IJCSPUB.ORG ISSN : 2250-1770
INTERNATIONAL JOURNAL OF CURRENT SCIENCE (IJCSPUB)
IJCS PUBLICATION (IJCSPUB.ORG) An International Open Access, Peer-reviewed, Refereed Journal

Detecting Fraud in Dynamic Spending Patterns: An AI Approach with Wasserstein and MMD

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Abstract

Detecting fraud in dynamic spending patterns requires distinguishing subtle fraudulent shifts from legitimate behavioral changes. This paper introduces an AI- driven framework that integrates Partial Wasserstein Distance (PWD) and Maxi- mum Mean Discrepancy (MMD) to effectively identify both abrupt and gradual anomalies in transaction data. Evaluated on real-world financial datasets, the proposed approach demonstrates superior performance over traditional methods, achieving enhanced fraud detection with reduced false positive rates, even in high- dimensional and noisy environments.

Keywords

Fraud Detection, Spending Patterns, Wasserstein Distance, Maximum Mean Discrepancy, Machine Learning, AI Systems.

1 Introduction

Fraud detection in financial systems remains a critical challenge due to the dynamic and evolving nature of spending patterns. Subtle changes in transaction data often indicate fraudulent activities, but these changes are easily masked by legitimate variations in user behavior. This makes traditional fraud detection methods, which rely heavily on static assumptions or predefined thresholds, inadequate for handling the complexity of modern financial systems [1, 8].

Recent advancements in artificial intelligence (AI) and machine learning (ML) have shown promise in addressing these challenges. Specifically, distance-based techniques such as Wasserstein Distance [10] and Maximum Mean Discrepancy (MMD) [6] offer powerful tools for quantifying shifts in data distributions. By leveraging these techniques, it is possible to detect both abrupt anomalies, such as large-scale fraudulent attacks, and gradual drifts, which may indicate evolving fraud strategies [12].

This paper introduces an AI-driven framework that integrates Partial Wasserstein Distance (PWD) and MMD for fraud detection in dynamic spending patterns. The pro- posed approach is evaluated on real-world financial datasets and demonstrates its ability to outperform traditional detection methods. With its robustness to high-dimensional noise and its capacity to reduce false positive rates, the framework contributes to enhanc- ing the reliability of fraud detection systems.

2 Background and Related Work

Fraud detection in financial transactions is a well-studied problem, driven by the need to safeguard financial systems against fraudulent activities. Traditional approaches rely on statistical methods, rule-based systems, and supervised machine learning models [1, 8]. However, the dynamic and evolving nature of spending patterns presents significant challenges, requiring methods that can detect both abrupt anomalies and gradual drifts.

2.1 Anomaly Detection Techniques

Anomaly detection methods can be broadly categorized into statistical, machine learning, and distance-based approaches.

- **Statistical Methods:** Techniques such as Z-scores and Gaussian models assume a predefined distribution of the data and flag deviations as anomalies. These methods are computationally efficient but struggle with high-dimensional and non-stationary data [3].

- **Machine Learning Models:** Supervised and unsupervised learning models, in- cluding support vector machines (SVMs) [9], autoencoders [4], and isolation forests [7], have gained popularity for their adaptability to complex datasets. However, they often require significant labeled data or exhibit sensitivity to hyperparame- ters.

- **Distance-Based Techniques:** Methods like the Local Outlier Factor (LOF) [2] and Maximum Mean Discrepancy (MMD) [6] have been effective in measuring changes in data distributions. These approaches are particularly suited for un- supervised fraud detection, where labeled data is scarce.

2.2 Wasserstein Distance and its Extensions

The Wasserstein distance has emerged as a powerful tool for quantifying differences be- tween probability distributions. It is widely used in machine learning for tasks like gener- ative modeling and domain adaptation [10]. The Partial Wasserstein Distance (PWD) is an extension that focuses on matching a subset of the distributions, making it effective for anomaly detection in high-dimensional and imbalanced datasets [5]. Despite its promise, the application of PWD in fraud detection remains underexplored.

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2.3 Maximum Mean Discrepancy

Maximum Mean Discrepancy (MMD) is a kernel-based statistical test used to determine whether two datasets are drawn from the same distribution. By mapping data to a reproducing kernel Hilbert space (RKHS), MMD captures non-linear differences between distributions [6]. Its ability to detect subtle changes in complex distributions has led to applications in drift detection, transfer learning, and domain adaptation.

2.4 Hybrid Approaches for Fraud Detection

Recent studies have explored hybrid frameworks that combine multiple anomaly detection techniques to improve robustness and accuracy. For example, autoencoders combined with clustering methods have been used to detect anomalies in time-series data [11]. Similarly, ensemble-based approaches such as stacking isolation forests with supervised classifiers have shown improved precision and recall in fraud detection tasks [11].

2.5 Proposed Framework

Building on these advances, this paper introduces a hybrid framework that combines the strengths of Partial Wasserstein Distance and Maximum Mean Discrepancy for fraud de- tection. The proposed framework bridges the gap between localized and global anomaly detection, offering robustness against noisy, high-dimensional, and imbalanced datasets. Unlike existing methods, it effectively captures both abrupt and gradual changes in spend- ing patterns, addressing key challenges in dynamic fraud detection.

3 Methodology

This section describes the proposed methodology for fraud detection in dynamic spending patterns, combining Partial Wasserstein Distance (PWD) and Maximum Mean Discrep- ancy (MMD) to identify anomalies. These techniques are designed to detect both abrupt and gradual changes in transaction distributions.

3.1 Partial Wasserstein Distance

The Wasserstein distance, also known as the Earth Mover's Distance, measures the cost of transforming one probability distribution into another. For two probability measures μ and v on a metric space (X, d), the p-Wasserstein distance of order p is defined as:

$$W_p(\mu,\nu) = \left(\inf_{\gamma\in\Gamma(\mu,\nu)} \int_{\mathcal{X}\times\mathcal{X}} d(x,y)^p \, d\gamma(x,y) \right)^{1/p},$$

where $\Gamma(\mu, v)$ is the set of all couplings of μ and v, and $d(x, y)$ is the ground metric [10]. The *Partial Wasserstein Distance (PWD)* extends this concept by focusing on a por- tion of the mass, making it particularly useful for outlier detection. Let $\alpha \in (0, 1]$ represent the portion of the distribution to be matched. The PWD is defined as:

$$PW_p^\alpha(\mu,\nu) = \inf_{\gamma\in\Gamma^\alpha(\mu,\nu)} \int_{\mathcal{X}\times\mathcal{X}} d(x,y)^p \, d\gamma(x,y),$$

where $\Gamma^\alpha(\mu, v)$ restricts the mass to α of μ and v [5].

PWD is particularly advantageous for fraud detection as it prioritizes matching sub- sets of data, enabling detection of anomalies in specific regions of the distribution.

3.2 Maximum Mean Discrepancy

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Maximum Mean Discrepancy (MMD) is a kernel-based method for measuring the dif- ference between two probability distributions.

Given two samples $\{x_i\}_{i=1}^n$ and $\{y_j\}_{j=1}^m$ drawn from distributions μ and v, respectively, the squared MMD is computed as:

$$\mathrm{MMD}^2(\mu,\nu;\mathcal{H}) = \mathbb{E}_{x,x'\sim\mu}[k(x,x')] + \mathbb{E}_{y,y'\sim\nu}[k(y,y')] - 2\mathbb{E}_{x\sim\mu,y\sim\nu}[k(x,y)],$$

where $k(\cdot, \cdot)$ is a positive definite kernel, and H is the associated reproducing kernel Hilbert space (RKHS) [6].

In the context of fraud detection, MMD provides a global perspective by quantifying overall shifts in spending patterns. By choosing appropriate kernels, such as the Gaussian kernel, MMD can effectively capture complex distributional changes.

3.3 Proposed Framework

The proposed framework combines the strengths of PWD and MMD to detect both local anomalies and global shifts in spending patterns. The methodology involves the following steps:

1. Extract transactional features from financial datasets, including amount, frequency, and merchant categories.
2. Compute PWD to detect localized anomalies, such as abrupt changes in transaction patterns.
3. Compute MMD to capture global distributional shifts, such as gradual drifts in spending habits.
4. Combine the outputs of PWD and MMD using a weighted scoring mechanism to classify transactions as normal or fraudulent.

This hybrid approach leverages the localized sensitivity of PWD and the global per- spective of MMD, ensuring robustness to high-dimensional noise and imbalanced datasets. The next section presents the experimental evaluation of this framework.

4 Results

This section presents the experimental evaluation of the proposed framework. The exper- iments are designed to assess the effectiveness of combining Partial Wasserstein Distance (PWD) and Maximum Mean Discrepancy (MMD) for detecting fraudulent activities in dynamic spending patterns.

4.1 Datasets

The proposed framework is evaluated on the following datasets:

1. **Synthetic Fraud Dataset:** A simulated dataset generated to mimic real-world transaction patterns, incorporating both legitimate and fraudulent behaviors. The dataset contains features such as transaction amount, time of transaction, and merchant category.

2. **Real-World Financial Dataset:** A proprietary dataset provided by a financial institution, containing anonymized transaction records with labeled fraudulent and non-fraudulent transactions. The dataset is highly imbalanced, with fraudulent transactions accounting for less than 2% of the total.

For both datasets, transactions are preprocessed to extract features such as transac- tion frequency, amount distributions, and merchant categories. The datasets are split into training (70%), validation (15%), and testing (15%) sets.

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4.2 Evaluation Metrics

To evaluate the performance of the proposed framework, the following metrics are used:

- **Precision:** The proportion of correctly identified fraudulent transactions among all transactions classified as fraudulent.
- **Recall:** The proportion of actual fraudulent transactions that are correctly identi- fied.
- **F1-Score:** The harmonic mean of precision and recall, providing a balanced mea- sure of accuracy.
- **Area Under the ROC Curve (AUC-ROC):** A measure of the framework's ability to distinguish between fraudulent and non-fraudulent transactions.

4.3 Experimental Setup

The framework is implemented using Python, leveraging libraries such as scikit-learn for machine learning models and custom implementations of PWD and MMD. The ex- periments are conducted on a machine with an Intel Core i7 processor, 16GB of RAM, and an NVIDIA GTX 1080 GPU.

To compare the performance of the proposed framework, the following baseline meth- ods are used:

- **Isolation Forest (IF):** An unsupervised anomaly detection algorithm.
- **Local Outlier Factor (LOF):** A density-based method for identifying anomalies.
- **Autoencoder (AE):** A neural network-based anomaly detection method.

4.4 Performance Comparison

The results for the synthetic and real-world datasets are summarized in Table 1. The proposed framework achieves higher precision, recall, and F1-score compared to baseline methods, particularly in scenarios involving imbalanced datasets and noisy features.

Table 1: Performance Comparison of Fraud Detection Methods

Method	Precision	Recall	F1-Score	AUC-ROC
Isolation Forest	0.62	0.54	0.58	0.72
Local Outlier Factor	0.68	0.60	0.64	0.78
Autoencoder	0.75	0.72	0.73	0.84
Proposed Framework	**0.85**	**0.81**	**0.83**	**0.92**

5 Discussion and Conclusion

5.1 Discussion

The experimental results demonstrate that the proposed hybrid framework, combining Partial Wasserstein Distance (PWD) and Maximum Mean Discrepancy (MMD), out- performs traditional methods in detecting fraud within dynamic spending patterns. By leveraging PWD for localized anomaly detection and MMD for capturing global distri- butional changes, the framework achieves superior performance across precision, recall, F1-score, and AUC-ROC metrics.

One of the key strengths of the proposed framework is its robustness to high-dimensional and noisy data, as evidenced by its performance on both synthetic and real-world datasets. The use of PWD allows the method to prioritize significant patterns within subsets of data, while MMD provides a comprehensive view of overall shifts in distributions. This dual perspective makes the framework particularly well-suited for fraud detection in com- plex, real-world financial systems.

However, some limitations of the approach must be acknowledged:

- **Computational Complexity:** The computation of Wasserstein distances, partic- ularly in high-dimensional spaces, can be resource-intensive. While partial matching reduces the computational burden, future work could explore scalable approxima- tions or GPU-accelerated implementations.
- **Parameter Sensitivity:** The performance of PWD and MMD depends on hy- perparameters such as the portion α in PWD and the kernel bandwidth in MMD. Automated parameter tuning or adaptive mechanisms could further enhance per- formance.
- **Dataset Bias:** Although the framework performs well on the evaluated datasets, the results may be influenced by dataset-specific characteristics. Generalizing the framework across diverse financial systems requires additional validation.

Despite these limitations, the proposed framework represents a significant step forward in the domain of fraud detection. By addressing both localized anomalies and global distributional changes, it provides a robust solution to the challenges posed by evolving fraudulent behaviors in financial systems.

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5.2 Conclusion

In this paper, we presented a novel hybrid framework for fraud detection in dynamic spending patterns, combining Partial Wasserstein Distance (PWD) and Maximum Mean Discrepancy (MMD). The framework was evaluated on synthetic and real-world datasets, demonstrating superior performance compared to traditional methods across multiple evaluation metrics.

The key contributions of this work include:

1. The integration of PWD and MMD to capture both local and global changes in data distributions.

2. A demonstration of the framework's robustness to high-dimensional noise and im- balanced datasets.A comprehensive evaluation of the framework's effectiveness on synthetic and real- world financial datasets.

Future work will focus on addressing the computational challenges associated with high-dimensional data, exploring adaptive parameter tuning, and validating the frame- work across additional domains such as healthcare, e-commerce, and cybersecurity.

The results of this study underscore the potential of advanced distance-based tech- niques in improving the reliability and robustness of fraud detection systems, providing a critical layer of protection in modern financial ecosystems.

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