



Rt Hon Andrew Tyrie MP
Treasury Select Committee
House of Commons
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Dear Andrew

Following Hannah Nixon's and my appearance before the Committee on 18 January, I agreed to write to you in my capacity as Chairman of the Financial Conduct Authority (FCA) on the issue of contactless payment fraud. The Committee asked about the role of the FCA and Payment Systems Regulator (PSR) in relation to contactless fraud, and what obligations we placed on banks. You were also interested in our views and in any work we had done on the scale of the issue. The Committee also asked for our views on the wider issue of unreported fraud. We are considering this issue and will communicate to the Committee on this separately in due course. In this letter we have referred to the available data we have on reported contactless card fraud. Unlike some other forms of fraud contactless card fraud can be easily identified by card issuers as they can identify transactions made on cards reported as lost or stolen making the issue of unreported contactless card fraud less of a risk.

The scale of card fraud in the UK and trends in contactless card fraud

The FCA is responsible for the conduct of payment firms, including banks. The use of contactless cards is increasing. There are 101.8m contactless cards in issue in the UK (69.7m debit cards and 32.1m credit/charge cards) and the average contactless transaction is £8.95.¹ In 2015, £7.75bn was spent using contactless cards or devices, generating £2.8m of reported fraud losses². This type of fraud therefore accounts for just under 0.036% of transactions by value. Over the same period, contactless card fraud represented around 0.5% of total card fraud.

Whilst this suggests the risk to consumers is relatively low, we agree public confidence could be eroded without further action. I have set out what we are doing below.

Risks and controls

The key risk to customers occurs from merchants who process payments 'offline' (i.e. retailers who store payments in a batch and process them later - usually overnight in the case of big

¹ Source: The UK Cards Association (November 2016)

² Source: Financial Fraud Action

retailers, but possibly up to a few days later for smaller retailers). Around 45%³ of contactless card transactions occur offline. In most cases merchants choose offline transactions for reasons of cost or convenience for the merchant. In other cases it is either not possible to process payments online (e.g. in-flight aeroplanes) or capped daily charging models make it unfeasible (e.g. Transport for London).

There are a number of controls in place, operated by payment schemes, individual card issuers and the industry which work to limit fraud losses or the impact on customers when losses do occur. You will appreciate that some of these are not publicised to avoid fraudsters gaming the controls. Nonetheless, at a high level some of the key controls are as follows.

Card schemes place limits on the value of each contactless transaction and the number of consecutive, contactless transactions before cardholder verification (i.e. a Chip & PIN transaction) is required. The current transaction limit for a contactless card transaction is £30. The number of consecutive, contactless transactions allowed before a PIN is required is not public to avoid tipping off fraudsters. In addition to these controls, both Visa and MasterCard have a lower cap on the value of transactions that are allowed to be processed offline. Again, these limits are not made public, but reflect awareness that there is a greater risk of fraud in offline transactions. Later this year Visa will require that almost all Visa contactless transactions in the UK are online authorised. This will give issuing banks greater visibility on transactions and will able them to prevent transactions being completed on cards that are reported lost, stolen or cancelled. Given Visa's large market share of the UK contactless card market, it is likely that this will significantly reduce offline processing of contactless transactions, correspondingly reducing contactless card fraud.

In addition to these controls, **card issuers** have their own controls. These include lower limits on the number of consecutive, contactless transactions before a PIN is required, and a lower cap on total contactless spending before a PIN is required. Some issuers issue contactless cards which lack an offline capability altogether, for example some banks restrict offline capability on children's accounts. There is clearly a trade-off here between security and functionality. Finally, some but not all, card issuers have systems that identify and block cancelled card transactions before they are debited from customer accounts. This is one of the solutions we would like to see adopted by all card issuers.

Industry Hot Card File (IHCF): The IHCF contains information on over 7.2m UK cards which have been reported lost, stolen or compromised. When a participating retailer accepts a card payment, in an on-line environment, it is automatically checked against the file, and the retailer is alerted if there is a match.

I would also re-iterate the comments that I made to the Committee on 18 January. Our work in 2015 suggests that firms are generally complying with our unauthorised transactions rules, although we clearly cannot guarantee they get it right in every case. The rules mean that customers are entitled to an immediate and full refund for any unauthorised transaction.

These controls explain why fraud and consumer losses in the contactless environment remain relatively small. However it remains, as in the case highlighted by Rachel Reeves MP, that there are currently a limited set of circumstances where a card can be used by a fraudster several months after it has been cancelled. I agree with the Committee that this needs further action, which is in train.

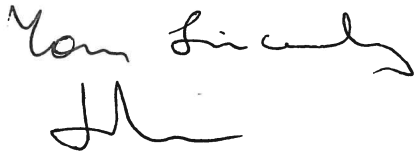
³ Source: The UK Cards Association

Next Steps

The FCA is working with industry to address the risks that have been identified. We have already met with a number of key players and have organised an industry roundtable, hosted by The UK Cards Association and the BBA, on 7 February. The issues we are exploring with the industry include:

- removing any onus on customers to identify fraudulent transactions;
- technical enhancements to reduce the likelihood of post-cancellation contactless fraud;
- making the option of having a non-contactless card more visible during card issuing;
- improving customer communications at the time of cancellation;
- providing clarity to customers on the clearing times for contactless payments; and
- raising awareness of the Industry Hot Card File.

The FCA believes these, and the other industry developments I have set out above, should reduce the incidence of contactless card fraud.



John Griffith-Jones
Chairman

Cc: Rachel Reeves MP