

CARD FRAUD: THE HIDDEN COSTS

Card fraud is a worry - and it's a worry for customers, issuers, acquirers and merchants alike.

Consider some numbers taken from a recent study of cardholders in 17 countries around the world¹:

- Of all cardholders—debit, credit and prepaid—27% have experienced card fraud in the past five years.
- In 2012, 14% of debit and credit card holders cite having experienced fraud multiple times during the past five years; this is compared to 6% in 2011, a statistically significant increase.
- After experiencing card fraud, 56% of cardholders use cash or an alternate form of payment instead of a debit or credit card.
- Of cardholders who received replacement cards as a result of a data breach or fraudulent activity in the past year, 46% used the new card less than the original.
- Attrition rates after experiencing card fraud average 21% among cardholders in the 17 countries surveyed.
- 81% of respondents think that government and law enforcement do only an “average” or “below average” job of fighting card or account fraud.

Hiking public concern are the heavily-publicised stories around the arrests of major cybercrime rings. Most recently, there was extensive coverage of an alleged \$45 mn prepaid card fraud affecting banks in the GCC, and earlier in the year, a US-based group said to have stolen \$200 mn. Interestingly, the great majority of this last appears not to have directly affected legitimate customer accounts, but it was still reported as, and presumably taken by the public to be, conventional card fraud².

The reality – and the perception

In truth, actual losses in mature markets with EMV are relatively low: according to an industry watchdog in the UK, for example, although card fraud losses last year were up 14%, they still only totalled £388 million – or around 7 basis points on billing³.

But there's no denying that there's a very real level of concern out there. Take India as a case in point: a Visa study⁴ showed that 46% of respondents were 'extremely' or 'very' concerned about payment card fraud. In fact, 29% went so far as to say that they felt 'extremely vulnerable' to payment card fraud, with a further 73% feeling that media reporting of fraud is a cause for concern. As a direct consequence of these consumer worries, the Reserve Bank of India has issued a specific call to issuers to tackle card fraud⁵. Even in the relatively safe environment of the UK, according to the Crime Survey for England and Wales published by the Office for National Statistics, 63% of adults thought that plastic card fraud had gone up a lot, compared with 3% who thought it had gone down a lot or a little⁶.

¹ ACE_AITE: Global Consumers React to Rising Fraud, 2012

² <http://www.bbc.co.uk/news/world-us-canada-21346871>

³ <http://www.financialfraudaction.org.uk/cms/assets/1/2013%2003%2006%20national%20fraud%20release%20v12%20-%20final.pdf>

⁴ <http://www.businesswireindia.com/PressRelease.asp?b2mid=26069>

⁵ <http://timesofindia.indiatimes.com/business/india-business/RBI-moves-to-check-credit-card-frauds/articleshow/18740126.cms>

⁶ <http://www.ons.gov.uk/ons/rel/crime-stats/crime-statistics/focus-on-property-crime--2011-12/rpt-chapter-3---plastic-card-fraud.html#tab-Perception-and-worry-about-plastic-card-fraud>

Taken together, these developments point to a disturbing conclusion: while the direct effects of card fraud may vary from country to country, they represent just a small fraction of the real cost.

The reason? It's all in the mind.

Consumers believe that fraud is much more prevalent than it is. As a result, in developing markets in particular, where EMV has yet to play a full role, customers are loth to make payments using plastic (or smart phones), and those that do, use them to get cash. It's no accident that the highest volume ATM in Africa stands in the lobby of a supermarket lavishly equipped with POS terminals.

The effect on profitability

The results of this nervousness around cards drop straight to the bottom line:

- Reduced uptake of cards among potential customers who would qualify for one
- Actual cardholders deliberately setting limits on usage
- Reduced interchange earnings, as customers use debit cards to access cash from ATMs, rather than using them at higher-earning POS terminals
- A choke hold on CNP transactions in general, and on e commerce in particular. A recent report on internet payments sums it up like this:
 - Fraud is the single biggest issue in the online space, from both the consumer and industry perspective
 - On the consumer side, fear of being defrauded is also the biggest barrier to online commerce⁷

As an illustration, take the effect of all these factors on a debit card book operated by a mid-sized bank in an emerging market, with say 1 mn active retail customers. High-level modelling suggests that if management were to:

- Increase active levels by 5%
- Switch the ATM/POS split % from around 80/20 to 70/30

the bank would see an increase in revenue of nearly 50%. And this assumes that account spend would stay constant, when in fact customers are likely to be more willing to use the card because they feel less nervous about it. Additionally, there will be important benefits from increased account balances because less cash is withdrawn.

It's a high level calculation⁸, certainly, and numbers will vary from issuer to issuer. But the direction of travel is very clear: relatively modest changes in behaviour will lead to disproportionately high improvements in earnings.

In this light, wouldn't it be more productive if issuers focussed on the positives: building customer confidence in cards rather than endless earnest homilies on fraud avoidance?

⁷ Datamonitor: Consumer Attitudes to Online Payments, 2012

⁸ For more information on the underlying model, please do contact us

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Background

- With more than 20 years of experience in the payment card industry, Roy was previously with American Express, where as VP and General Manager, he launched the highly successful commercial card business in the UK, going on to lead product rollout across EMEA and latterly Latin America/Caribbean.
- As a consultant, Roy works with banking and payment card clients around the world, identifying and advising on best practices in customer marketing and relationship management. He has also undertaken assignments in media, utilities, airlines and retail.
- He has developed and audited coalition and bank loyalty programmes in the UK, Ireland, the Netherlands, Spain, Canada, Dubai, Kuwait, Australia, Singapore, Spain, Israel, Turkey, Saudi Arabia, Brazil, Chile, Venezuela and Mexico.
- Roy has also advised on airline FF programmes, and has been the rewards lead in the MasterCard Advisors pool.
- He speaks fluent Spanish, reasonable French and is the author of *Marketing Planning for Financial Services* (Gower Publishing). He has a B. Com, holds an MA in Management Studies and is a Fellow of the RSA.
- For further background, client list, articles and sample engagements, please visit www.roystephenson.co.uk