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Zelle® Banks Exert Their Ownership Control, Contemplate a Change to a Key Fraud Loss Policy

EasCorp's President and CEO, Cindy Nelson, recently caught up with EasCorp's independent expert on payment systems, Peter Tapling, and one topic dominated their discussion – Zelle® and its center stage presence in 2022. The following is a compilation of their online correspondence which took place over several days. It has been edited for clarity only.

In case you don't know, Tapling is the lead instructor at EasCorp's Instant Payments Academy, which gets underway at the end of January.

NELSON:

Peter, US consumers have warmed to the concept of instant payments. Zelle has delivered on the promise of value moved from one person's account at a financial institution to another person's account at a different financial institution with real time funds availability. Zelle has clearly proven popular with consumers, recently eclipsing 5 billion transactions in just over 5 years in operation.

With all that popularity, recent news coverage about Zelle has been more focused on fraud concerns than its popularity. The owners of Zelle are reportedly working on a plan to compensate customers who fall victim to scams.

What does this mean for Zelle? And what does it portend for instant payments more generally?

TAPLING:

First, it is important to understand that Zelle is an overlay service, not an instant payment rail itself, and can move money a variety of ways. But you are right to draw the line between Zelle and instant payment rails like RTP® and FedNowSM.

The value proposition of Zelle is the immediate delivery of funds, between financial institution accounts, from a sender to a receiver. Zelle, and the instant payment schemes, work on a "credit push" model. The sender of funds controls the transaction, and money will not move unless funds are available and the account holder has authorized the transaction.

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Perhaps more importantly, the movement of funds is irrevocable – once done, it cannot be undone. That irrevocability means that there is no limit on usage of the funds by the receiver. It also means that there is no structured way for the sender to get the funds back using the Zelle platform.

Fraudsters, too, appreciate the value proposition of instant funds availability. Fraudsters know that if they can get their prey to send money via Zelle to an account they control, then they can immediately have access to the money.

But, despite what people are reading, Zelle remains a relatively safe way to move money digitally. As reported by the Bank Policy Institute, disputed transactions make up just 0.06% of Zelle transactions. By comparison, this is lower than some other P2P services and in line with historical fraud rates for all payment types.

NELSON:

So, if the fraud percentage is so low, then what is driving all of this negative attention on Zelle?

TAPLING:

Much of the press around “fraudulent Zelle transactions” is focused on scams – situations where a nefarious actor convinces an unwitting person to authorize a payment to an account they control. That said, this type of scam is not new. The United Kingdom (UK), which has had instant payments available since 2007, recognized this as a recurring theme and even coined the phrase “authorized push payment fraud” for this activity.

Here in the United States, we have trained consumers that if they used a bank-provided service to move money electronically, then they likely have some recourse to retrieve their funds. Programs like credit card “zero liability” and protections under Regulation E provide recovery options in a variety of circumstances – ranging from items being the wrong color when received, to transactions initiated using stolen credentials. This works because the underlying forms of payment – credit card, debit card, ACH, etc. – are supported by delayed settlement mechanisms and have rules for revoking a payment. Regulation E, particularly, protects customers from unauthorized transactions, but such protections are not available if a transaction is authorized.

Zelle payments, and indeed instant payments through RTP and soon FedNow, only support credit push transactions which are authorized by an account holder. These transactions are settled instantly and are by their very nature irrevocable.

Enter the “authorized” push payment. When a fraudster can convince, cajole, coerce, deceive, or dupe a consumer into making a payment, the fact is that the consumer is still in control and chose to make the payment. It is this act of control and authorization that sets this form of loss apart.

When true fraud occurs – account takeover, stolen authentication credentials, etc. – financial institutions continue to provide some protections to their members and customers. But when the account holder authorizes the transaction, no inherent protections exist.

NELSON:

So, in an authorized push payment, if the person approving the payment is the rightful owner of an account, then where is the fraudster?

TAPLING:

They must be on the receive side of the transaction! Or, more likely, somewhere downstream from the receive side of the payment.

It is possible that the account receiving the payment from the unfortunate party is an account which belongs to the fraudster. But that would be too simple. More likely it is an account over which the fraudster has some control. That control could be through further coercion (they've duped the receiving account holder), collaboration (the receiving account holder is providing a service), a sleeper account (opened solely for the purpose of moving illicit funds), or opened and held under a synthetic identity.

Once funds arrive in the first account, they are frequently divided and moved quickly to one or more subsequent accounts before being exfiltrated by the bad guys. This washing of the funds makes it very difficult to find the precise dollars taken from the first victim to return them directly.

NELSON:

Can you explain the reimbursement model being suggested for Zelle?

TAPLING:

The idea being floated by the owners of Zelle is an arrangement under which a member who has lost money due to an authorized push payment scam would be reimbursed. The reimbursement would be funded by the financial institution on the receive side of the transaction. In the reports, the receive side financial institution would be responsible for 100% of the reimbursement. Contrast this with a model under consideration in the UK called Contingent Reimbursement in which the sending and receiving financial institutions would share the reimbursement responsibility 50/50.

This model puts pressure on all participants in the Zelle network to increase diligence on all accounts. Still, credit unions will have to balance Zelle reimbursements with customer demand. And some credit unions could discontinue offering instant-payment apps like Zelle if required to reimburse consumers who are victimized by scams.

When choosing an instant payments path, credit unions will need to evaluate the competitive landscape to determine what P2P offering strikes the right balance between risk and customer satisfaction. For any Zelle alternatives, is the alternative providing greater value to the member while strengthening the relationship with the institution? And, what are the risk tools available to assist with mitigating potential fraud?

For the US instant payment rails, RTP and FedNow, there is no news discussing a reimbursement scheme as of this writing, but such a model seems likely. For financial institutions considering adoption of these new payment capabilities, a consistent mantra has been that "receive only is risk free." But under a reimbursement model as described above, there would clearly be some risk. However, the risks are manageable.

NELSON:

What suggestions do you have to manage the risks?

TAPLING:

Education of your member base is critical. We can again lean on the UK for an example in their Take 5 to Stop Fraud program. Provide resources to each of your members to ensure they take the time to verify payees, teach them to stop when something doesn't feel right, and remind them to always protect their account information. Financial institutions should review account onboarding processes and redouble efforts to prevent opening accounts for synthetic identities.

Consider enhanced account monitoring to identify suspicious activities, such as those that would indicate money mule accounts. Check with your risk management vendors – many of these platforms have evolved to include detection of these specific kinds of threats. And, speak with your outsourced providers about options they can include. Educate members and staff to be aware of, and be on the lookout for, money mule activity.

NELSON:

How does what we've discussed apply to FedNow and the adoption of instant payments?

TAPLING:

Instant payments provide real value to customers – consumers and businesses alike. All forms of payment carry the risk of fraud and financial institutions will, as always, be at the forefront of addressing payment fraud concerns. Instant payments will continue to be popular and financial institutions will be central to protecting these payments. In the new world of irrevocable payments, a new model of protections will evolve. It seems a reimbursement structure is likely to come into being. That could be soon for Zelle, and we can look to whatever happens with Zelle to inform similar models for RTP and FedNow.

NELSON:

Thank you, Peter. Our member credit unions can count on EasCorp to keep an eye on related developments.

We invite you to attend the EasCorp Instant Payments Academy to learn more about instant payments and the FedNow service. Session 3 of the Academy, in particular, covers business considerations of instant payments, including the risk of fraud. Issues like those addressed in our correspondence will be covered broadly and deeply in that session.

You can also register for all of EasCorp's Instant Payments Academy Sessions at <https://www.eascorp.org/company/NewsEvents.aspx>. Session 1, Instant Payments 101, will be held on Tuesday, January 31, 2023 at 2:00 p.m. ET.

Peter Tapling serves on the board of advisors group for the U.S. Faster Payments Council and as chair of the Directory Models Work Group. He was Chief Revenue Officer for Early Warning Services during the launch of Zelle. As managing director, PTap Advisory, LLC he has been advising on the topic of instant payments since 2018.

If you would like additional information regarding EasCorp's Instant Payments Academy or FedNow Solutions, then please contact Michael O'Brien (mobrien@eascorp.org) at 800.428.1144, Ext. 3324.



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