PAYSYS REPORT

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In this issue:

Fourth ECB report on card fraud published

The ECB has published its fourth report on card fraud.[1] The latest card fraud report does not contain anything spectacularly new. But it provides a large amount of data on card fraud in SEPA and in individual countries.

In 2013 total fraud amounted to €1.44 billion or 0.039 % of the value of transactions (incl. ATM). About two thirds were card-not-present (CNP) fraud (see figure 1).

Figure 1: Card issuing fraud segments (2013)

	Fraud* (mn. €)	Change (%)	Share (%)
CNP	958	+20.6	66
POS	288	-7.9	20
ATM	202	-13.7	14
Total	1,440	+8.1	100

ECB (2015): Fourth report on card fraud, and own calculations.
*: Figures may not add up due to rounding errors.

Compared to 2012, CNP fraud has also risen significantly, while fraud at ATMs and at the POS has declined. Overall, fraud has risen by 8.1%. However, since the value of card transactions has also risen, the fraud rate only increased from 0.038% to 0.039%.

Besides CNP, x-border transactions are also particularly vulnerable to fraud. Only 8% of transactions are carried out across borders, however 51% of fraudulent transactions are x-border (see figure 2).

Figure 2: Fraud shares: x-border vs. domestic (%)

		x-border*	
	domestic	within SEPA	outside SEPA
Trx. Share (%)	92	6	2
Fraud share (%)	49	29	22

Transactions with cards issued within SEPA
ECB (2015): Fourth report on card fraud

The data in figure 2 refers to fraud carried out with cards issued within SEPA. The ECB also collects data on fraud carried with cards issued outside SEPA and used within SEPA. Fraud that hits SEPA on the acquiring side is much larger than the corresponding fraud with SEPA cards that takes place outside SEPA (see figure 3).

Figure 3: X-border fraud:
issuing and acquiring perspective (mn. €)

	Acquirer in SEPA	Acquirer outside SEPA
Cards issued in SEPA	1,120	320 (0.45%)*
	Cards issued in SEPA	Cards issued outside SEPA
Acquirers in SEPA	1,120	566 (0.57%)*

*: fraud rate

ECB (2015): Fourth report on card fraud

Overall, fraud has risen a little in the years 2011 to 2013. But this has to be interpreted against the strong decline that took place from 2009 on.

Figure 4: Evolution of card fraud

	Fraud rate (%)
2009	0.048
2010	0.040
2011	0.036
2012	0.038
2013	0.039

ECB (2015): Fourth report on card fraud

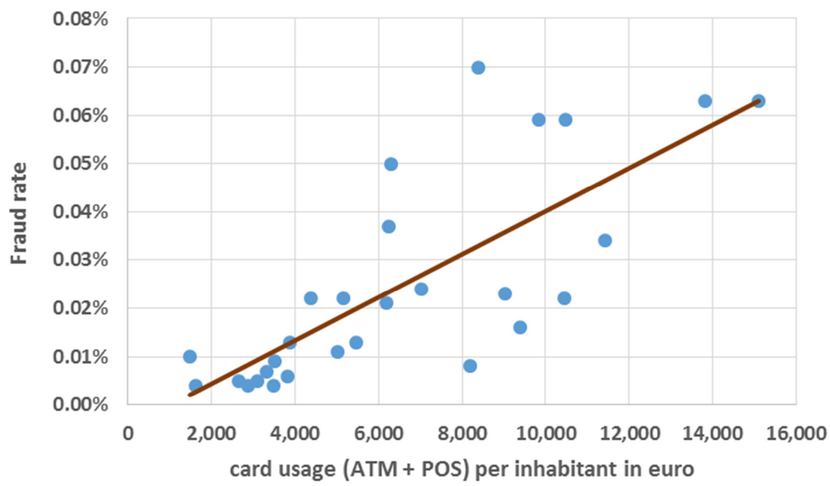
Our Comment:

Overall, the figures seem to indicate that the industry is capable to manage risk effectively. For CNP, the situation seems to be more serious. Thus, the authorities may feel vindicated in their approach to impose security requirements (SecuRe Pay). However, as discussed below, the evolution of CNP fraud does not support the claim that regulatory intervention is urgently required to enhance the security of internet payments.

The Card Fraud Report does not only contain aggregate fraud but also country-level fraud rates. Fraud rates within individual European countries range from 0.2 basis points in Hungary to 7 basis points in France. An interesting feature of the country level data is the positive relationship between the intensity of card use and the level of fraud.
As the ECB notes: *"Most of the countries with mature card markets (defined as countries with high volumes and values of card transactions per inhabitant) experienced high rates of fraud."* (p. 3) Indeed, the relationship is strikingly close (see figure 5). This shows that the anti-fraud fight is something like an uphill struggle. The more successful the industry becomes in its attempt to replace cash payments by card payments, the more difficult it becomes to fight fraud.

However, country-level fraud rates should be interpreted with caution because fraud data and transaction data are from different databases. The fraud figures are derived from 23 card payment schemes, the transaction volume dates from the ECB´s Statistical Data Warehouse (SDW). A comparison of the ECB data with the scheme data has shown that the ECB figures are at least € 325 billion too low. Thus, there is a gap of about 13 % of the transaction volume (see the analysis in our last report, no. 3/2015). It is interesting to see, that the ECB has come to recognise the uncertain quality of its own database by comparing the data received from the card schemes and the SDW figures delivered by the banks for this fraud report. In the fraud report, the ECB notes that for three countries the gap is higher than 20 %. As a result, the ECB confirms our doubts regarding the accuracy of its data: *"the figure must be treated with caution, as it may reflect both gaps in SDW data and double counting in the data reported for oversight purposes"* (p. 5).

Figure 5: Card use per person (€) and fraud rates (per cent)



Based on data of: ECB (2015): Fourth report on card fraud

The methodology and therefore the results could be improved by taking the same data source (here the figures from the card schemes). As a result of mixing two data sources, the fraud rate for Germany (2.4 basis points) is too low, because the debit card volume in the ECB´s SDW is including ELV (at least partly), while the ELV-fraud volume is not included in the ECB analysis (ELV is not a card payment scheme with reporting obligation to the ECB).

We cannot confirm the ECB´s assessment, that CNP fraud rates are increasing.

Unfortunately, the ECB does not provide data on fraud rates within the three segments (CNP, ATM, POS). However, based on the data presented, a rough estimate of the CNP fraud rate would place this figure at approximately 0.25 %. This is much higher than the average rate. However, x-border use outside SEPA seems to involve even higher rates (around 0.4%).

CNP-fraud is rocketing (in 2013 by 21 % to € 958 million). That is not astonishing because ecommerce generated by cards is rocketing too. But is the fraud volume in relation to the CNP-volume rising too? Figures of CNP-volume are only partially available. Therefore there are no fraud figures of the development of CNP fraud rates, which would be important regarding EBA´s SecuRe Pay Regulation for internet payments. The ECB states: *"However, based on this partial information, CNP fraud grew faster than CNP transactions"* (p. 2) and *"taking into account data for only those schemes reporting a split of CNP fraud into internet and mail or phone fraud, CNP fraud over the internet grew slightly more than the respective transactions"* (p. 12).

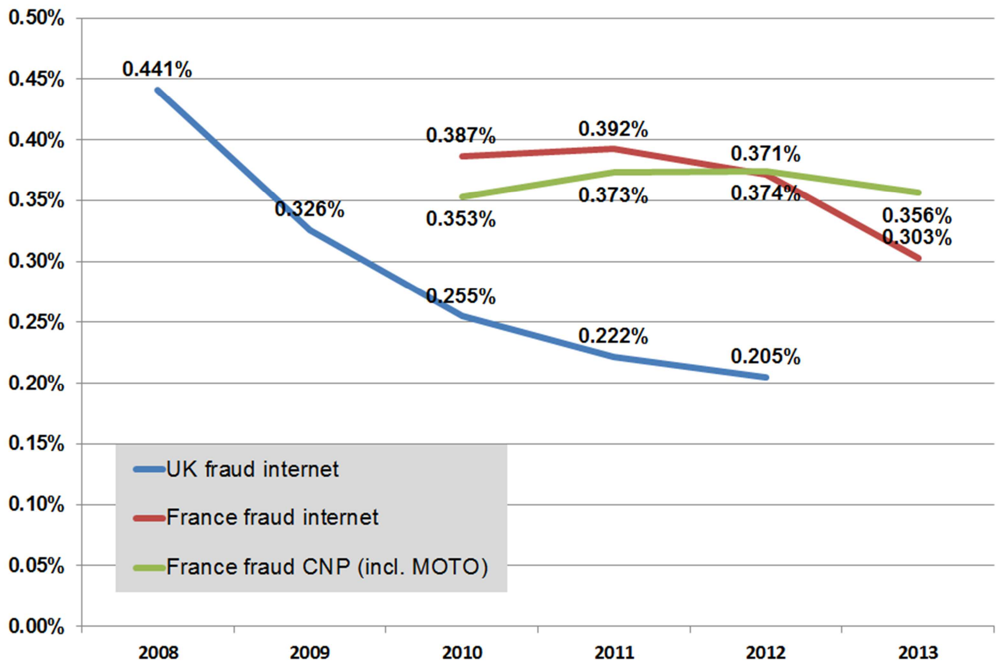
We cannot confirm the ECB´s assessment, that CNP fraud rates are increasing. Let us have a closer look at the figures of France and UK, which are generating 63 % of the total fraud volume in Europe (€ 1.44 billion). Both countries with top fraud rates (7 resp. 6.3 basis points) published detailed card fraud figures (France: Observatoire de la sécurité des cartes de paiement; UK: Financial Fraud Action). Both countries are ecommerce champions and the internet consumers are using cards as preferred payment instrument. Users of cards issued in France are spending about € 66 billion in the card-not-present segment, thereof 94 % in the internet (2013). The internet spending (inside and outside France) increased from 8.5 % (2010) to 14.2 % (2013) of the total sales volume of French cards. In the UK the level is slightly lower at 13.2 % (2013), but is excluding the ecommerce sales volume with non-consumer cards.

The fraud rates of CNP-fraud for internet payments (excluding MOTO-transactions) are decreasing in both countries (see figure 6[2]). In its annual report (2013) the French Observatory states: *"The pronounced decline in the fraud rate for internet card payments in 2013 testifies to the progress in enhancing protection in this area."* (p. 7).

In its Fourth fraud report the ECB reports a reduction of the absolute level of CNP fraud in the UK compared to the level of 2008 (p. 12). For France an increase of the CNP-fraud rate (internet & MOTO) is not evident. It would be surprising if other European countries with less fraud rates would show a different development.

However, for domestic payments the decreasing fraud rate of internet payments in France is compensated by an increasing fraud rate of MOTO-transactions. Obviously, card fraud in the CNP segment is partly shifted from epayments to other types of CNP-payments. The SecuRe Pay regulation is focussed strictly on internet payments within SEPA. In France about 10 % of the total CNP-volume is not affected by the regulation: internet payments acquired outside SEPA and MOTO-payments.

Figure 6: Fraud rates in France and UK



The ongoing reduction of the internet fraud rate in France is the result of the efforts of the card industry initiated by the card issuers. Almost all issuers are offering strong authentication solutions. In France the share of authenticated transactions in ecommerce increased from 27.5 % to 29.7 % in 2013. However, the main obstacle for further fraud reduction for internet payments is on the part of acquiring side. The proportion of e-merchants that supports strong authentication is stagnating at 43%.

A further risk and liability shift from the issuing to the acquirer side could pave the way within card schemes without regulation. Despite the increasing absolute level of internet fraud, more and more consumers are using their cards for internet payments. Ecommerce is obviously not affected by fraud. So the question still remains: Why SecuRe Pay by oversight regulation? The market is able to handle this risk without putting a disadvantage on the consumers. This question is even more justified regarding the hasty SecuRe Pay Regulation by the EBA coming into effect in this year, which obviously cannot wait for a more democratic process as outcome of the PSD II.

German discounters are accepting credit cards

or: SEPA, interchange fees and the law of unintended consequences

German discounters are going to accept credit cards – this news has even found its way into Germany's number 1 tabloid "Bild Zeitung" [3]. Given that not so long ago, discounters stubbornly refused to accept any payment cards at all, this moment definitely defines a watershed in the German card market. The announcement coincides with the lowering of interchange fees brought about by European regulators.

Our Comment:

Time and again, the EU Commission and the ECB have been stressing that Europe needs a European card scheme.[4] MasterCard and Visa are seen as American players (even though Visa Europe is owned by European banks) and regulators feared that these two heavyweights might carve up the European market between themselves. The two main concerns were (1) governance and (2) competition. First, as American companies, MasterCard and Visa have to obey the US government and – the interest of the US may not always be exactly equal to the interests of Europe. Second, with just two players in the market, competition may be fairly limited and prices correspondingly high. Thus, the call for a third scheme.

European regulators have worked hard to encourage banks and others to come up with a credible competitor. However, so far, the result has been disappointing. Paradoxically, one reason may be the wave of new regulations imposed on the payments market. Forcing domestic schemes to become European players and making new standards compulsory has led to a first wave of closures of European schemes. Now price regulation may endanger the rest. Domestic schemes that have survived because they are far cheaper than the international schemes suddenly face intense price competition. The decision of German discounters to accept credit cards shows how swiftly the market is reacting when prices are changing. Visa and MasterCard acceptance will become far more widespread. From the point of view of card holders, this means that a MasterCard or Visa branded card is as good as a card of a domestic brand – for domestic transactions. For international transactions, of course, MasterCard and Visa have much more to offer. Moreover, they are more widely accepted online and they have come quite some way towards establishing contactless infrastructure. Thus, the international cards will be more valuable for card holders.

The EU Commission has argued that high interchange fees are a barrier to entry for new low-cost players.[5] However, current developments seem to suggest that, in many countries, high interchange fees have prevented the international schemes from achieving wide card acceptance. As we are currently witnessing, this is about to change. The EU Commission has indeed removed a barrier to entry. The result may well be the dominance of a duopoly – the very result the EU Commission has always tried to prevent.

Lessons to be learned from the Greek tragedy

During the last weeks, most of our readers have followed the spectacular daily Greek drama (or soap opera?) in the comfortable role of a not directly involved audience. The script of the actors is still dominated by political arguments rather than economic arguments. However, the first act already affected our daily business of payment systems. Although the play is far from being over, we see already some impulses for small talk during the short breaks between the acts.

Our Comment:

The first lesson learned is the fact that Greek capital controls are linked to accounts at banks located in the Greek territory (see box below). Greek inhabitants usually have a bank account at a bank affected by the capital controls. Up to now, there are still huge obstacles for a European citizen to open a bank account in another member state. Such obstacles violate the SEPA goal. One of the obstacles is the cross-border account holder identification and the check of the credit history. The recently agreed EU Directive on Payment Accounts (2014/92/EU) which will be effective in all Member States (Greece included) at the latest on 18 September 2016, will force credit institutions to eliminate such territorial discriminations for opening a payment account by non-inhabitants. Article 15 states: *"Member States shall ensure that credit institutions do not discriminate against consumers legally resident in the Union by reason of their nationality or place of residence or by reason of any other ground as referred to in Article 21 of the Charter, when those consumers apply for or access a payment account within the Union."* Since the outbreak of the Greek financial crisis in 2012 wealthy Greeks already have moved billions of Euro into other Member States and Switzerland. From September 2016 on, when capital controls will be cancelled, even "Jannis Papadopoulos" should easily have access to an online payment account outside of Greece with full SEPA facilities. Traumatized by the long queues in front of ATMs of closed Greek banks, Greek inhabitants will probably exercise their rights. This implies that, the capital controls imposed in Cyprus and Greece will not work in the future. It is hard to imagine, that the Greek government will be able to block payment accounts of Greek inhabitants outside of Greece.

Without considering this superior benefit of cash for its users, all comparative analyses of cash versus non-cash are obsolete.

The second lesson learned by Greek payment users is the inequality between cash and account-based funds. In the "war on cash" rhetoric, often found in documents of the EU Commission, banks, researchers, card schemes etc., scriptural money is usually seen as equivalent to cash. The discussion on "cash versus non-cash payments" focusses on the cost side and the negative societal effects of cash (money laundering, criminality, tax evasion etc.). In all analyses about the old-fashioned cash the benefits of cash as anonymous decentralised bearer instrument are faded out as non-existent or being negligible. In contrast to account-based funds, it is almost impossible to block or restrict the usage of cash within certain groups of persons (e.g. Greek people). This dilemma is enhanced in a monetary union, where cash is not limited to one country. Without considering this superior benefit of cash for its users, all comparative analyses of cash versus non-cash are obsolete.[6]

Thirdly, the Greek government and the "Institutions" (ECB, IMF and Commission) probably did not have a Plan C besides Plan A (staying in the Euro-zone) or Plan B (Grexit by return to the Drachma as a national currency). What about the third way-option by introducing a complementary currency besides the Euro? The ECB does not seem to take such ideas lightly. On July 3, the Austrian member of the Governing Council of the ECB, Ewald Nowotny, stated that each currency that is issued in the Euro-zone by an institution other than the ECB is - from a legal point of view - "counterfeit money". This thoughtless statement, expressed in the hot phase of the Greek drama, is deceptive. From a legal perspective, counterfeit money is an imitation of the official currency. The discussed parallel currency in Greece would not imitate the Euro. Thus, users could not be confounded. In his statement, Nowotny probably referred to a second legal tender besides the Euro, issued by the local central bank or by the government, which could in fact be illegal but it would be no counterfeit money. In the Euro zone, the issuance of the Euro in the form of bank notes and coins is monopolised by the ECB (banknotes) and governments of the member states (coins). But is "different" money not being legal tender per definition "illegal tender"?

Article 128 of the Treaty of the functioning of the European Union (Version 2012) says: *"The European Central Bank shall have the exclusive right to authorise the issue of euro banknotes within the Union. The European Central Bank and the national central banks may issue such notes. The banknotes issued by the European Central Bank and the national central banks shall be the only such notes to have the status of legal tender within the Union."* Therefore the issuance of a parallel legal tender besides the Euro in the Euro-zone is against the European law. Nevertheless, the issuance of IOU´s as promissory notes by the Greek state without being legal tender would be no problem from a European point of view. The overall majority of all payments is carried out with means of payments (bank deposits) that are not legal tender. The traditional importance of the label "legal tender" is probably overestimated.

However, an obstacle could be the legal situation in Greece itself. Article 3 of the statutes of the (not-nationalized!) Greek Central Bank says: *"The Greek state undertakes the obligation, during the period of the privilege granted to the Bank, not to issue or re-issue money of any type other than coins in circulation…"* This shift of monetary sovereignty from the Greek state to a private-public institution dated from 1927 where the Bank of Greece was established. To issue a complementary currency the statue of the Bank of Greece has to be amended.[7] Then the Greek state could issue additional paper-based currency or a cashless account-based complementary currency without Grexit. However, a non-governmental entity, like a bank or another payment service provider could start a cashless complementary currency today outside the regulatory playing field of the Euro-denominated currency and its derived euro-denominated account-based bank money. As strictly closed-loop, the additional cashless currency would be independent of the Euro. The WIR Bank in Switzerland is practising successfully such a cashless complementary currency since 1934 as crisis-related monetary innovation. A crisis is a good hotbed for innovations!

Bank account linked capital controls in Greece effective since 29 June (bank holiday)

- The fact conditions for the legal effectiveness of the capital controls of the Greece government are payment instruments (credit transfers, cards etc.) linked to the holder of an account at a bank or at a bank branch (local or foreign banks) in Greece (territorial principle of the account independently from the nationality or location of the account holder).
- Funds transfers from these bank accounts by credit transfer, card or other payment instruments to accounts outside of Greece are not possible or restricted.
- Cash withdrawals for holders of these accounts are limited to 60 Euro per account holder per day (since 20 July: 420 € as weekly limit) independently from the number of cards linked to this account and its holder. If an account has more holders, the limits are effective for each holder. If someone has more accounts, the limits are linked to each account.
- Consequently there are restrictions to open new accounts or to activate dormant accounts.
- It is interesting to see that prepaid cards linked to an e-money account are differently approached by the capital controls. The prepaid funds imposed before the decree are not affected, but the cards cannot be reloaded and no new prepaid cards can be issued.
- Payments to (e-)merchants and online providers which are located outside of Greece are not restricted if the funds are transferred to an account located in Greece.
- Most of the e-merchants outside of Greece (like PayPal, Amazon, Apple, Facebook etc.) stopped the acceptance of cards issued in Greece.
- Payment accounts at Payment Institutions and E-Money-Institutions are indirectly affected as their transfers are effected via a credit institution.
- A special Committee has been established at the State General Accounting Office to approve transactions by bank accounts.
- Within the Euro-zone and SEPA such restrictions to the free flow of funds are against the law. The European Commission give permission to Greece to impose such temporarily capital controls since it appears justified to break EU laws.

Notes
1 ECB (2015): Fourth report on card fraud, July 2015
2 In case of France, for the years 2008-2009 only fraud rates for domestic transactions (French cardholders in France) are available. For the UK the figures of 2013 cannot be used, because the FFA UK changed its methodology from 2013 onwards. Sources: Annual Report of the Observatory for Payment Card Security 2013, figures of UK Cards Association and the Financial Fraud Action UK.
3 See http://www.bild.de/geld/wirtschaft/lidl/zahlen-mit-kreditkarte-41431486.bild.html.
4 This topic has been an evergreen in this newsletter. See also Judt, Ewald and Malte Krueger: A European Card Payments Scheme - Forever a phantom?, Journal of Payment Strategy & Systems, Vol.7, No. 4, 2013, 344-358.
5 *„In addition, high MIFs may act as entry barriers to low-cost card schemes and other payment systems (e.g. e-payments and m-payments)"* EU Commission: Green Paper. Towards an integrated European market for card, internet and mobile payments, Brussels 11.1.2012, COM(2011) 941 final, p. 8.
6 The same applies when the pros and cons of other bearer instruments or decentral account-based monies (like Bitcoin) are discussed.
7 See the interesting paper of Nikolaos Karatsoris, A Complementary Currency for Greece". As download: http://folk.ntnu.no/tronda/econ/Currency-Greece-Karatsoris.pdf.

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