A FINANCIAL FRAUD CRACKDOWN WON'T PROTECT CONSUMERS FROM SCAMS

CONSUMER CHOICE CENTER

# ANALYSIS OF THE PROTECTING CONSUMERS FROM PAYMENT SCAMS ACT


**Authors:**

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# INTRODUCTION

"There's a sucker born every minute" is a quote sometimes attributed to American circus promoter and showman P. T. Barnum. Though it likely didn't originate with him, we know the sentiment very well.

Hucksters, scammers, cheats, fraudsters, and criminals are a dime a dozen, and you've likely interacted with a few in your life. Our electronic way of life has only added to this threat.

In the United States, our nation is awash in scams and fraud, many of which are committed online. For 2023, the Federal Trade Commission reports that over $10 billion was lost to fraud and scams, ranging from investment scams to identity theft and social engineering.

While consumers have generally gotten savvier about detecting frauds, the deceivers and swindlers have grown more sophisticated and adaptable to new technology and trends.

In response, companies have poured billions of dollars into fraud detection and prevention. Federal agencies such as the Consumer Financial Protection Bureau have upped their enforcement for firms not for the criminals responsible for the scams but for the platforms the criminals are using.

At the same time, a cottage industry of security specialists, technology providers, and educators have also developed new methods available to both consumers and financial institutions to stop frauds and scams in their tracks, vastly improving the tools available to better protect potential victims. The industry is expected to grow to $53 billion by 2024.

In Congress, a legislative response has been found in the *Protecting Consumers From Payment Scams Act*, introduced into the House by Rep. Maxime Waters (D-CA) and into the Senate by Sens. Richard Blumenthal (D-CT) and Elizabeth Warren (D-MA).

The bill attempts to codify a new category of "fraudulently induced" transactions, while demanding that participating financial institutions reimburse customers for any losses occurred due to fraud or scams. It also attempts to shield consumers from their own financial errors in transactions, forcing repayment or reimbursement while also penalizing any financial institution that may restrict access to an account if transactions are deemed suspicious or fraudulent.

In this policy primer, we will examine and analyze the effects of the proposed bill on financial institutions, payment providers, and consumers, as well as suggest alternative methods that would alleviate some of the unintended consequences that shifting liability would create, or perhaps prevent their necessity in the first place.

# THE CREATION OF NEW LIABILITY

The starkest provision of the Protecting Consumers From Payment Scams Act is the new shift of liability that places the financial burden of scams onto financial institutions, while absolving those who commit them.

If a fraudster requests a payment using a financial app or platform, and a victim sends a payment from their own app, both institutions would be responsible for reimbursing the victim if it is later deemed that the transaction was "fraudulently induced". The legislation does not address alleged criminals or clawing back the money from their fraudulent activity, which should be the more pressing concern.

Now, who would make the determination that fraud took place? Today, if a customer falls for a scam or fraud, and sends the money willingly with full knowledge of where they were sending it, they are free to take legal action against those who they believe have defrauded them. Tort law exists for this reason, and criminal penalties can apply if the money is large enough to warrant police intervention.

At the same time, financial institutions will have different processes for reversing or reimbursing charges their customers will claim were fraudulent. When transactions are disputed and flagged by customers, a financial institution will conduct their own investigation and determine whether the charge should be reversed or reimbursed, and where this money should come from, in line with Regulation E from the Federal Reserve's guidance.

While such practices are much easier in credit card networks, which assume as much as 5% to 10% of charges to be disputed, it is much more difficult with debit card and bank transfers where settlements are final.

The bill as written makes room for eventual rulemaking to outline a process for flagging fraud and determining liability, led by the **Consumer Financial Protection Bureau**, the independent federal agency charged with protecting consumer finance. If the *Protecting Consumers From Payment Scams Act* is enshrined into law, the enforcement of liability would be carried out by the CFPB, and would likely reduce the agency of banks and financial institutions in deeming a transaction fraudulent or "fraudulently induced".

The shifting of liability unfairly places the financial burden of criminal activity on financial institutions and their customers. These firms are already required to monitor transactions they deem fraudulent, suspicious, or classify as potential money laundering, in line with the *Electronic Fund Transfer Act* and the *Bank Secrecy Act*.

What's more, any transactions above a certain threshold or deemed suspicious automatically trigger a "Suspicious Activity Report" which must be sent to the **Financial Crimes Enforcement Network** of the **Treasury Department**, of which there are approximately 24 million per year. As a recent case in the news has proven, these rules are severely enforced by the **Department of Justice**.

Considering that financial institutions are already required to collect *Know Your Customer* information on their customers, as well as monitor transactions that could violate the **BSA** and **EFTA**, banks and FinTech firms are already obligated to surveil transactions and avoid any risky behavior or customers.

It is for this reason that many Americans find themselves getting "debanked" or remain "unbanked", deemed too risky for financial institutions that are ultimately liable for any transactions that could violate the law. While the reasons are varied, a shocking 4.5% of American households do not currently have bank accounts and an underreported number of them have had their accounts closed without their consent.

If financial institutions are forced to assume liability for scams or fraud their customers fall victim to, no matter the circumstance, it stands to reason that any bank would be forced to raise fees that would be passed on to consumers. Thus, with the introduction of liability for potentially fraudulent or "fraudulently induced" transactions, financial institutions will face new risks that could be avoided by becoming much more selective with their customers, denying those with unsteady or irregular income, lower income limits, too many peer-to-peer transactions, or any other criteria.

The forced compliance would also drive higher costs as banks and financial institutions would be driven to more forcibly surveil the transactions of their customers, either by using new algorithms and technology or hiring new staff. Overall, this would have the effect of degrading the customer experience as transactions are policed more heavily, and perhaps even lead to fewer affordable or "free" options for both banking and checking offered to consumers. More than anyone, this would have a direct negative impact on those less well off or who cannot afford more premium banking services.

## HANDCUFFING INSTITUTIONS FROM COMBATING FRAUD

Paradoxically, the bill also adds a provision that if a bank account is restricted because of suspected fraud or any other reason, "error resolution duties" would have to apply, thereby defanging a financial institution's ability to stop a bad actor or to protect their customers.

If a bank or financial institution freezes an account for suspected fraudulent activity, either in sending or receiving, it would therefore also become financially liable as long as that account is restricted.

By requiring financial institutions and payment apps to assume liability for "fraudulently induced" transactions while at the same time subjecting them to fines for proactively protecting accounts by restricting them, the legislation creates a Catch-22 for any bank or app that effectively handcuffs them and restrains their ability to combat fraud.

Banks and financial institutions, as well as nascent FinTech apps and platforms, already have a required amount of due diligence to apply to each customer and transaction. To increase this for the sole purpose of detecting fraud or scams, without giving these same institutions the adequate tools to root out these issues would not only be ineffective but counterproductive.

## CONSUMER FINANCIAL EDUCATION

What is lost in the debate over the liability for fraudulent or scam transactions is the role of the customer themselves and the notion of personal responsibility and education.

Though many of us have been hardened to be suspicious of giveaways, sweepstakes, or too-good-to-be-true opportunities when it comes to money, there is no doubt that we could all do much better. Technical sophistication, as mentioned above, is making scams more targeted and more compelling for us to fall for.

Owing to this, many financial institutions, FinTech apps, or payment services offer various informative steps and tools to better inform their customers of certain risks when they depart with their money. The double-checking of account numbers or email addresses, as well as strict payment references, ensure that customers aren't making mistakes or getting swindled.

While these apps can steer their customers away from mistakes, mishaps, and more obvious scams with some educational or platform tools, there is no viable way to completely prevent them from spending their own money. This is a risk we all take as consumers who trust a bank or platform with our money.

If banks and financial institutions are forced to do everything possible to restrict customers from withdrawing and sending money, based on the risk of fraud or scams, there is a very reasonable concern that they are completely degrading the consumer experience.

Indeed, if consumers cannot reasonably send or access their money for legitimate purposes, it defeats the purpose of trying to police any inducements to fraud. In conjunction with the additional surveillance required by the federal government on banks and payments apps, customers are further removed from their ability to control their funds and decide how to spend it, lest they trigger an alert that results in their accounts being disabled or shut down.

In order to be reasonable, therefore, we propose that additional consumer finance education be offered and encouraged as a method for avoiding susceptibility to fraud or scams in the first place. Whether through the CFPB's outreach programs or through block grants to states that implement these in their educational curricula, there is a role to play for proper financial education that makes consumers savvier with their money. And it doesn't all have to come from the government.

There's a reason why popular radio host and financial guru Dave Ramsey has over 14 million listeners on over 600 radio stations each week and popular TikTok accounts like Caleb Hammer's "Financial Audit" can easily rack in tens of millions of views per video.

Financial advice, as well as improved financial literacy, is a booming market that provides information and knowledge that can better empower and inform consumers who want to be smarter with their money.

Being more mindful with spending, saving, and investing is not only a prudent strategy for consumers to care for their families and their lives, but it is also the most battle-hardened approach to safeguarding them from scams and dupes that could otherwise steal from them. We must also grant agency to consumers to protect and better educate themselves without vastly re-shaping the nature of our banking relationships.

Creating a new liability for payment providers whole cloth, while ratcheting up the compliance and surveillance that must be carried out by banks, ultimately has the result of absolving personal responsibility and infantilizing consumers, which would do nothing to prevent fraud and scams.

# OTHER APPROACHES

While identity theft was briefly mentioned in the introduction of this primer, we know that the stealing of personal information via social engineering or data hacks is also a primary attack vector for customers victimized by scammers and fraudsters.

Increasing penalties for these actions would go a long way to deter criminals who otherwise face lax punishment in the event they are caught, either through a national privacy law that can protect consumers' information and punish bad actors who misuse it.

Past attempts at national privacy bills have not addressed this in a satisfactory way, preferring to create new private rights of action against companies to punish fraudsters, but we can hope that an eventual version would satisfy these demands while remaining consumer-friendly.

The *Saving Privacy* Act, a bill introduced by Sens. Mike Lee (R-UT) and Rick Scott (R-FL), would take the opposite approach of the *Protecting Consumers From Payment Scams Act*, repealing the threshold requirements for Suspicious Activity Reports and increasing the warrant requirements for government agencies requesting financial information from banks and citizens.

It would also require congressional approval for any new financial regulations as a means of reducing the compliance and surveillance weaponization that have led to more debanking and unbanked Americans.

# CONCLUSION

Though scams and fraud are a persistent issue in the American economy, and for many of our bank accounts, we should guard against the imposition of yet more costly and intrusive rules that will degrade the consumer experience and likely create more amenable conditions for bad actors to steal.

Rather than creating a new liability between financial institutions that would have unintended consequences for consumers of all income levels, authorities should concentrate on finding and punishing fraudsters and scammers we can already catch.

Systematic and institutionalized fraud is wholly within the scope of existing law and should be punished as such or should be folded in for the consideration of a new national privacy law.

We should also empower financial institutions to better inform and educate their customers, adding to the ever-important market of financial education and literacy that is influencing better behavior for consumers when they spend their own money.

Creating new powers or liabilities for fraud on parties that aren't a party to them will necessarily lead to more crackdowns and scrutiny of law-abiding and responsible citizens who are using their money as they see fit.

While we should commend legislators for attempting a solution to frauds and scams, we cannot accept the false promise that more rules and regulations on those who follow and abide by the law will deter those who have so far evaded responsibility or punishment.

# REVIEW

1. Shifting liability to financial institutions will ultimately backfire on consumers, leading to more expansive financial surveillance, higher costs due to more compliance and reimbursements, and a generally degraded consumer experience that eradicates the advantage of popular financial tech and banks.
2. Consumer financial education is the most effective way to prevent scams.
3. A national privacy law that fosters innovation while protecting consumers would help guard consumer data to avoid encounters between consumers and scammers.
4. Stiffer penalties for individuals committing frauds and scams should be utilized.

# ABOUT THE AUTHORS

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Yaël Ossowski is a consumer and technology advocate, journalist, and writer. He is deputy director at the Consumer Choice Center.

Since 2010, he has worked as a journalist, policy analyst, and grassroots organizer both in Europe and North America. He was previously Watchdog.org's Florida Bureau Chief, chief Spanish translator, and national investigative reporter from 2012-2015, and Senior Development Officer at Students For Liberty.

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