Bank B to take advantage of the time it takes for checks to clear. Leveraging the ability to deposit a check before the bank has processed it can falsely inflate the balance. The funds may be made available without confirmation from the paying bank that the paying account has sufficient funds to cover the check.
3. The customer then writes a check to himself drawn off the account at Bank B.
4. The check from Bank B is deposited into his account at Bank A to cover the prior check that was written from the account at Bank A.

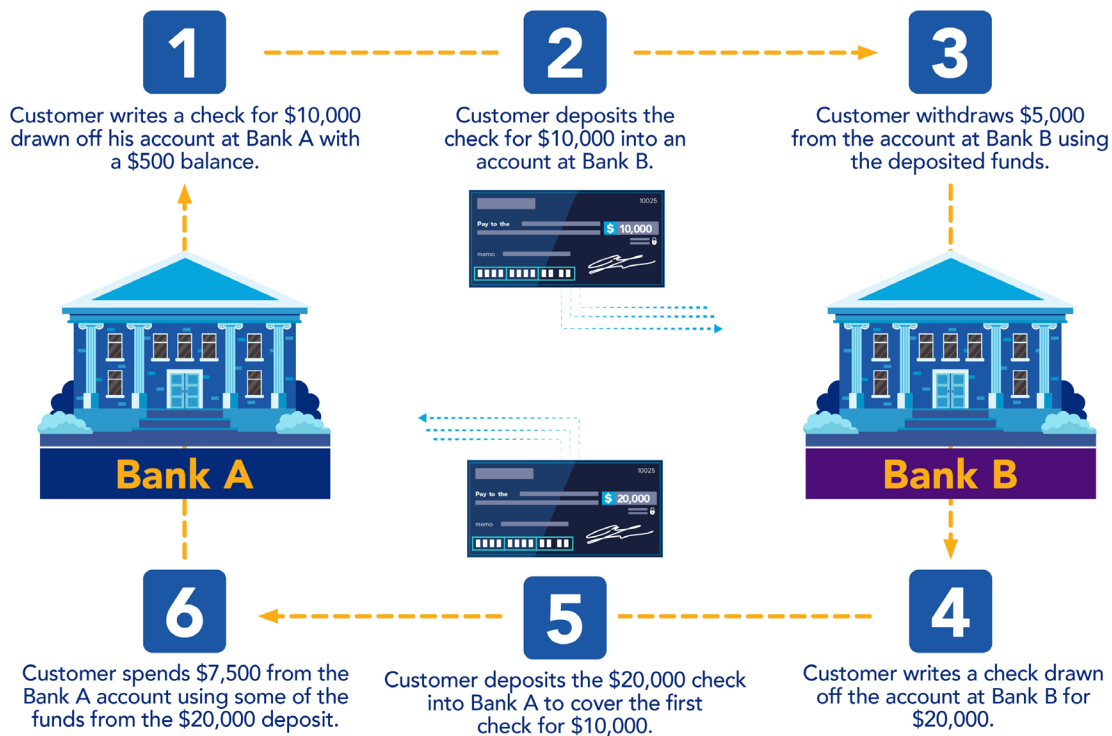


THE ANATOMY OF CHECK KITING

This pattern repeats and the amounts involved may grow over time as the kiter becomes more confident in the timing of his transactions and his ability to carry out the activity undetected.

INCREASING RISK AND COMPLEXITY OF CHECK KITING SCHEMES

As the check kiting scheme continues, it may become larger and more complex. Typically, accounts are matured over time — gradually increasing transaction amounts so the activity does not raise red flags. Customers involved in check kiting also may introduce other accounts and payment methods into the cycle. The example below illustrates how the payment amounts can increase and how the customer withdraws funds from the falsely inflated balances.



As the scheme unravels, the deposited checks may begin returning to the depository institution. The returns may result in overdrawn accounts and potentially, large losses for financial institutions.



THE ANATOMY OF CHECK KITING

IDENTIFYING CHECK KITING

Quick identification of check kiting is key to minimizing potential losses. Some indicators of possible check kiting that may warrant additional investigation include:

- Checks being deposited from and written to the customer (“to-me-from-me” checks)
- Average balance is low compared to the amount / value of incoming and outgoing checks
- Multiple accounts where funds are being transferred back and forth
- Deposit values are comparable to the value of outgoing withdrawals each month
- The amount of the deposits / withdrawals steadily increases each month, but the average balance or collected balance remains consistently low
- An increase in inquiries about account balances and cleared transactions could indicate a customer determining what funds are available and when to deposit another check to cover the next in-clearing check debit in order to continue this scheme
- Debits and negative balances are typically covered with a check deposit instead of cash
- Check deposits returning for insufficient funds
- Checks flowing back and forth between accounts are often for even-dollar amounts
- Incoming and outgoing transaction patterns are atypical for the account type, business or general use of the account

CONCLUSION

Throughout the cycle of check kiting, the amounts involved and the complexity of the scheme — especially if other accounts and transaction types become involved — often continue to grow, creating a significant risk of loss to financial institutions. Early detection is key to minimizing the exposure of check kiting and customers taking advantage of the float timeframe of paper checks. This starts with a solid understanding of the check kiting scheme and its identifying traits to effectively detect and respond to it.

The check fraud mitigation toolkit was developed by the Federal Reserve to help educate the industry about check fraud and outline potential ways to help detect and mitigate this fraud type. Insights for this toolkit were provided through interviews with industry experts, publicly available research, and team member expertise. This toolkit is not intended to result in any regulatory or reporting requirements, imply any liabilities for fraud loss, or confer any legal status, legal definitions, or legal rights or responsibilities. While use of this toolkit throughout the industry is encouraged, utilization of the toolkit is voluntary at the discretion of each individual entity. Absent written consent, this toolkit may not be used in a manner that suggests the Federal Reserve endorses a third-party product or service.