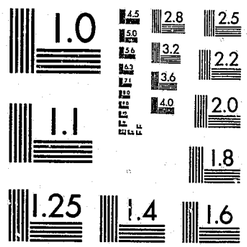

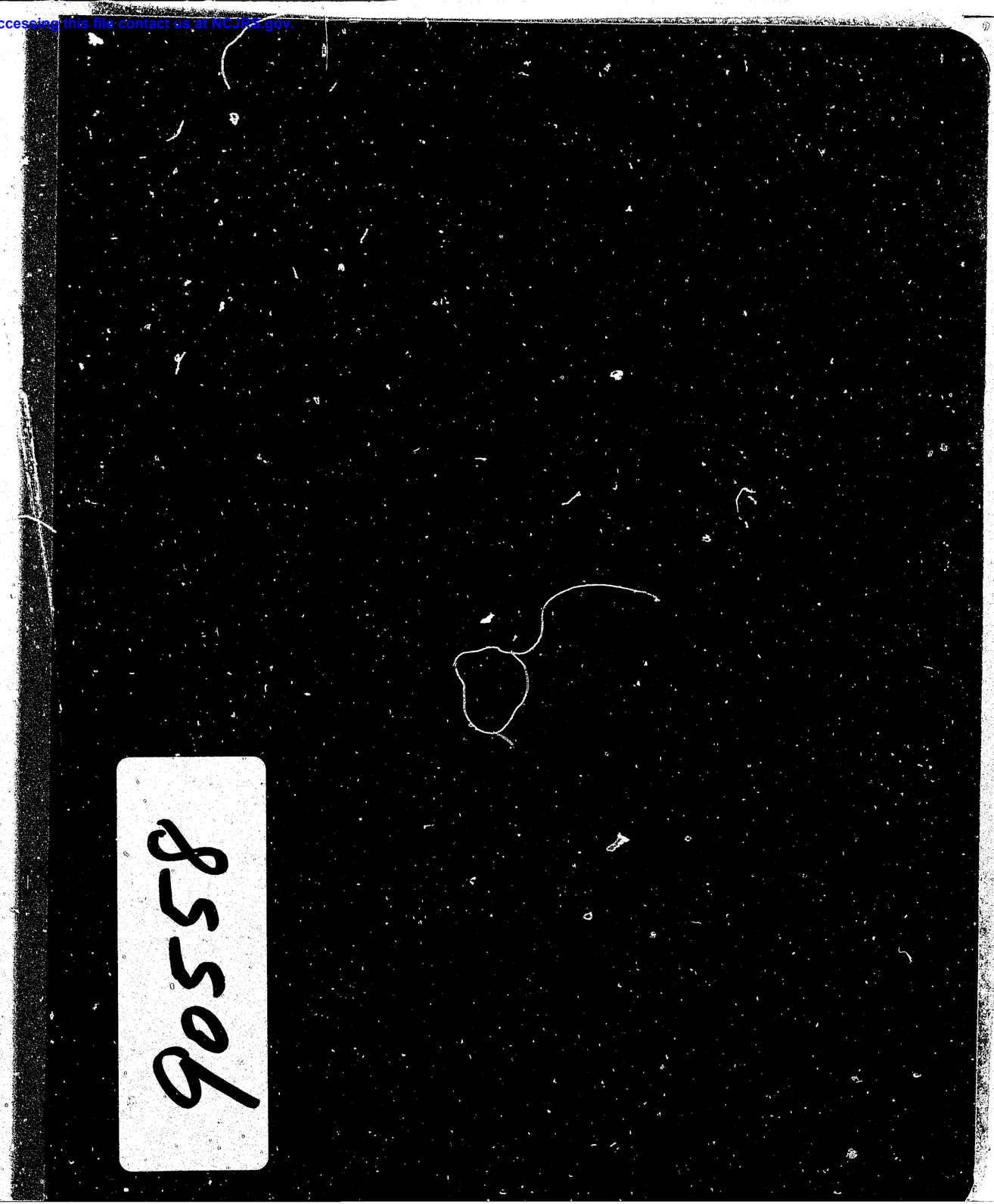

Department of Justice

STATEMENT

OF

JAMES KNAPP
DEPUTY ASSISTANT ATTORNEY GENERAL
CRIMINAL DIVISION

BEFORE

THE

SUBCOMMITTEE ON CONSUMER AFFAIRS
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

CONCERNING

CREDIT CARD AND EFT FRAUD

ON

MAY 18, 1983

Madam Chairman and Members of the Subcommittee, I am pleased to be here to discuss the magnitude of credit and debit card fraud and the adequacy of protection afforded by the Truth in Lending Act and the Electronic Funds Transfer Act for consumers and issuers of credit and debit cards. With me today is Donald Foster, Deputy Chief of the Fraud Section of the Criminal Division. We will be looking at the criminal fraud provisions of the Truth in Lending Act, 15 U.S.C. §1644, and the criminal fraud provisions of the Electronic Funds Transfer Act, 15 U.S.C. §1693n. We will also look at the present and proposed statutes that are germane to the problem of credit and debit card fraud.

Our basic conclusion is that no significant changes are needed with the provisions of these two statutes other than to clarify two problems which have arisen as a result of case law decisions and to broaden their coverage to include counterfeiting and altering of credit cards. We also support changes in the Right to Financial Privacy Act, 12 U.S.C. §3401, et. seq., and a proposal, pending before the Congress in the President's Crime Bill, S.829.

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activity in the credit card area. We are also aware of the dramatic increase in Electronic Fund Transfer (EFT) activity through a preliminary study done by the Department's Bureau of Justice Statistics in June of 1982, and our conversations with the industry representatives. The industry statistics clearly show the increase in credit card fraud: losses in 1981 and 1982 were nine times as great as the total for the past seven years; and the annual loss to the banking community through credit card fraud is far in excess of the proceeds of bank robberies (some $128 million vs. $46.8 million in 1982). Similarly, we realize that the increased numbers of EFT systems and the proliferation of debit cards creates the possibility for the same rapid rise in losses. Since the first Automatic Teller Machine (ATM) was installed in 1970, there are now approximately 26,000 units, each processing an average of 7,000 transactions per month. There are about 50 million debit cards in circulation, triple the number two years ago and almost equal to the domestic circulation of VISA credit cards. We further understand that with ATM network sharing the volume is expected to continue to expand even more dramatically, and ATMs are only one of the five principal EFT systems.

Our concern in this area, however, is not with the high volume, low dollar losses of present or future credit or debit card transactions. The average credit or debit card

fraud loss is small and can be prosecuted on a local level, if prosecution is warranted.

The federal investigation and prosecution effort has not been extensive. The Postal Inspection Service investigated 80 credit card frauds in 1982. The Federal Bureau of Investigation, with separate statistics available on EFT investigations only from October 1, 1982, have investigated nine cases since then. There have been only minimal federal prosecutions using the credit card statute, 15 U.S.C. §1644, and none using the EFT statute, 15 U.S.C. §1693n. There are, as I indicated, far more state and local prosecutions since credit card fraud is traditionally an area handled on a local basis.

These problems, do not, however, mandate a wholesale revision as contemplated in draft bills we have seen prepared by the banking and credit card industry. Some of these bills would involve the Federal Government in traditional areas of exclusively local interest by making virtually every credit card offense a federal office. Some remove the $500 and $1,000 dollar limitations in the amount of loss contained in present law. Since the average ATM transaction in 1982 was only $47.00 and the average crime only $265.00, state prosecution is more appropriate. The high volume, low dollar loss situation is consistent with the use of state prosecution where personnel resources are greater by far.

The Department of Justice has been working more closely than ever before with state Attorneys General and local District Attorneys through our Executive Working Group of Federal, State and Local Prosecutors on a national level and the Law Enforcement Coordinating Committees on a state and local level. After discussing some of the changes the bank and bank card representatives are seeking with state and local prosecutors, we have learned that they are uniformly opposed to any intrusion into this area of traditionally local concern.

Before the criminal sanctions are made more stringent, we strongly believe that card issuers need to do more to protect themselves. For a number of years the credit card issuers provided cards for any and everyone to attract business. Although they say now that they realize the error of their ways and should have had a more selective application and approval process, we see the same type of phenomenon in the tripling of debit cards in two years. Further, counterfeiting and unauthorized access to account information is indeed a problem for the industry, but it is in large part due to the lack of security built into the cards and the internal systems. We would prefer that the credit card and EFT industry leaders continue to improve the integrity of their own systems.

The Department is more concerned about the problem of counterfeiting and altering credit and debit cards. A number of investigations, federal and local, have shown that there exists a substantial problem with organized criminal activity; not traditional Organized Crime, but ring activity of people associated together to commit a variety of crimes. The easy availability of false identification and the sophisticated techniques used in counterfeiting and altering cards makes it very easy for such groups to commit these types of crimes to support other criminal activity. We could support the amendment of the two statutes to cover counterfeiting and altering of the account numbers.

The federal prosecutions in the credit card area do reveal certain defects in the Truth in Lending Act credit card statute that could be corrected. The Ninth Circuit Court of Appeals held in 1982 that the communication by telephone between Spokane, Washington, and Reno, Nevada, of fraudulently obtained credit card account numbers is not covered by the statute [United States v. Callihan, 666 F.2d 422 (9th Cir. 1982)]. However, the court also held that the conviction under the wire fraud statute, 18 U.S.C. §1343, for transmitting the account number information was valid. As you are aware, had the telephone call not crossed state lines and thereby affected interstate commerce, the wire

fraud statute would not have been applicable. The credit card statute could, therefore, be amended to include the fraudulent use of account numbers and information alone rather than the entire plastic card itself.

Other cases have highlighted a problem area with the statutory phrase "fraudulently obtained." Credit cards may be obtained by the original cardholder without an intent to defraud. They may later be sold or given to a defendant with the knowledge that the defendant would use the card to charge purchases without paying for them. Then the cards may be reported stolen or lost by the original cardholder. Under the present credit card statute, the cards are not "fraudulently obtained" within the meaning of the statute. Title 15 U.S.C. §1644 could therefore be amended to include transferring or obtaining a credit card as part of a scheme to defraud.

Since the EFT statute, 15 U.S.C. §1693n, parallels the credit card statute almost word-for-word, it also could be amended in these two respects.

To the extent that the subcommittee is reviewing federal statutes affecting the ability of the federal government to investigate and prosecute fraud against financial institutions and other credit card issuers, I would invite your attention to the Right to Financial Privacy Act of 1978, 12 U.S.C. §3401, et seq. That statute

impedes federal law enforcement efforts directed at crimes against financial institutions [which term embraces credit and debit card issuers, 12 U.S.C. §3401(1)] by prohibiting such institutions from disclosing financial records evidencing a fraud scheme except pursuant to legal process. Thus, a financial institution that has been defrauded cannot report the offense to federal law enforcement officials complete with copies of financial records evidencing the crime. Rather, they must engage in a game of "Twenty Questions" with the Federal Bureau of Investigation in an effort to provide us with sufficient information to enable federal officials to establish the basis for issuance of a grand jury subpoena or other form of legal process necessary to secure access to the records that evidence the crime. The Financial Privacy Act also restrains the ability of federal bank supervisory agencies to transfer information relating to criminal activity to the Department of Justice.

In short, financial institutions are severely restricted by the Financial Privacy Act in their ability to report crimes, even when the financial institutions are themselves the victims. Any mistake by a financial institution in reporting a crime to federal authorities exposes the institution to potential civil liability under 12 U.S.C. §3417. Moreover, any technical defect in a disclosure of records by a victimized financial institution

entitles the fraud perpetrator to liquidated damages against the institution without regard to whether he was guilty of defrauding the bank. From a law enforcement perspective, it seems incredible that a financial institution could be punished civilly for reporting a crime against itself, yet this is the law today in the United States.

I would also like to comment briefly on a pending legislative item that impacts on the Credit Card and EFT Acts. It is contained in the President's Comprehensive Crime Control Act of 1983, S.829, Title XV, Part H, Section 1508. Present laws designed to protect banks cover the offenses of embezzlement, robbery, larceny, burglary, and false statements. The proposed statute is designed to fill the gaps in the present law regarding defrauding banks. It is modeled on the present mail and wire fraud statutes and proscribes a scheme or artifice to defraud a federally charted or insured financial institution or to obtain property owned or under the custody or control of such an institution by means of false or fraudulent pretenses, representatives, or promises.

In conclusion, let me summarize our position. We support a tightening of the EFT and Truth in Lending statutes since case law has demonstrated a need to include account numbers and information within the definition of credit card and to expand the covered acts to obtaining or transferring cards as a part of a scheme to defraud. We

support an expansion of both statutes to provide protection against counterfeiting and alteration. We support the President's Comprehensive Crime Control Bill that will fill in a gap in existing law on schemes and artifices to defraud banks.

However, we do not support lowering existing minimum dollar loss requirements for federal jurisdiction. Ordinary credit card fraud is an area of local concern, traditionally addressed by state and local prosecutors. Existing federal law is adequate.

Thank you for this time. We will be pleased to answer any questions.

END