

The cost of the crisis: exposure to fraud

For three years Norkom's research has tracked the progress of financial institutions' fight against crime. This year, that progress has faltered. Budget cuts imposed in the wake of the banking crisis are leaving financial institutions – and their customers – exposed to a rising tide of fraud attacks. This month's Intelligence Survey highlights their increased vulnerability to fraud and a diminished ability to combat it. David Dixon considers the dangers

Thirty per cent of the world's financial institutions have reduced their fraud management budgets by up to 25% as part of post-crisis cost-cutting measures. And, for many, this seems to represent a new reality; 65% of those who've seen their budgets slashed expect the reductions to last beyond 12 months.

But these specific budget cuts aren't the only cause for concern. Half of all respondents believe general belt-tightening across their organisations is increasing their vulnerability to criminal attack. As headcount disappears, the pressure to remove non-revenue adding business processes becomes intense. Along the way, many vital checks and balances are abandoned, leaving weak links in the risk management chain.

The rising tide

Budget cuts couldn't come at a worse time. Seventy-one per cent of respondents say fraud attacks against their organisations have increased this year and almost all (91%) expect those rises to continue.

And here lies the ultimate irony. Sixty-seven per cent of respondents say their financial losses to fraud have increased over the past year. As fraud attacks escalate, those losses can only rise. By cutting their crime-fighting budgets, institutions might be sabotaging rather than saving their already shaky finances.

Nor are criminal attacks the only threat banks are laying themselves open to. Eighty-three per cent of respondents expect increased regulatory oversight of their fraud risk management activities over the next three years. The US, UK and the EU are debating more stringent financial serv-

ices risk governance proposals. Although details won't be finalised for some time, they'll certainly generate stronger regulatory oversight of fraud risk governance.

Reasons to be cheerful

It's hard not to sympathise with any bank's determination to save money right now. But there's more than one way to skin a cat. The sharp blade of technology might prove more effective than the blunt cudgel of spending cuts.

Last year we reported that 64% of organisations had reduced operating costs by up to 30% by using consolidated crime-fighting technologies to achieve more consistent analysis and investigation of suspected fraud attacks. Sixty-six per cent also said their ability to detect crime had improved by up to 40%.

This year's research provides even clearer evidence of technology's efficacy. Generally banks are, it seems, fairly poor at measuring the financial impact of fraud. Only 28% actively correlate the amount of fraud successfully detected against the total amount of fraud reported to them by their customers. Of those that do, 79% fail to detect more than 20% of the fraud reported to them and only a tiny group (13%) achieve the Holy Grail target of 80%. Among those using a consolidating technology, all achieve at least 20%, and 22% achieve more than 80%.

Furthermore, 56% of companies whose technology includes common case and workflow management capabilities are achieving 'a substantive reduction' in fraud losses, because they're able to take immediate action to prevent

crime. Actively monitoring for fraud, they can automatically block individual accounts, cards and devices that appear to be at risk.

The 18% of our research respondents that are pursuing a multi-year technology strategy to develop their financial crime-fighting capability are probably onto a winner. A further 20% will do likewise within 12 to 24 months. Their foresight will do more to protect their organisations' financial health than swingeing spending cuts.

Hope on the horizon

Two clear messages emerge from this research. First, attempts to save money by cutting financial crime budgets are likely to be counterproductive. Second, fraud losses can be reduced through the use of consolidating technologies, which, in turn, allow business processes to be streamlined. So, if the driving imperative to cut costs remains – good news – that benefit is there for the taking, too.

There is hope on the horizon. Fifty per cent of respondents say the economic crisis has intensified their senior management team's focus on fraud. This is good news. It suggests that, once the general purse strings are loosened even a little, financial crime is likely to be their first priority for renewed investment. If anyone is looking for evidence this should happen sooner rather than later, this research provides it.

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