



PAYSYS **REPORT**

Issue 7 – October 2018

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Card fraud in Europe

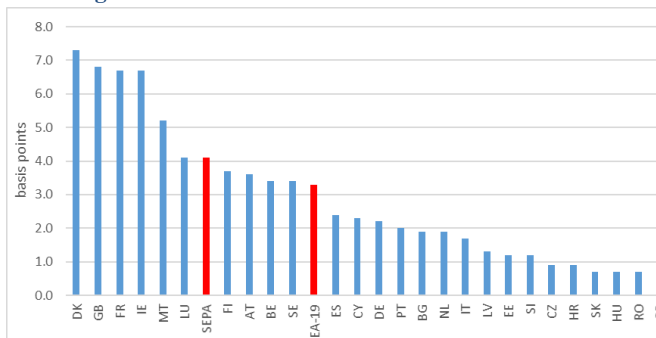
(mk) The European Central Bank has released its latest card fraud report with data for the year 2016.¹ The report covers all of the EU countries. According to the report, card fraud in the EU amounted to almost EUR 1.8 b. Compared with 2015 figures this amounts to a decrease of 0.4%.

The average fraud rate (fraud in % of card spend) amounts to 4.1 basis points (bp) – down from 4.2 bp in 2015 (see Figure 1). For the euro area the fraud rate is even lower: 3.3 bp (almost unchanged from 2015). Fraud rates in individual EU countries differ significantly from the average, ranging from 0.5 basis points (bp) for Poland to 7.3 bp for Denmark.

It is noteworthy that the two largest card markets, the UK and France, have the second and third highest fraud rates in the EU. However, as stated in the card fraud report, in both countries fraud rates have been declining relative to 2015.

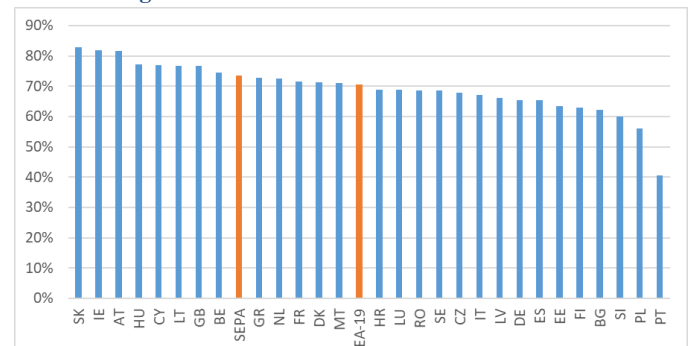
For the group of countries as a whole, card-not-present (CNP) fraud has become the biggest headache for the cards industry: 73% of card fraud in the euro area and 71% in the EU. But the relative importance of CNP fraud varies strongly over different countries. It ranges from 41% (Portugal)² to over 83% (Slovakia) (see Figure 2).

Figure 1 Card fraud rate in EU member states



Source: ECB - Fifth report on card fraud

Figure 2 CNP fraud in % of total fraud



Source: ECB - Fifth report on card fraud

Obviously it takes time to collect and analyse data from a large number of countries. However, the end of 2016 is almost two years in the past. In the world of fraud a lot can happen in two years, therefore we also provide here a brief summary of the FICO Fraud Map that provides data for 2017.³ These data are not strictly comparable with the ECB data because the countries covered and the methodology are different.

According to the FICO report, in 2017 fraud in the group of countries included amounted to almost EUR 1.6 b. This value implies an average fraud rate (fraud in % of card spend) of 2.79 bp. Compared with 2016 figures fraud has increased by 1.9%. Since the value of card transactions in the EU has increased by 4.6% in 2017⁴ the FICO data also imply a decline of the fraud rate.

Our Comment:

Summary: Card fraud differs substantially across Europe. First, fraud rates vary from 0.5 to 7.3 basis points. Second, CNP fraud has become the dominant type of fraud but the share of CNP fraud (in % of total fraud) varies between 41% (Portugal) and 83% (Slovakia). Since 2010 the card fraud rate has been relatively stable and it is lower than in the first 2 years for which the ECB provided data (2008 and 2009). Thus the data suggest that drastic regulatory action is not warranted. Third, domestic payments are much safer than x-border payments – even within SEPA. Therefore it seems to be misguided to force merchants to treat x-border customers like domestic customers.

CNP fraud has probably declined. Regulators would like to take credit for this positive development:

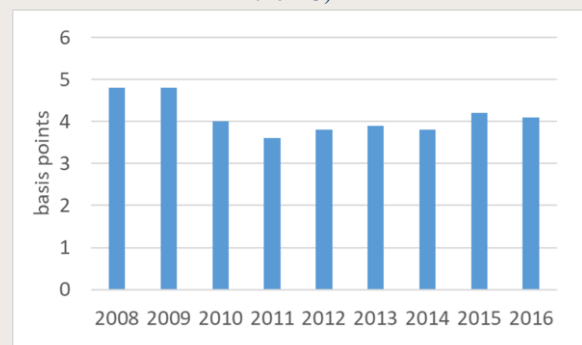
„Enhanced security standards for payment service providers and card schemes issued by the EBA and the Eurosystem at the end of 2014 and beginning of 2015 seem to have led to early signs of improvement in fraud rates in the EU.“ (Fifth ECB Fraud Report, p. 27)

However, if all of the years covered in the five ECB Card Fraud Reports are taken into account, there was a fall in the fraud rate well before the regulations cited above were introduced. In the years 2008 and 2009, the first 2 years for which the ECB provided data, fraud was significantly higher than in later years. If we only take the last four values reported (2013-2016), the average fraud rate is basically flat (see Figure 3).

Card fraud is not an issue that seems to be getting out of control.

For regulators, there are some important take-aways. First, card fraud is not an issue that seems to be getting out of control. In fact, the ECB fraud report notes the decline in the overall fraud rate and also points out that the rate of

Figure 3 Card fraud in the EU (as a share of card spend in the EU)

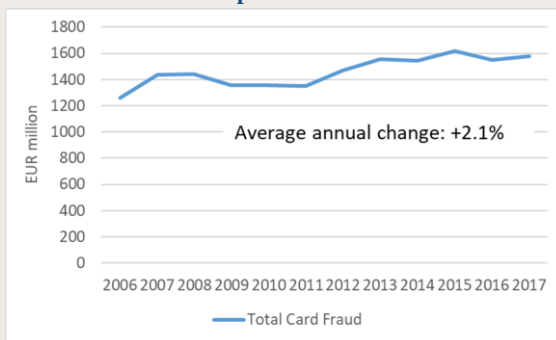


Source: ECB, various card fraud reports

The FICO data provide a comparable picture with card payment growth outpacing fraud growth. For the period 2006 to 2017 the average annual growth rate is 2.1%.

FICO does not provide the value of card payments for this particular group of countries. But if we take the ECB’s data for all of the EU countries, we find that card payments have increased much faster, on average by a rate of 6.6%. Consequently, in relative terms, total fraud has become less of a problem.

Figure 4 FICO data on card fraud in a group of 19 European countries



Source: www.fico.com and own calculations

Unfortunately, the FICO report does not provide information on CNP fraud rates.⁵ This is likely to be much higher than the average. For instance, the UK’s 2016 fraud rate for e-commerce was 9.3 bp (down from 9.5 bp) for local transactions and 23 bp (down from 24.3 bp) for foreign transactions.⁶

From a policy point of view it would often be important to know who bears the damage.

Second, while such comparative statistics are interesting, from a policy point of view it would often be important to know who bears the damage. For instance, for the purpose of consumer protection total fraud is not all that significant. It would be much more helpful to know something about the losses incurred by consumers. Such losses are likely to be relatively small. For instance, the Dutch Payments Association points out that 96.7% of internet banking fraud losses have been fully reimbursed by the victims’ banks.⁷ Of course, it is difficult to get such data. Here the industry should be more forthcoming, in its own interests. It is understandable that many market players are hesitant to publish sensitive data such as fraud data. But when comprehensive and reliable data are missing the result may be bad regulation.

Third, x-border is still a different ball game – even within SEPA. Average fraud rates for domestic transactions, i.e. domestic card and domestic merchant, are often much lower than x-border fraud rates. When looking at x-border, within SEPA is usually less risky than a transaction with a merchant or card holder from outside SEPA.

For instance, the 2017 fraud rates for SEPA x-border transactions in France (French card with foreign SEPA merchant or foreign SEPA card with French merchant) was seven (!) times higher than the fraud rate for a purely domestic transaction. A non-SEPA x.-border transaction carried about double the risk of a SEPA x-border transaction.⁸

Table 1 French Card Fraud Rates

	Fraud rates (bp)
Domestic	3
SEPA x-border	21
Outside SEPA	43

Source: www.observatoire-paiement.fr

In Denmark, the difference is even more extreme. Dancort transactions (incl. co-branded Dancorts) carried out in Denmark have a very low fraud rate between 2 and 3 basis points. When used outside Denmark, the fraud rate rises to values between 22 and 35 bp. Given the very intensive x-border use of Danish cards, this also explains why the average fraud rate for Denmark is the highest in the EU – although domestic transactions are relatively safe.

Therefore, it is difficult to understand that regulators want to force European merchants to treat local intra-SEPA transactions like domestic transactions. As much as one might wish that „European“ is the same as „domestic“ this is still not the case. „Domestic“ still involves lower „fraud

temperatures“ than x-border intra-SEPA. You cannot change that by simply mandating that the thermometer should indicate the same temperature anywhere.

Table 2 Fraud rate for Dancort transactions (bp)

	2017Q1	2017Q2	2017Q3	2017Q4	2018Q1	2018Q2
In Denmark	3	2	2	2	2	2
Abroad	27	24	24	33	35	22

Source: <http://nationalbanken.statbank.dk/nbf/208814>

Donald Trump – Father of the European Card Scheme?

(mk) On 3 September 2018, Yves Mersch, member of the Executive Board of the ECB, delivered a speech at the European Institute of Financial Regulation. In this speech he devoted considerable time to the topic of a European card scheme.

Regarding the current state of play of European card payments, Mersch makes three observations:

„Europe still does not have an integrated, standardised card payment network“

„Europe’s largest card payment networks are still not interoperable“

„It is more convenient to use non-European cards when travelling across Europe“

In his speech, Yves Mersch explains why he is not happy with this situation:

„..., we have to be mindful of the fact that extraterritorial jurisdiction could, in a worst case scenario, affect the operation of those companies and disrupt payments between European counterparties. In the current geopolitical environment, such risks are, unfortunately, not as remote as they once were and need to be taken seriously by European policymakers.“

Therefore, he concludes that

„Our reliance on non-European card schemes for domestic payments in Europe is suboptimal. European card schemes should make interoperability and full pan-European reach their main priorities, enabling any card to be used at any terminal.“

Our Comment:

Summary: The „European Card Payment Scheme“ is back on the political agenda. The outlook of having European card payments carried out by schemes under US governance seems to look even less appealing than a few years ago. We expect political pressure for a European scheme to rise. But we are not sure about the outcome.

For many years, the „European Card Scheme“ has been a topic that was frequently addressed in the context of SEPA. It was also a recurring topic in this newsletter.⁹ However, none of the initiatives succeeded and in recent years policy makers have had other priorities. But the Mersch speech has put the European Card Scheme back again high on the agenda of policy makers.

The main motive for a European card scheme has always been governance.¹⁰ This is also the main argument put

forward by Yves Mersch. Moreover, Yves Mersch argues that „in the current geopolitical environment“ this issue has become more relevant. Given that the two most important international payment schemes, Mastercard and Visa, are both domiciled in the United States, it does not seem far fetched that the somewhat erratic policy stance of the current US administration has pushed the topic „governance of European card payments“ higher up on the agenda of European policy makers. In the current climate, it is highly unlikely that the Mersch speech is a one-off. Rather it can be expected that policy makers will increase the pressure on European banks to come up with a European solution, as they did in the case of credit transfers, direct debits and real-time payments.

The speech comes at a moment in which one had already

accepted that „European card scheme“ had fallen off the policy agenda and that somewhat involuntarily, Europe was sliding towards a situation with a duopoly of card schemes: Mastercard and Visa. In fact, the EU Commission with its un-coordinated anti-trust and internal market policies did a lot to promote such an outcome.¹¹

European policy makers need to re-think their policy stance on cards.

„Governance“ sometimes seems a somewhat arcane topic. Economists and business people are more concerned with efficiency, innovation and profits. However, given the many uncertainties surrounding international politics it seem reasonable to pursue the creation of a card scheme

with 100% European governance.

So, maybe in a few years we will get a European card scheme. If this should be the case, looking back one could rightly say that Donald Trump had involuntarily become the father of the European card scheme. Thank you, Mr. President!

But to get there, European policy makers need to re-think their policy stance on cards. A European card scheme requires co-operation of European banks. Since the payments market is a two-sided market, such co-operation includes - *horribile dictu* - co-operation on business models. If DG Competition is not willing to accept that, the result will be a card duopoly in Europe: Mastercard plus Visa – with a duopoly of Apple and Google (plus maybe Samsung) as additional service providers for mobile payments.

Notes

- 1 European Central Bank: Fifth report on card fraud, September 2018.
- 2 The ECB points out that, in the case of Portugal, the relative share of CNP versus POS fraud was influenced by a severe case of counterfeit fraud. See footnote 18 on page 21 of the Fifth Card Fraud Report.
- 3 FICO (Fair Isaac Corporation), has released its latest card fraud report including data up to 2017 (EVOLUTION OF CARD FRAUD IN EUROPE 2017. <http://www.fico.com/europeanfraud/index>). The report covers 19 countries – a selection of 15 EU countries plus Norway, Russia, Turkey and Ukraine.
- 4 Own calculation based on Blue Book data.
- 5 It provides CNP fraud in % of total transaction value. However, the interesting figure would be CNP fraud in % of CNP transaction value.
- 6 UK Finance: Fraud the Facts 2018, p. 21.
- 7 Dutch Payments Association, Annual Report 2017, p. 48.
- 8 Observatory for the Security of Payment Means: Présentation du 2ème rapport annuel par François Villeroy de Galhau, Président, Conférence de presse du 10 juillet 2018. (www.observatoire-paiement.fr)
- 9 On September 2015, we addressed this issue for the last time: „SEPA for Cards: Completed or not? An inventory“. See also „Domestic card schemes: the ghosts that haunt SEPA for Cards“ (July/August 2014).
- 10 See, for instance our article „A question of governance“ in the September/October 2011 edition.
- 11 See Ewald Judt and Malte Krueger: A European Card Payments Scheme – forever a phantom?, Journal of Payment Strategy & Systems, Vol.7, No. 4, 2013, pp. 344-358.

Should you have any questions or comments please contact:

Dr. Hugo Godschalk (hgodschalk@paysys.de)

Dr. Malte Krueger (mkrueger@paysys.de)

Please, send us your views to:

paysys-report@paysys.de

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PaySys Consultancy GmbH

Im Uhrig 7
 60433 Frankfurt /Germany
 Tel.: +49 (0) 69 / 95 11 77 0
 Fax.: +49 (0) 69 / 52 10 90
 email: info@paysys.de
www.paysys.de

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