PAYMENTS FRAUD: PERCEPTION VS. REALITY

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OVERVIEW

• Electronic Payments Default Fraud Liability Architecture
  – Public Law
  – Private Rules
• Use of Contracts to Shift Fraud Liability
• Optimizing Fraud Liability Allocation
ELECTRONIC PAYMENT SYSTEM DEFAULT FRAUD LIABILITY ARCHITECTURE – PUBLIC LAW

- **Credit Card Payments – Truth in Lending Act (TILA)/Regulation Z**
  - Limits cardholder liability for unauthorized use to maximum of $50

- **Debit/Payroll Cards and Certain ACH Payments – Electronic Fund Transfer Act (EFTA)/Regulation E**
  - Card Transaction (Access Device) – liability limited to:
    - Maximum of $50 of unauthorized transactions if issuer notified within 2 business days after learning of loss/theft
    - Maximum of $500 of unauthorized transactions if issuer notified after 2 business days but within 60 days of first fraudulent transaction appearing on statement
  - All EFTs (Card/ACH) – unlimited liability for unauthorized transactions beginning 61st day after fraud first appears on statement until fraud is reported to issuer
ELECTRONIC PAYMENT SYSTEM DEFAULT FRAUD LIABILITY ARCHITECTURE – PRIVATE RULES

- Zero Liability for Cardholders
- Establish rules/requirements intended to mitigate system-wide fraud risk
  - Holograms, signature requirements
  - CID, Address Verification
  - PCI DSS
- Allocate fraud liability to payment stream participant that fails to comply with fraud-prevention rules
USE OF CONTRACTS TO FURTHER SHIFT FRAUD LIABILITY – TEXTBOOK MODEL

Model payment system framework contemplates 4 (or 2) parties for fraud liability allocation.
Default liability holders in payment systems use contracts to shift liability:
- Issuer shifts fraud monitoring responsibility and liability to processor
- Acquirer shifts PCI compliance responsibilities to Gateway service provider
WHAT IS THE OPTIMAL ALLOCATION OF FRAUD LIABILITY?

• Protectionism/paternalism v. confidence in payment system
  – Electronic payment systems depend on consumer confidence – may fall if increased fraud liability exposure
  – Insurance dilemma – low or no liability encourages risky behavior (but is fraud ever really free?)

• Impact on development of new payment technologies