

PROPERTY & CASUALTY

An Old School Mitigant for a Low-Tech Problem Check Fraud and Your Fidelity Bond

By, Judd Zimmerman and Vincent Filippini



Low-tech risk continues to rear its head as the world races to achieve its digital ambitions. This has played out geopolitically and is now impacting the banking community. While 90% of community banks indicated they are ready to implement new digital initiatives, and 40% said they are already integrating artificial intelligence and machine learning into their strategic plans,¹ old school check fraud remains an outsized problem for the banking community. Bad actors continue to develop new strategies to cash fraudulent checks, and some continue to use old-school methods.

No matter the method, losses from check fraud add up for banks worldwide. Last year, check fraud cost banks \$27 billion globally, 80% of which was in the Americas. Three of the most common methods for check fraud include mail theft, marketplaces on the dark web for exchanging stolen checks and fake check deposits at ATMs.

While numerous technology solutions exist to combat this issue, and employees are becoming more adept at identifying fraudulent activity, the problem persists. The good news is that one of the most longstanding insurance products, the financial institutions bond (FI bond), is designed to cover the common methods used to commit check fraud.



Check Fraud through Mail Theft

One traditional method bad actors use to commit check fraud is mail theft. This involves stealing checks from mailboxes, postal facilities or other points in the mail system. Once stolen, fraudsters may employ techniques like “check

washing,” where chemicals erase the ink on the check, allowing them to rewrite it with new payee information and amounts. Alternatively, they might forge endorsements or create counterfeit checks using the stolen information. These altered or forged checks are then deposited or cashed, resulting in financial losses.

The primary area where a financial institution can find coverage is under the unauthorized signature or alteration coverage portion of the FI bond. This provision covers losses resulting from the forgery or alteration of checks. This coverage would likely apply if checks were stolen through mail theft and subsequently altered or forged.

Another potential avenue of recovery is through the in-transit portion of the FI bond. This coverage is designed to protect against property losses, including checks, due to robbery, larceny, theft, misplacement or other disappearances during transportation. Under this coverage, the check would need to be in the custody of a messenger or transportation company, which are defined terms under the policies.



Under both insuring agreements, the deductibles would apply, and the insurer would begin to pay the financial institution for losses once the deductible is met.

Check Fraud through Marketplaces on the Dark Web for Exchanging Stolen Checks

A new method for bad actors to commit check fraud is through exchanging stolen checks on the dark web. Stolen checks are sold on dark web marketplaces, where criminals can purchase them for a fraction of their face value. These checks are then used in various fraudulent schemes. Buyers of these stolen checks may alter or use them as-is to make unauthorized withdrawals or deposits. The anonymity and vastness of the dark web create a thriving ecosystem for such illicit activities. It also allows one bad actor to gather a large number of checks without having to steal mail or seek them out through other physical means.

Like the first scenario, the unauthorized signature or alteration coverage portion of the FI bond would likely cover losses from forged or altered checks, assuming the bad actor altered the signatures or provided some form of altered signature once they received the physical check. This coverage is likely to apply regardless of how the bad actor obtains the check and would be subject to the deductible amounts in the policy.

Another area where a financial institution may find coverage is the computer systems fraud coverage provision. This provision is intended to cover the financial institution's own computer system. It covers losses from fraudulent electronic data entered or changed within a computer system, resulting in currency or property changing possession fraudulently. Depending on how the bad actor obtains or uses the information from the dark web, this coverage may apply, subject to a deductible.

Check Fraud through Fake Check Deposits at ATMs

Another common scenario where a bad actor can commit check fraud is through fake check deposits at ATMs. In this case, fraudsters create counterfeit checks that look legitimate and deposit them at ATMs. Due to regulations requiring banks to make funds available quickly, the fraudsters can withdraw the money before the bank realizes the check is fake. This type of fraud exploits the time gap between the deposit and the bank verifying the check's authenticity.

Much like the two previous scenarios, the unauthorized signature or alteration coverage portion of the FI Bond would likely apply, subject to the deductible. Beyond that coverage, the FI Bond's computer systems fraud coverage provision may also apply. The entry of a check into the ATM may be seen as the entry of fraudulent electronic data into the financial institution's computer system.



Check Fraud through Remote Deposit

As more people turn to mobile apps and online platforms for their banking needs, remote deposit has become a new vulnerability for check fraud. Fraudsters can try to deposit checks with unauthorized signatures or alterations through online applications. Since these checks are deposited using images captured by a camera, there is less human oversight, reducing the likelihood of detecting discrepancies.



Practical Application of a Fidelity Bond as a Check Fraud Mitigant

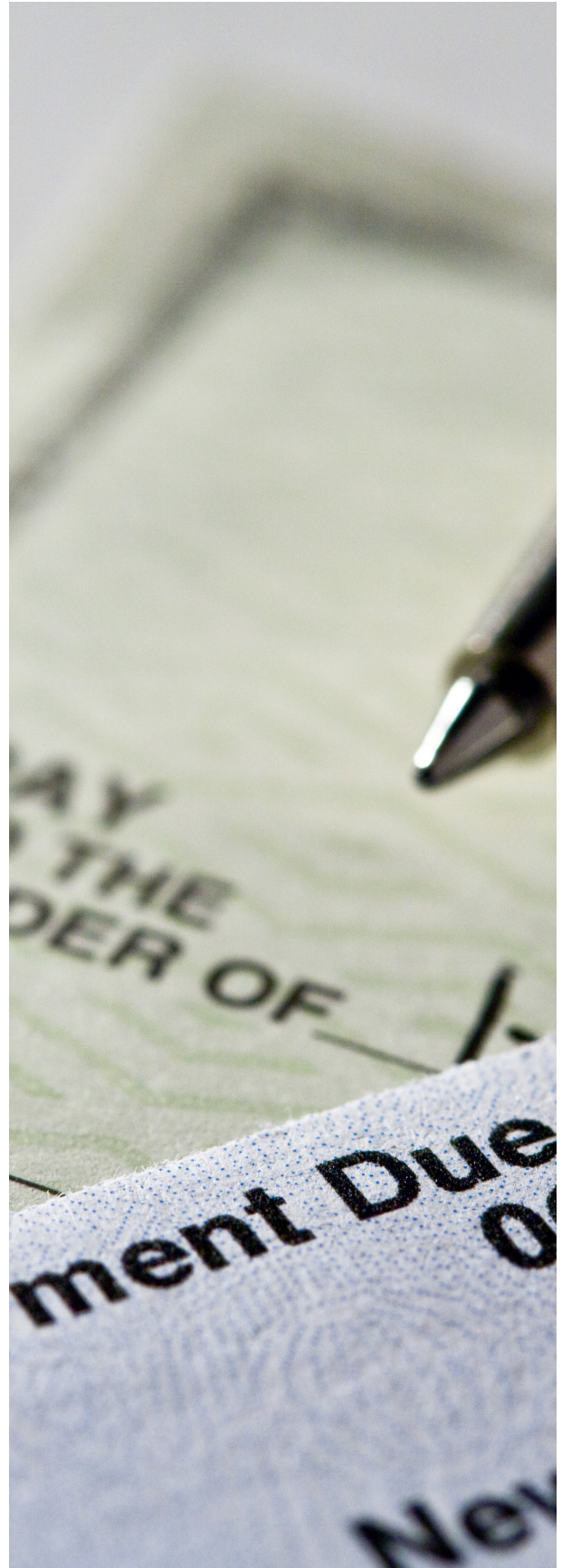
In each scenario, the insuring clause most likely affected is unauthorized signature or alteration. However, depending on the specific circumstances, reviewing other insuring agreements is important to help ensure maximum coverage.

While the above examples are likely to trigger coverage under a typical fidelity bond policy, policy deductibles can nullify any actual claim recoveries. Deductibles are intended to eliminate moral hazard through risk-sharing with the policyholder. Ultimately, neither the insurer nor the policyholder benefits from “trading dollars” on frequent and/or de minimis losses. It is critical that financial institutions size their deductibles according to the nature of their business and their risk appetite for fraudulent losses. For example, a bank’s risk appetite to assume smaller check fraud losses arising from its personal checking business may be greater than its appetite to assume losses from a commercial checking business.



Conclusion

Because the financial services industry is still far from fully preventing check fraud and bad actors continually find new ways to exploit checks, it is important to have an FI bond policy in place to help mitigate losses related to check fraud. The FI bond has been a profitable product to the insurance industry for decades. While the bond’s overall shape and utility have stayed consistent over the years, certain bond insurers are willing to creatively explore adaptations to support the banking community in managing check fraud risk. Experienced insurance brokers can help your organization work with your FI bond insurer to obtain and structure a policy that meets your needs, provide claims support and align coverage terms and conditions to your organization’s risk appetite.



1. 2024 Bank of New York Community Bank Survey



How Brown & Brown Can Help

Connect with our Brown & Brown team to learn about our knowledge in your industry, how we build our risk mitigation strategies and how we can aid your business in building a cost-saving program.



Find Your Solution at [BBrown.com](https://www.brownandbrown.com)

Brown & Brown, Inc. and all its affiliates, do not provide legal, regulatory or tax guidance, or advice. If legal advice counsel or representation is needed, the services of a legal professional should be sought. The information in this document is intended to provide a general overview of the topics and services contained herein. Brown & Brown, Inc. and all its affiliates, make no representation or warranty as to the accuracy or completeness of the document and undertakes no obligation to update or revise the document based upon new information or future changes.

©2025 Brown & Brown. All rights reserved.