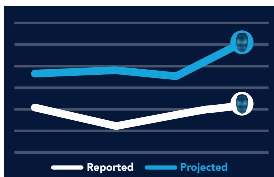
MISCATEGORIZATION OF SYNTHETIC IDENTITY FRAUD

Synthetic identity fraud is a type of identity fraud that has devastating impacts across multiple industries. This type of fraud is estimated to ***cost the payments industry $20 billion in annual losses***.[1] However, many experts believe this estimate is too low because synthetic identity fraud is often miscategorized as a credit loss and therefore, is underreported. Financial losses due to non-payment by synthetics often can appear to be caused by personal bankruptcy, other financial hardships or poor management of one's finances by a "real" person. Industry experts ***predict that synthetic identity fraud will continue to increase in 2022***, making accurate reporting even more critical. Accurate categorization of the losses associated with synthetic identity fraud can yield major benefits and avoid the following potential negative impacts:



LACK OF PROPER IDENTIFICATION LEADS TO UNDERREPORTING

Underreporting of synthetic identity fraud disguises the full scope of the issue. Less-than-optimal fraud reporting can lead an organization to under-fund resources to help detect and mitigate this type of fraud. To build a robust risk mitigation strategy, it's helpful for institutions to be aware of the scope of synthetic identity fraud's impact on their portfolios so they can properly mitigate it.

IMPROPER CLASSIFICATION OF SYNTHETIC IDENTITIES CAN LEAD TO POOR DETECTION

Financial institutions that properly categorize losses associated with synthetic identity fraud can use information on these synthetic accounts to identify other accounts linked to these "bad actors." For example, the financial institution can use customer profiles (such as name, address and Social Security number) in conjunction with their digital footprint information (such as IP address and mobile device ID) to identify other accounts linked by this information. The institution then can choose to investigate further or close accounts that were opened using a given synthetic identity. Furthermore, proper classification of synthetic identity fraud can be used to help train the institution's fraud engine to detect other potential instances of fraud, while improper classification would train the model to see suspicious behavior as good.

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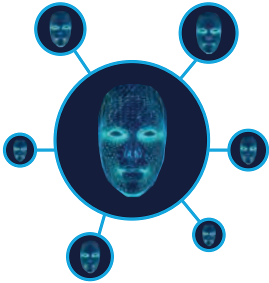

MISCATEGORIZATION OF SYNTHETIC IDENTITY FRAUD ALLOWS FURTHER PERPETUATION OF THIS TYPE OF FRAUD

If accounts are incorrectly identified as credit losses rather than synthetic identity fraud, fraudsters have an opportunity to reuse the same synthetic identity, as no fraud notation is associated with the identity's accounts. Accounts classified as a credit delinquency rather than a fraud loss allow fraudsters to dispute the reported delinquency with credit reporting agencies. This process is termed "credit washing." Once the delinquencies are removed from the credit report, fraudsters then reapply for credit with a clean report. Had losses been properly attributed to synthetic identity fraud, these accounts could have been properly flagged, and the bad actor information associated with these accounts could have been identified and used to help detect further synthetics.

MISCATEGORIZATION LEADS TO INDUSTRYWIDE MISUNDERSTANDING OF SYNTHETIC IDENTITY FRAUD'S MAGNITUDE

Misclassification of losses caused by synthetic identity fraud make the scope of the problem difficult to quantify across the industry. Without a good industrywide mechanism for classifying and reporting synthetic identity fraud losses, the pervasiveness of this type of fraud is widely unknown.

SOURCES

[1] ***2021 Synthetic Identity Fraud Report***, FiVerity

The synthetic identity fraud mitigation toolkit was developed by the Federal Reserve to help educate the industry about synthetic identity fraud and outline potential ways to help detect and mitigate this fraud type. Insights for this toolkit were provided through interviews with industry experts, publicly available research, and team member expertise. This toolkit is not intended to result in any regulatory or reporting requirements, imply any liabilities for fraud loss, or confer any legal status, legal definitions, or legal rights or responsibilities. While use of this toolkit throughout the industry is encouraged, utilization of the toolkit is voluntary at the discretion of each individual entity. Absent written consent, this toolkit may not be used in a manner that suggests the Federal Reserve endorses a third-party product or service.