



BULLETIN

No. B-89-1

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Subject: Merchant Fraud - Bank Issued Credit Cards

It has come to the Department's attention in recent months that "merchant fraud" has become a serious problem in the bank credit card industry. A number of Tennessee banks have recently become victims of this type of activity. So-called "telemarketing" companies have been the principal perpetrators - products such as vacation packages, vitamin products, and jewelry are marketed by phone on a large scale. Often, a mass mailing notifies individuals that they have "won" a valuable prize which can be claimed by calling an 800 number. The caller is then enticed to give out his credit card number, either for "identification" or for payment of a small service charge. The caller will later find that his account has been charged with an amount in excess of the price quoted, or, that the product is actually of little or no value. The volume of sales slips deposited under these schemes may reach hundreds of thousands of dollars within a short period of time - two or three months. Of course, a flood of charge backs ensue - but by then the merchant's DDA account has been depleted by withdrawals, and the bank is left with an uncollectible overdraft.

Banks are urged to use extreme care in the approval of new merchant accounts - these accounts, in effect, constitute an unlimited line of unsecured credit. All Visa and MasterCard rules should be observed, including an on-site visit to the proposed customer and a thorough credit investigation.

When the fraudulent operators are unable to convince a bank to accept their business, they seek out a third party to "factor" or "launder" their sales slips by depositing them in a depository bank along with their legitimate slips. Although this practice is prohibited by the rules of both Visa and MasterCard, the merchant may be tempted by an offer of 5 or 10 percent of the sales just to run the items through his account. Banks should monitor merchant accounts for warning signals such as sudden increases in volume and large numbers of hand prepared sales slips for the same amount. Merchant activity reports should be monitored on a regular basis and all suspect situations investigated.

The Visa and MasterCard organizations are in the forefront in the ongoing battle against merchant fraud, and we encourage all Tennessee banks to cooperate fully in the effort to eradicate this problem.