



## Sometimes Fraud Is “Just” Fraud November 1, 2007

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**All forms of value exchange—from cash, checks and wire transfers to ACH payments and card-based products—are subject to fraud and money laundering. Because of the attention now focused on the potential use of prepaid cards as money laundering tools, it seems that when a prepaid card is linked to a fraudulent incident, the specter of money laundering is likely to be raised. It’s important to recognize, however, that money laundering schemes—while dangerous and illegal—may or may not involve fraud. And, although card payments fraud can play a part in money laundering, not all cards payments fraud is money laundering. Sometimes fraud is “just” fraud.**

According to FATF<sup>2</sup>, **money laundering** is processing criminal proceeds to disguise their illegal origin. When criminal activity generates profits, the individual or group involved must find a way to convert the funds to “clean” funds without attracting attention to the underlying activity or the persons involved. Criminals do this by disguising the sources, changing the form, or moving the funds to a place where they are less likely to attract attention. This contrasts with payments fraud that involves cards. Stanley Sienkiewicz suggests in “Prepaid Cards: Vulnerable to Payment Risk?”<sup>3</sup> that card-based payments fraud may include using a stolen payment card or account information to buy goods and services. To this we add, altering data on the magnetic stripes of payment cards, card skimming and counterfeiting, and a variety of inventive schemes—many of which involve insider criminal activity and collusion. It is these types of criminal activities that, when applied to prepaid cards, we regard as “garden variety” prepaid fraud.<sup>4</sup>

When there is a failure to draw the distinction between money laundering and garden variety prepaid fraud (and, unfortunately, not drawing this distinction is a relatively common occurrence), the risks associated with prepaid cards can be mischaracterized and/or overstated. Prepaid products are tainted with the money laundering stigma, potentially inhibiting their growth and limiting the value and benefits they offer to consumers. In addition, failure to delineate the issues clearly has the potential to divert attention from the real issues of preventing and detecting money laundering activity and prepaid fraud.

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<sup>2</sup> The Financial Action Task Force (FATF) is an inter-governmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing. The FATF is therefore a “policy-making body” created in 1989 that works to generate the necessary political will to bring about legislative and regulatory reforms in these areas. [http://www.fatf-gafi.org/pages/0,2987,en\\_32250379\\_32235720\\_1\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/pages/0,2987,en_32250379_32235720_1_1_1_1_1,00.html)

<sup>3</sup> <http://www.philadelphiafed.org/pcc/papers/2007/D2007FebPrepaidCardsandMoneyLaundering.pdf>

<sup>4</sup> The purpose of “fraud” is personal gain at the expense of others. Fraud causes another party—for example, an individual, a bank, or another company—to suffer a loss, often related to the theft of funds. But money laundering isn’t about stealing funds (the funds already have been stolen, acquired illegally, or even acquired legally); it’s about *hiding* the source of the funds. In addition, unlike fraud, money laundering does not necessarily result in a loss. Viewed alone or superficially, money laundering transactions are likely to appear innocuous, creating the ultimate challenge for financial institutions—detecting transactions carefully disguised to launder money from among millions of legitimate transactions.

## Prepaid Cards and Money Laundering

Since the emergence of prepaid cards, there has been significant discussion about their potential to be used in money laundering schemes. Government identifies prepaid cards, or in government terminology “stored value” cards, as a significant channel for money laundering—largely based on its perception of prepaid products as anonymous and unregulated and providing the opportunity to access large (even unlimited) amounts of cash outside of the United States.

Although the network branded prepaid card industry<sup>5</sup> has largely self regulated to increase the barriers to using prepaid cards for money laundering, the reality is that no financial product—no matter how mature or tested—has been able to eradicate its involuntary participation in money laundering schemes. The International Monetary Fund in 1996, well before the introduction of network branded prepaid cards, estimated that “the aggregate size of money laundering in the world could be somewhere between two and five percent of the world’s gross domestic product” —the equivalent of \$590 billion to \$1.5 trillion.<sup>6</sup> This is despite many years of effort by governments worldwide to combat the misuse of financial systems by persons seeking to launder dirty money.

## Prepaid Products Keep Funds *IN* the Banking System

Several examples of prepaid cards used to facilitate money laundering in the United States have been identified, and, sadly, there will be more. But the barriers to misuse that the industry has established combined with existing regulatory requirements (for example SAR filings for most regulated financial services organizations) have contributed to keeping money laundering activities directly involving prepaid cards low. And, industry—through forums such as the NBPCA—is using the documented cases as a tool to evaluate and strengthen its money laundering defenses including prevention and early detection.

The question, which remains unanswerable for a variety of reasons, is whether the electronic footprint left by every network branded prepaid card transaction and the cooperation of organizations involved in prepaid, have enhanced the ability of authorities to detect money laundering. It seems logical that they have.

It also seems logical that in terms of combating money laundering, it is actually *beneficial* to have funds *in* the regulated banking environment rather than outside of it. Which is preferable from the perspective of money laundering prevention and detection: cash transported cross borders using informal remittance systems such as hawala<sup>7</sup> or funds held in a bank account that, when deposited or accessed, leave a transaction history?

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<sup>5</sup> Network branded prepaid cards display the logo of a major acceptance brand and, typically, can be used at multiple retailers to pay for goods and services.

<sup>6</sup> Source: FATF Website [http://www.fatf-gafi.org/document/29/0,3343,en\\_32250379\\_32235720\\_33659613\\_1\\_1\\_1\\_1,00.html#howmuchmoneyislaunderedperyear](http://www.fatf-gafi.org/document/29/0,3343,en_32250379_32235720_33659613_1_1_1_1,00.html#howmuchmoneyislaunderedperyear)

<sup>7</sup> Hawala is an informal value transfer system. Hawala transactions are usually based on trust and leave no written records. According to FATF (<http://www.menafatf.org/images/UploadFiles/TypologiesCross-BorderEng.pdf>), hawala represents funds transferred through an informal network, typically without a “physical or electronic transfer every time a remittance is made.” physical or electronic transfer.

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## **Prepaid Cards and “Garden Variety” Card Payments Fraud**

Labeling card payments fraud not associated with money laundering as “garden variety” is not meant to diminish its serious ramifications and challenges to the prepaid industry. But, the card industry, which includes prepaid, is accustomed to managing this type of fraud and has made huge investments over many years to manage and mitigate risk. Certainly, risk management principles must be (and have been) extended to new prepaid functionalities (such as reload) and new participants in the prepaid value chain (such as program managers and card marketers and distributors).

Often, garden variety fraud involving prepaid boils down to an opportunistic situation. If prepaid cards weren't there, the crime would have occurred nonetheless—albeit in, perhaps, a less traceable way.

A recent example occurred in Nebraska at a Walgreens store, where an employee attempted to load a large amount of funds to multiple prepaid cards. The success of the endeavor was thwarted by the systems of the prepaid program manager, which noted the exceptional value of the attempted load and notified the store. Although the employee used prepaid cards to carry out his scheme, this incident was the equivalent of a dishonest employee putting his hand in the till. The systems in place to support prepaid highlighted the crime and mitigated the damage. Perhaps the same outcome would have occurred if the employee used another vehicle to steal from his employer, but the controls in place to prevent garden variety prepaid fraud worked.

### **Conclusion**

Government is justified in its concern about money laundering and ensuring that financial products, including prepaid cards, are designed and managed to minimize their ability to be used to disguise the criminal origins of funds. But equating simple fraud with money laundering distorts the fact that money laundering may not involve the telltale signs of fraud. This myth is dangerous on both sides: it overestimates the risks of prepaid cards and may underestimate the potentially significant risk of non-fraud transactions.

Preventing money laundering is something that we all can agree on.

But let's make certain that as we continue to scrutinize prepaid cards that we don't jump to the incorrect conclusion that any time a prepaid card is used in a fraudulent scheme that money laundering is involved. The two are clearly different and the recent proclivity to treat fraud as if it were the equivalent of money laundering is a critical error that distorts the problem and the possible remedies.

As with any and all financial products, the safety and security of prepaid cards are paramount. Our zeal to create and maintain a safe and secure environment should include an accurate assessment of the type of risks we are facing.

### **About the NBPCA**

The Network Branded Prepaid Card Association (NBPCA) is a nonprofit, inter-industry trade association that supports the growth and success of network branded prepaid cards and represents the common interests of the many players in this new and rapidly growing payments category. The NBPCA's Working Groups drive the activities of the Association for its more than 35 members. For additional information, visit [www.NBPCA.com](http://www.NBPCA.com).