

The death knell for the magnetic stripe?

Since Chip and PIN was introduced in Europe, it has been largely accredited for the fall in card present fraud. Latest statistics released by the UK Cards Association, for example, show that fraud losses on UK cards, cheques and online banking have fallen to their lowest levels since the turn of the century.

The largest drop has been in counterfeit card fraud – where a card is cloned or skimmed – which in 2010 was cut by an impressive 41% to GBP 47.6m when compared to the previous year.

Several factors have been attributed to the decline of this type of fraud all across Europe. Specifically, the greater adoption of anti-skimming equipment attached to ATMs have helped reduce counterfeit fraud. Yet, still cited as the main driver behind the fall in fraud is Chip and PIN, where stronger cryptographic algorithms can be used to authenticate cards and the cardholder.

However, while it is positive and reassuring that counterfeit fraud is decreasing, it has not been completely eradicated and is still a big issue for many European banks' card operations and merchants despite the now widespread roll-out of Chip and PIN in the region. EMV migration has been effective as far as minimizing losses against card-present fraud but, until it becomes a universally applied standard across the world, fraud techniques around skimming will remain attractive to fraudsters keen to exploit regional loopholes, such as in the US.

No business case in the US?

Despite the successful implementation of Chip and PIN in Europe, the US has been reluctant to embrace this proven technology across their own continent. Aside from consumer habits and preferences, there is also no perceived financial benefit of migrating from magnetic stripes over to EMV. Historically, relatively low telecommunication costs was a factor. More recently, the sheer number of POS terminals and volume of card transactions means that the expense and inconvenience of implementing Chip and PIN technology for many stateside outweighs the cost of absorbing any losses due to fraud. In addition, as there is no liability on banks in the US should their customers lose out to fraud, the business case for a move to EMV is further undermined.

However, now that companies like Chase Card Services and Wells Fargo have announced initiatives to adopt EMV, the move towards the chip technology looks like it has taken a step closer. US companies are beginning to recognize how outdated the 50-year old magnetic stripe is and how its

presence with customer and account identification makes the card vulnerable to skimming. Americans themselves are also starting to realize that there are situations – such as train ticket vending machines – where only Chip and PIN are accepted. In such situations, they have to revert to cash which makes travelling more inconvenient and expensive for them.

The Belgian's move

These hurdles are increasing as more and more EMV enabled countries look to fight fraudsters. The concern over card fraud is illustrated by the decision taken by 22 Belgian banks to block their debit cards for usage outside Europe as of January 2011. It has been reported that this measure has already lead to a decrease in fraud. While this is a first step in combating fraud, in the long run, it is recommended that steps should be taken to tackle the problem of skimming at its root by removing the magnetic stripe altogether. This is the approach Luxembourg has taken where banks have decided to replace Maestro cards with VPay cards, which have only Chip and PIN capability.

These moves follow the publication of the Seventh Progress Report by the European Central Bank (ECB) last October, which recommended that from 2012 onwards, all newly issued cards in SEPA should be issued, by default, as 'chip-only' cards.

Indeed, the debate around the universal adoption of Chip and PIN and the existence of cards with magnetic stripes was reignited in the UK earlier this year following news reports that fraudsters have been targeting tube and rail commuters by attaching skimming devices to station ticket machines. Similar to ATM fraud, the magnetic stripe was being copied as passengers bought tickets and then used to create fake cards for use in countries with no Chip and PIN protection.

Criminals finding new ways

This new approach to skimming highlights how fraudsters are reinventing ways in which to defraud their victims and are always looking at ways to counteract the fraud prevention tools already in place. Whereby ATM fraud has been reduced by anti-skimming devices, these fraudsters have simply turned to other terminals where they can capture



Skimming utensils, Copyright KEYSTONE/Thomas Frey

the same data. With authorities describing this twist to ATM skimming as a new development that may take time for frauds to become apparent, it is clear that the industry cannot take the declining counterfeit fraud figures for granted and become complacent.

The fact is that while cards with magnetic stripes continue to exist, there remains the opportunity for fraudsters to commit their crimes in countries where Chip and PIN still hasn't been introduced. One simple solution is to mandate Chip and PIN technology worldwide in order to stamp out this fraud altogether. Adopting this proactive security measure will no doubt place more pressure on non-EMV countries like the US to follow suit. However, we are not even close to such a scenario.

The SEPA regulation mandates EMV in the euro zone but only as far as the issuing side. Therefore, there needs to be broader and more far reaching regulation, as well as an industry agreement, on how to move forward with this issue. If global legislation does come in to prohibit magnetic stripe cards, it will require countries like the US to introduce alternative ways for card users to authorize their payments and ensure the genuine card is being used but won't guarantee that EMV will be adopted as the trusted method to do so. There is speculation that should the US implement a card fraud strategy, it is likely to be a mobile solution. However, this would again fragment the industry's response to counterfeit fraud and could oblige Europe to follow the US's lead.

Role of the banks

The fact is that until a common standard is introduced, counterfeit fraud will continue to appeal to fraudsters keen to take advantage of the gaps in Chip and PIN protection. As such, banks need to ensure that if they cannot prevent a card being reproduced for fraudulent purposes, they should be able to monitor the transaction flow and stop the fraud in its tracks. This requires effective fraud management processes, such as the setting up of reliable customer-specific rules and back-office tools to block settlements. At least these systems can flag any irregularities in a customer's transaction behavior as soon as possible and open a case to investigate.

Despite promising statistics on the fall in counterfeit fraud, the key to eliminating it is to fight it together. While the industry can sit and wait for a political consensus, it really needs to initiate the first steps and present a united front. As the banks grapple with this specific fraud issue and the innovative ways in which fraudsters are approaching it, they also need to keep an eye on fraud levels associated with new payment methods such as mobile and contactless payments. The industry has done well in reducing fraud, and Europe is certainly on its way to eradicating it by killing off the magnetic stripe. However, for these efforts to continue and to have a real impact, the US will need to say farewell to the die-hard magnetic stripe as well. <

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