e-finance&payments law & policy

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Cash payments in UK more common in 2011

Consumers are increasingly using cash to make payments in store in order to keep track of their spending, the British Retail Consortium (BRC) said on 8 June. "Customers are more likely to be paying with cash", said Tom Ironside, Director Business and Regulation at the BRC. "They have less money. They are buying things only as and when they need them, and spending less each time."

The use of cash in 2011 was up by 5.7% compared to 2010. The BRC based its figures on 9.5 billion transactions in British shops. Ironside: "In 2010 financial worries were putting people off running-up debt and they turned away from cards. Now times are even tougher."

The figures come only weeks after the Court of Justice of the European Union, on 24 May, rejected a legal challenge by MasterCard, to the European Commission's decision classifing their cross-border transaction fees as uncompetitive. The fees are charged by a cardholder's bank to a merchant's bank for each card transaction. MasterCard had agreed to lower its charges in 2009 but the EU Commission believed MasterCard had not gone far enough.

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SEPA progress under pressure as Europe battles with Eurocrisis

The financial crisis and the uncertainty about the future of the Euro puts progress of ambitious European payment integration plans, such as the Single European Payments Area (SEPA), increasingly under pressure. "The Spanish bail out and discussions about deeper Eurozone integration may slow down SEPA," said Michael McKee, Partner at DLA Piper in London, while Mark Taylor, Partner with Hogan Lovells, thinks that "the focus and priority of regulators and governments is inevitably drawn elsewhere. There is a risk that this may lead to a slower rate of progress."

According to Nathalie Moreno, of Speechly Bircham, "the impacts of increased lending and bailouts to keep the Euro afloat will surely affect the ability to make a certain decision on the future of SEPA". To make SEPA a success "we surely would need to ensure we have a Euro", said Gareth Lodge, a Consultant at Celent. McKee agrees with Lodge: "There is no question that the SEPA project is fundamentally tied up in the future of the euro itself."

The crucial role that banks play in the development of SEPA raises concerns since "those banks who have heard of SEPA, and an alarming number still have not, are placing big bets as a way of capitalising on their strengths and their competitors weaknesses. Whilst others are simply trying to survive the month", said Lodge. Regarding the EU Green Paper, calling for an integrated market for card, internet and mobile payments, Moreno said that "as the markets fragment more it is difficult for many to reconcile a unified approach to enable efficient cross border payments".

"SEPA is more and more political", said McKee. That is "why the Green Paper raises issues about mandatory completion times and about SEPA governance; a coded threat that the Commission, European Central Bank and Member States want to wrest more control of the [SEPA] project from the banking industry." Moreno agrees with McKee: "There is a worry that regulatory intervention could hamper the banking sector's competitiveness in the global marketplace and also lead to the lack of development and innovation in this space."

There are also concerns whether the SEPA migration deadline of February 2014 is still realistic: "There will be more than a handful of banks and corporates who will miss the deadline. The questions then are how many, by how much and how long are they given," said Lodge.

Michiel Willems

New EU plans require all Member States to recognise e-ID cards

The European Commission (EC) proposed on 4 June new rules to enable secure cross-border electronic transactions across Europe as part of its Digital Agenda. The proposal requires countries within the EU to recognise the validity of e-ID cards from other Member States and requires those Member States that opt-in to set up independent supervisory bodies to evaluate verification technology for e-signature and website authentication.

"The payments industry will be interested in new and inexpensive ways to authenticate purchase transactions, given that biometrics have been hard to implement," said Mark Beresford, Director at Edgar, Dunn & Co. The proposed regulation presents "a less intrusive and simple to use manner that would simultaneously mitigate the risk of fraud for a large consumer base".

Currently only Belgium, Estonia, Germany, Italy and the Netherlands have national e-identity schemes. The EC clarified in a statement that 'the proposed Regulation will not oblige EU Member States to introduce, or individuals, to obtain national identity cards'.

This "could be the EC's attempt to create an alternative to 3D secure [an authentication step for e-payments provided by Visa or MasterCard], but it would be difficult to achieve without the support of the card schemes," said Beresford. "There may also be implications for SEPA Direct Debits and the requirement for electronic mandates. The implementation of SEPA Direct Debits will be a step forward for some markets but a step backwards for others who are further advanced in direct debits like the UK".

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At a glance

Global – Mobile payments set to soar in value this year from $105.9 billion in 2011 to $171.5 billion in 2012, according to research by Gartner.
UK – A report released on 5 June, initiated by the Ministry of Defense, puts the cost of cybercrime to the UK at £11.6bn per year, significantly lower than the previous government estimate of £27bn.
Australia – The Commonwealth Bank of Australia is to offer cloud-based safety deposit boxes to customers – for storing important documents – as part of its banking services upgrades.
UK - Customers of the Royal Bank of Scotland and NatWest who forget or lose their cards can now withdraw money from ATMs using a mobile banking app.
US – American banks consider technology investments to be a top priority, according to a survey by KPMG.
Europe – The Court of Justice of the European Union has dismissed MasterCard's challenge against a European Commission ruling that its cross-border interchange fees violated competition law.
Global – NCR has introduced a card-less, PIN-less ATM that allows customers to transact through their mobile phones, withdrawing money by scanning a 2D barcode on the ATM screen.
US - PayPal has reached a deal with digital video recorder company DVR to let viewers buy products from interactive TV advertisements through PayPal with a few clicks of their remote control.
Canada – New standards for the use of mobile devices in retail purchases were released on 14 May by the Canadian Bankers Association.
US – Bank of America, JPMorgan and Wells Fargo have launched clearXchange, a peer-to-peer payments platform, allowing users to send and receive payments using just an email address or mobile number.
UK – The UK Post Office has announced it is going to roll out contactless payment terminals across its national network, to encourage the uptake of near field communication technology.
Global – Facebook has launched a direct-to-carrier billing system to simplify payments to developers for their mobile web apps.
Kenya – Google has launched pre-paid near field communication cards for transit payments in Kenya.
US - A Dutch citizen has appeared in a US court this week accused of building websites through which he sold tens of thousands of stolen credit card details obtained by hackers.
India - The Indian financial services industry will spend Rs 377 billion ($6.7 billion) on IT this year, 17% more than a year ago, according research by Gartner.

Editorial board

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Editorial

E-money EU law: the root of all e-commerce regulation

App-commerce, e-coupons, virtual goods, mobile payments; there are many new forms of business succeeding online right now. These new forms are being adopted by very different operators to target several markets in a variety of sectors but they all have one thing in common: anyone wanting to operate them in the UK or the rest of the European Union needs to understand the rules on electronic money.

The EU has had special rules on electronic money for over ten years. The original form of those rules was set out in the Electronic Money Directive 2000. Like many other similar laws - devised in response to the newly emerging e-commerce markets of the first dotcom boom - those original rules did not prove to be as effective in practice as the law-makers had intended.

There were three main problems. First, individual Members States in the EU implemented the Directive into their local law in very different ways, which created an inconsistent legal framework. Secondly, no matter how they were implemented, the way the basic rules were structured actually seemed to deter new providers from adopting new models and innovation in European e-commerce.

Arguably the most important problem, however, was the uncertain definition of electronic money itself. Nobody knew what did or did not fall within the scope of the regulations. With such a fundamental failing it was no surprise that before the end of the decade the lawmakers had another go. The Second Electronic Money Directive was adopted in September 2009.

Member States were required to implement the new Directive into national law by the end of April last year. The Electronic Money Regulations 2011 transposed it into UK law within that deadline. At the same time there were delays in implementation in many other Members States. So, one year on, is it now easier to identify what is or is not electronic money under the new law?

It should be noted that there is only limited official guidance on the new law. Not just because it has only recently been implemented but also because it is a 'maximum harmonisation' measure, i.e. it prohibits additional local restrictions in order to prevent uneven national rules. That means local regulators are reluctant to provide further guidance that might amount to prescriptive national limits.

What is clear, however, is that the new definition is intended to be technology-neutral. So it should be irrelevant whether a physical payment card or a desktop computer or a smart phone or some other device is used. It is also clear that where the provider issuing the monetary value is the only person who then accepts it as payment this will not be considered electronic money.

Under the old law, however, this closed system was limited in scope as in some countries, including the UK; it was interpreted strictly to apply to one legal entity only i.e. where no other party was involved. This created a practical difficulty where a provider wanted to avoid the regulations but an associated company, franchisee, joint venture or any other commercial partner was involved.

This has been amended. There are now several specific exceptions that may apply even if there is more than one legal entity involved. The first applies to payment systems operating only on the premises of the issuer. This likely requires the payment user to be physically present so suggests limited relevance to most applications in the world of e-commerce.

The second and third exceptions apply where the payment system can only be used within a limited network of service providers or for a limited range of goods or services. This is a very helpful change and should help clarify the position of many services. But care is still needed because there is formal definition of, and no conditions or criteria for determining, a 'limited network' or 'limited range'.

Indeed, the Directive does warn that a limited system that then develops into a 'general-purpose' one or which is based on a 'continuously growing' list of merchant participants should not be exempted. The factors which the UK regulator lists as relevant in determining a 'limited network' includes the scope and terms of participation as well as the scale and nature of the services.

The final exception tries to clarify the position of mobile phones which have for many years been used to purchase ringtones or apps but might otherwise fall within the definition of electronic money. Hoever the exception is limited to products capable of being enjoyed on the device itself, so would not extend to purchases of train tickets or theatre tickets delivered by mobile.

In summary, the new law does provide very valuable clarification of the concept of electronic money across the EU. The rules do still need careful consideration however. If the exceptions do not apply to a specific service then it will be necessary to operate under the specific regulations set out in the law.

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The latest developments in legal e-billing in Europe and the US

Electronic invoicing has become common practice in the United States and an increasing number of companies in the UK and throughout Europe are delivering bills electronically. Bryan King, an independent e-billing consultant who previously worked for Linklaters, Lovells and Clifford Chance, discusses the latest developments in relation to electronic billing and examines the differences between the US and European e-billing experience.

The concept of e-bills

Before looking at the latest international trends we need to distinguish between 'full' e-billing as against the uploading of a PDF or Word copy of a paper bill or the keying of invoice details to a client or third party web site. Full e-billing involves the production of an electronic file, usually in one of the LEDES (Legal Electronic Data Exchange Standards) formats which contains not just the invoice header, matter information and bill totals but a detailed breakdown of time lines and expenses, coded using the UTBMS (Uniform Task Based Management System) code set for tasks, activities and expenses. The e-bill passes various levels of validation before being uploaded to the client's systems where it is finally authorised and paid. The client's legal team is then able to use specialist software to analyse all aspects of the billing data and compare like-with-like information across all their external advisers submitting e-bills.

Differences between the US and UK/EU e-billing

Although e-billing is now making an impact in the commercial relationship between a growing number of UK/EU in-house legal departments and their external law firms there are still a large number of organisations who are not yet reaping the benefits that e-billing can bring. Indeed it has recently been said that many non-US corporate legal departments still do not 'get it' as far as e-billing is concerned.

There is no doubt that in the US, clients have been getting it for many years and the size of the US e-billing market is a testament to this. For example, it is estimated that in 2010 over $25bn of legal bills were processed electronically in the US and that over 85% of all litigation work is now e-billed.

Looking at the UK market, in a recent survey of general counsel by PLC, almost 60% of in-house lawyers wanted to be able to see their bills electronically, compared with a figure of fewer than 10% of counsel who currently are able to receive billing data directly from their law firms.

What then is the driver for legal e-billing and what returns are corporate legal departments expecting e-billing to deliver for them?

Some of the often claimed benefits are:

- What in-house counsel want from their external advisers is clarity, consistency and transparency in the billing process and e-billing is the only way to deliver this.
- E-billing enforces compliance with a client's billing rules and agreed fee rates and ensures that bills are mathematically correct, and that only those disbursements allowed are billed.
- Enables in-house counsel to analyse billing data in detail, improves management information and assists in the legal spend budget process.
- Allows counsel to know exactly what their external firms are working on and that the appropriate firms are being instructed for the most suitable work.
- Finally, e-billing will reduce the paper trail of bills within a client's organisation and will improve the processes for invoice approval and payment.

Given that e-billing is in its relative infancy outside of the US there is not a large amount of data that can show whether these benefits have been realised but from some US case studies it would appear that it is certainly possible. What is clear is that US experience shows that the improved quality of data that e-billing brings, and the ability to analyse spend across firms, allows a much more informed discussion to take place with outside counsel.

While cost reduction may be the primary driver in the US, several UK-based organisations have realised that other benefits can accrue from e-billing. One of the most high profile e-billing projects outside of the US was recently completed by Barclays. Andrew Dey, Head of Operations at Barclays Legal, maintains that e-billing is not just about cutting costs and fees but part of a much wider strategic relationship with their external firms.

Recent developments

In many firms e-billing is still a manual operation and is seen as 'something different'. These firms have not really understood or begun to overcome some of the issues that need to be addressed. This approach will lead to a high level of resources being required and much manual intervention in the production of e-bills. Certainly, firms in this position will find e-billing a high-cost process and will not see many benefits.

However, as a contrast, in a number of other firms, e-billing is now fully integrated into the normal billing routines, which means that there is less manual intervention and the costs associated with e-billing are lower. Ideally in these firms there will be validation of time recorded, codes, narratives, rates, timekeepers and expenses earlier in the billing process; e-bill production will be integrated into the firm's time and billing system; and there will be checks for compliance with client billing rules before the bill is finalised. These firms are now much more on the front foot, have well defined processes for the take-on of new e-billing clients, have support for e-billing in client/matter inception and time-recording systems; and their staff are comfortable with e-billing requirements and processes.

In many firms e-billing is still a manual operation and is seen as 'something different'. These firms have not really understood or begun to overcome some of the issues that need to be addressed.

However, it is not necessarily the large City-based firms that have led the way in e-billing.

UK

In the UK, successful e-billing implementations have taken place in a number of smaller firms, while at least one regional firm is now e-billing over 30 of its largest clients. The key success factor that marks out these firms is their ability to integrate e-billing into their normal business routines. These firms have changed their internal processes to support the move, have trained their staff, and made key changes to their systems to support the technical requirements.

Finally, a recent development, where legal e-billing will have an impact in the UK, is in the area of civil litigation, particularly cost budgeting and the preparation of bills of costs. Up until now the billing of non-commercial legal work, has remained a heavily manual and expensive process and has benefitted little from advances in technology.

Much has been written about Lord Justice Jackson's 2009 review of civil litigation and one area of the review, which has been widely accepted is the future budgeting and billing of legal costs. The Association of Cost Lawyers' Jackson working group followed up the 2009 review and inter alia looked at how e-billing standards and technology could benefit the civil justice process.

The group's 'Modernising Bills of Costs' report published in October 2011 has made a series of recommendations - one of which is to introduce some aspects of the successful commercial e-billing processes into civil litigation costs management. A key proposal is that law firms working in this area should begin to think about recording time along the lines of the UTBMS phase, task and activity codes and producing billing data in a LEDES type file format. Even though this is a medium term goal many of the law firms and costs drafting companies working on personal injury, road traffic, medical negligence and other civil litigation matters will have to start thinking about these issues and looking at how their time recording, billing and accounting systems can be upgraded to support e-billing.

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Mobile services to transform the financial services industry

The invention of the smart phone has presented businesses, especially retail banks, with direct channels to better engage with and empower customers in their everyday lives. A lack of trust has blighted the financial services industry since the financial crisis, so the possibilities inherent within mobile channels present a real opportunity for banks to rebuild this trust through positive communication. Roger Peverelli, Partner at VODW, and Reggy de Feniks, Partner at 9senses, discuss the current trends in the uptake of mobile channels within the financial services industry and examine how the smart phone reshapes the retail banking ecosystem.

The way most financial services firms are exploring mobile makes you think you've travelled back to 1995, to the early days of the internet. The first applications we saw back then on the internet were typical examples of what Marshall McLuhan called the 'Horseless carriage syndrome'. The first car looked like a carriage without a horse. When we try to grasp a new medium, we always do so within the confines of a medium we already know. Financial institutions are still at this stage; they are currently replicating existing processes to the mobile channel. Don't get us wrong: this is good. But we feel - like everyone - that so much more is possible. We really need to think beyond the horseless carriage.

We have identified the six most important consumer trends that set the stage for the future and the design imperatives for the successful financial company of the future. Mobile will play a crucial role in tapping into every single trend. Financial institutions should be more aware of this and use the trends as principles for mobile strategy. For the purpose of this article we will introduce three of the six trends to illustrate this.

Consumer relationships

Consumer relationships with financial institutions have changed. Trust is still under pressure. We researched what drives trust and found that the basic daily provision of services determines no less than 40% trust. Morality only accounted for 2.5%. Trust cannot be restored simply by talking about it in advertising: it is won back by excelling in the daily provision of services. Financial institutions should create service excellence on top of operational excellence. According to Pablo Cardona and Wei He of IESE Business School in Spain, trust is the willingness to be vulnerable to another person, based on positive expectations about the other person's intentions and behaviour. Trust increases through a series of positive experiences, interactions and observations. In other words: the frequency and added value of interaction between customer and bank dictate the pace of growth in trust.

The reality is that in Western countries people rarely visit their bank branch anymore. A lot of branches see 20 customers per day, at most. New research shows that visits to the web sites of most major Western banks outnumber branch visits by a factor of 50 to 100. And we now see that apps from banks are used much more often by customers to login to their bank's website. Customers that use ABN AMRO's app access the bank 11 times more than they did via their computer. The contact frequency and added value banks can offer with mobile are therefore the keys to restore and expand trust.

Transparency and simplicity

Consumers are calling for transparency and simplicity. Transparency is the single most important factor in corporate reputation. Choice and information overload, drive the call for simplicity. Our experience in the worldwide implementation of transparency and simplicity in financial institutions is that this goes beyond the products. It for instance requires major adaptations to business models. With transparency and simplicity lies the risk that products from different competitors start to look alike, resulting in commoditisation and competitive pricing, which in turn puts pressure on margins. The only way for a bank to escape this is to combine transparency and simplicity with specific value-added services and a superior customer experience that differentiates it from the competition. Again taking the ABN AMRO app as an example: To access a bank account via a laptop takes 1 minute and 5 steps, via the mobile app it takes only 10 seconds and 2 steps. This simplicity enforces the perception of being in control.

Consumers preferences

Consumers crave identity and authenticity and being recognised and treated as an individual. It is about added value and the human dimension. 'Closeness' is more than 'physical proximity'. The challenge is to be 'close' across the different channels. The rise of smart phones and tablets adds another dimension. Phones are not phones anymore. Not that long ago a phone's purpose was to make calls. With the arrival of the smart phone that notion has become outdated. Calling and sending text messages makes up only 10% of the time spent on a smart phone. Research by VODW shows that the other 90% is used: 'to wake up', 'to make pictures', 'to boil an egg', 'to check Facebook', 'to keep the kids busy' - all kinds of uses that have next to nothing to do with the original purpose of the phone. One third of young women check Facebook before brushing their teeth in the mornings according to a study of American social media users by Oxygen Media. The smart phone has become an essential part of life; the first thing you look at in the morning, and the last thing you check before going to sleep.

Understanding the mobile device

Understanding what a smart phone means to your customer, and how it relates to your brand, product, or service, should be the starting point for real consumer insights. It is important to look beyond the core product. The context in which the product is used should be taken into account, as well as the situations in which it plays a part. For a suntan lotion manufacturer it would be the beach, for insurers it would be situations that put consumers at risk, and for a bank it would be the moment a consumer spends money. This will yield consumer insights and opportunities to help customers' lives.

Every bank will do this in their own way. But from what we've seen so far in mobile services, we think there is one denominator for success: helping. For many, the smart phone has become the number one device to aid all activities by taking care of things faster and easier, and providing insights that are specific to the place and situation. The consumer should be given insights, information, and opportunities that help them in specific moments or places during their day. American general insurer State Farm realised it had hardly any contact with its customers. Once a year it sent out a notification that the premium had gone up. To address that, State Farm developed a simple app that enables customers to view weather forecasts and road conditions on their smart phone. In a simple way it ensures one daily positive contact, instead of a yearly negative one.

What all these applications share is their customer centricity, rather than product centricity. Financial institutions can now accompany their customers wherever they go in the world.

What all these applications share is their customer centricity, rather than product centricity. Financial institutions can now accompany their customers wherever they go in the world. Mobile phones offer contact points not only through their checking and savings accounts, but also through the possibility of offering additional services that support their everyday lives. Mobile phones give financial service providers the opportunity to be close to their customers and part of people's lives.

Mobile banking transforms the customer experience

A worldwide TNS study in 2011 showed that more mobile phone subscriptions existed (5.3 billion) than bank accounts (1.6 billion) and PCs (1.1 billion). According to Forrester, there will be 1 billion smart phone customers by 2016. Estimates for the amount of people worldwide accessing financial services through their mobile vary from between 500 million and 1 billion people by 2015. At Finovate 2012 it was mentioned that 30% of banking app users at Rabobank replaced online banking with their mobile app. Clearly there is a shift from online to mobile.

Another perspective is the added value that is being offered via the mobile device. The current account and everything that goes with it is currently the most important part of the relationship between a customer and their bank. According to Strands, developer of personal finance tools, the first generation of digital budget tools is already used around 10 times per month on average. To us it is clear the core of the relationship with a bank will shift from online and the current account to mobile and everyday tools for daily empowerment. Obviously that will lead to new exciting challenges, it will help interaction, it will help banks learn more about their customers, restore trust and create new added value.

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Interview: Jake Berry MP

Michiel Willems spoke to Jake Berry, Member of Parliament for Rossendale and Darwen, and a former City solicitor, on the government's role in developing and regulating the mobile phone industry, broadband issues and the future of the UK's online infrastructure.

How do you see the future of the mobile phone in the UK?
Already great strides have been made with the availability of many 'apps' giving mobile phones the flexibility of being more than just a communication tool. Indeed, one of the newer apps is to summon a taxi and have it arrive within minutes that takes you to the destination you have programmed and finally charges the cost to a credit/debit card and emails the receipt to the passenger.

What should happen to give mobile payments a breakthrough with the mass audience?
It is down to the banks and retailers to make a breakthrough with the mass audience. Without the participation of the majority of retailers and all banks it would not be viable. Costs and security issues would also have to be taken into account. As banks, retailers, phone manufacturers and many others are involved, there needs to be a common set of protocols and standards.

What do you think of the Communications White Paper?
To help inform policy options for a White Paper, a number of half-day seminars will be held and will cover a range of topics, with the aim to promote growth and evolution in the communications sector, to meet consumer expectations of high-quality content and services delivered in a variety of ways, to improve connectivity and speed, and to ensure sufficient protection from unfair practices and inappropriate content.

Do you think the current Government is giving the industry the space to grow and develop?
Yes, The Government is undertaking a wide-scale review of the regulatory framework supporting the communications sector. The aim is to strip away unnecessary red tape and remove barriers to growth. The wider public interest will underpin the way we address these issues.

Do you think the Government should regulate the mobile industry more?
The Government is committed to the principle of independent regulation and will ensure that Ofcom has the right powers and duties to work in a way that gives businesses confidence in the regulatory system.

It is crucial that the Government implements a deregulated framework suitable for the digital age and properly oriented towards growth in order to take account of the rapid pace of change in new communications technologies in the last few years.

How do you see the future of broadband?
Many of the most dynamic developments in broadband are in wireless devices and the development of very high data rates in mobility. Whether in the home or outside, consumers are enjoying services and content over devices which connect wirelessly.

Could you give an example?
Grant Shapps MP, Minster for Housing, is calling on every social landlord to look long and hard at how they can help their tenants get online, from offering networks of public internet cafes to providing the technology to log on at home. The Minster for Housing said internet connectivity is considered by many to be the fourth essential utility, and should be a necessity, not a luxury. The Government is committed to helping demolish the unacceptable digital divide that is blocking social mobility for millions of council tenants.

Will the UK infrastructure be able to cope with increasing data demands?
The current Mobile networks were engineered to support a real-time voice service which supported roaming between cells. Today, devices such as Apple's iPhone and iPad make very different demands on the network infrastructure, requiring operators to meet customer expectations of mobility, but with rapidly growing demands for data downloads.

Broadband infrastructure investment is vital in supporting the overall growth agenda. Rural and remote areas of the country should benefit from this infrastructure upgrade at the same time as more populated areas, ensuring that an acceptable level of broadband is delivered to those parts of the country that are currently excluded.

Infrastructure sharing and new overhead deployment can play an important role in delivering superfast broadband that meets increasing data demands.

Do you embrace the concept of net neutrality?
Yes. The internet has brought huge economic and social benefits across the world because of its openness and that must continue.

Technology neutrality will be an essential criterion, as we believe a mix of technologies will be needed. It will be important that Government maintains its commitment to technology-neutral solutions for broadband.

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UK and mobile payments: let the Games commence

In the final instalment of the two-part article on the mobile payments industry in the UK, Jonathan Bye and Carlo R.W. de Meijer, of the Royal Bank of Scotland, analyse the other side of the coin - the inhibitors to widespread consumer adoption of mobile payment technologies, the lack of standardisation and the regulatory hurdles and significant collaboration attempts that may very well stifle competition within the industry.

Since our first article on mobile payments in the UK, in this magazine in July 2011, activities in the mobile payments market have intensified. Over recent months a growing number of new initiatives and announcements have come out of the UK. But we are also seeing new players coming to the UK mobile payments market wishing to take advantage of this open and receptive environment. The level of activity is increasing not only amongst mobile operators and the cards industry, but also now within the banking sector, through launching their own competing services.

Some are predicting mobile payments will soon become commonplace in the UK. According to a recent survey by Intelligent Environment (IE) the London Olympics 2012 could act as a decisive trigger for both the delivering and adoption of mobile payment services in the UK.

Consumer adoption

Despite the advancements in the UK and the growing number of mobile payment propositions, consumer adoption is still relatively low compared to other European countries. Only recently have handset manufacturers started to produce sophisticated phones capable of managing mobile wallets.

Many consumers seem unconvinced of the benefits of making payments in this way. According to a recent Finaccord's Payment Metrics consumer research study, across all owners of mobile phones in the UK, just 10% stated they were favourable towards the concept with a further 20% reporting that they were quite favourable. Specifically older consumers are less receptive to the concept than their younger counterparts. Customer education and marketing along with incentives may be required to encourage take-up.

Fear over safety

There are a number of concerns making would-be consumers reluctant to carry out mobile payments. One main reason for the slower-than-expected uptake of mobile payments in the UK has to do with security concerns. According to a recent report from consumer research company Interspeience the vast majority of British citizens fear that mobile payment services could lead to security breaches. 44 percent of research participants cited security concerns as the main risk for using a mobile device to carry out payments. Another 24 percent of interviewees believe that their mobile phone is more likely to be stolen than their wallet. Only 17% of the interviewees are interested in using their mobile phones like mobile wallets.

Recent publicity has highlighted the risk of fraudsters scanning NFC equipped mobile phones to capture card details that can then be used to manufacture counterfeit cards or used online at eCommerce merchants that do not demand CVV details.

It is up to the industry to educate consumers about the facts. Consumer awareness needs to be improved and that requires more education and information on the new technologies and their advantages. But even then, only with time and familiarity (as with online banking) will consumers become comfortable with making mobile payments.

Retailers: slow to adopt

Acceptance of mobile applications in the merchant sector is also a hard struggle because of the cost of implementation, staff training and integration with existing eftpos solutions. However there are encouraging signs that the NFC acceptance market is taking off and this will help the mobile business case. The lack of standards and interoperability, as well as a lack of multi-stakeholder collaboration between telcos, banks and IT suppliers in the UK has constrained mobile payments from becoming mainstream.

Lack of standardisation and interoperability

A major obstacle holding back mobile payments in the UK is standardisation, and the lack of interoperability. Parties are mutually waiting on one another for some standards to evolve, perhaps more so in the remote mobile payments sphere than for contactless payments.

The UK mobile ecosystem is very diverse, fragmented with a wide array of coexisting stand-alone mobile solutions using different technologies. There are many forms of mobile payments, from contactless and mobile card readers to mobile wallets and payment apps, each trying to forge their own defacto 'standards'. As a consequence matching consumer's mobile devices with the corresponding technology that banks and vendors need to receive payment is difficult to say the least.

There are many different stakeholders involved, including banks, mobile network operators, retailers and handset manufacturers to name just a few. All of these companies have conflicting agendas, making interoperability more difficult. The debate surrounding the secure element is just one example of the lack of consensus that is currently slowing the development of contactless mobile payments. The secure element (SE) is a cryptographic engine within a mobile handset that can store data securely. Mobile network operators favour the SIM card for this role whereas some financial institutions' preference is for mobile payment apps to run off a separate SE embedded within the handset, which they issue. Only with effective cooperation for standards and supportive regulation can one push mobile payments forward.

UK: limited multi-stakeholder collaboration

Another challenge is the limited collaboration in the mobile payments space in the UK between the various stakeholders involved. Mobile operators and technology providers are still pushing proprietary developments, being pro-active in the UK market. Although banks have been making waves in the mobile payments sector, on the whole financial institutions still appear to be off the pace. There are collaborations but often these are bilateral agreements leading to partial roll outs, most of which are not UK-wide. But for a real breakthrough so that mobile payments become mainstream, the industry will need to adopt a more collaborative approach in which multiple stakeholders across the industry participate.

The Payments Council initiative in the P2P space is one glimmer of hope and the UK Cards Association is bringing together card payment providers and MNOs to discuss potential areas of collaboration, though as yet without any clear implementation plan.

The Netherlands: Multi-stakeholder collaboration

The contactless mobile situation in the UK does not compare well to the multi-stakeholder collaboration in the Netherlands, where financial services providers ABN AMRO, Rabobank and ING joined forces with telcos and ICT service providers T-Mobile, KPN and Vodafone. They signed a letter of intent to jointly introduce mobile payments using NFC technology at the point of sales (POS) in the Netherlands. Despite the withdrawal of T-Mobile due to the lack of contactless infrastructure in the Netherlands the project is continuing. To enhance the ease of use and safety, a single uniform system for mobile transactions in the Netherlands is envisioned, based on international standards. It is expected Travik (formerly known as Sixpack, before T-Mobile's withdrawal) will now go live in 2013 subject to meeting the regulatory and competition concerns of the European Commission.

Regulatory clearance: lack of competition

Regulatory clearance could also be a major hurdle. Projects such as Oscar and others that might damage competition require regulatory approval from the European Commission. The partners submitted their plans to the European Commission in March and a 25 day investigation period has now come to its end. Preliminary findings suggest concerns about competition in the emerging mobile wallet market, mobile advertising and related data analytics services market. The Commission remains concerned that the proposed mobile payments plans could block future potential competitors.

The Commission decided not to reject or wave through the plans, instead demanding more time to scrutinise them. The European Commission has opened an ´in-depth investigation' to determine whether these initial concerns are confirmed or not. The EC will now have 90 working days, until the end of August, to investigate the project with a focus on its potential impact on competitors, and to take a final decision on whether the proposed transaction would reduce effective competition in the European Economic Area. It is now impossible for Project Oscar to be ready in time for the London Olympics.

Project Oscar is not alone in arousing the interests of European competition authorities. The Dutch Travik collective of banks and telcos have set back their planned launch date until 2013 while they pro-actively submit their plans to DC Comp to examine their proposal for approval, rather than have it referred later.

Acceptance of mobile applications in the merchant sector is also a hard struggle because of the cost of implementation, staff training and integration with existing eftpos solutions.

Future

Though there are reservations about the quick take up of mobile payments and many think the UK is still far away from critical mass, there are also a number of encouraging signs.

Innovation

There is increasing innovation in the mobile payments arena in the UK together with big and trusted names like Visa, Vodafone and now banks stepping in. The number of players in the mobile payments arena will certainly increase further.

Smartphones

The growing number of smartphone users in the UK; there were over 27 million active smartphones by the end of 2011. That number is expected to dramatically increase by 63 per cent during 2012. Persuading significant numbers of consumers in the UK to use their mobile phones to make payments will remain a challenge.

Contactless POS terminals

Major retailers offering contactless point-of-sale terminals in the UK such as Waitrose, McDonalds, Boots, WH Smith and Tesco are expanding to provide wider coverage in branches. Visa predicts the number of contactless POS terminals in the UK will rise by 50% to 150,000 this year. All these might contribute to increased usage of mobile payments in the UK.

One thing is clear, mobile payments come in many flavours and there is no single solution. Multiple stakeholders play different roles according to whether they are deploying mobile contactless or mobile remote payments. New entrants are emerging all the time offering specialist services. Proprietary solutions are fighting to develop brand and market share while interoperability and standardisation is taking longer to be agreed.

There is a real risk that consumers will become confused and overwhelmed by technology, given a choice between a V.me wallet, a Google wallet, a PayPal wallet, an O2 wallet and a host of bank branded wallets, how will the customer choose what is best for their needs?

Given a choice between a contactless card, an NFC sticker, or an NFC smartphone where do consumers go for information? Ultimately it is the end user that will decide what will be successful; ease of use, great functionality and widespread acceptance will be the critical drivers.

London 2012 kicks off in July and runs until Mid August, it is a unique opportunity to show the future of payments coming to life. This could motivate people to experiment and adopt easy and safe payments through mobile devices. The 2012 London Olympics may be the stage to showcase what mobile banking and mobile payments can really offer.

So, let the Games commence!

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Interview: Darren Hodder

In the first of a two part series, Michiel Willems and Sophie Cameron, spoke to Darren Hodder, Director at Fraud Consulting Ltd, about what appears to be a significant increase in fraud and cybercrime, the use of fraud statistics, and the role of businesses in developing robust fraud strategies.

The UK's Annual Fraud Indicator 2012 released by the National Fraud Authority (NFA) puts losses to the UK economy at £73 billion, a significantly higher estimate than previous studies. What is to blame for such an increase? Having spent some time with the authors of that report, what is clear is that fraud isn't massively increasing from one year to the next. What's actually happening is that the NFA has got far more sophisticated at measuring the fraud that is already out there. Fraud is being measured across the public and private sector and then broken down into sub-sectors. The harder and the more you look the more fraud you find.

What is the reason for that increase in measurement, is it for instance businesses reporting more fraud or better tools to do the job? I think it is an increase in awareness of fraud issues and an increase in resourcing to understand the size of the problem. Having said that there are still a lot of companies out there that are unsure about fraud and their losses to fraud. When you look at the fraud reports they give a red, amber, and green status to each estimate, which indicates how confident the NFA are in the accuracy of each estimate. We will get a more accurate picture of fraud every year.

Do you think we will ever reach a point where we can say that figure is exactly how much fraud is going on? Is that possible? I think that is probably unlikely. One of the key challenges in studies like this is that everybody has differing opinions on what constitutes fraud. For example in the financial services sector if you are a company dealing with the sub-prime market you expect a certain amount of soft fraud whereby the people doing business are genuine but they may manipulate their personal data slightly, now in the sub-prime sector this is expected to some extent and not considered fraudulent, but in the prime lending sector if you were to lie on your application that would certainly be deemed fraudulent. There are complexities surrounding how you define fraud in certain scenarios. I don't think you will ever get complete agreement around the definition. And obviously there will always be a certain amount of fraud that you only find out about in hindsight. Having said that we are getting better at measuring the problem and the UK is better than most at measuring the true extent of fraud across the public and private sector.

What are fraud statistics useful for? They help to raise awareness generally. Since the NFA began this study the statistics have really hit home particularly within the public sector, which is now more aware of exactly how much fraud is costing the public purse. Rather than cuts within the public sector one way to achieve savings would be to reduce fraud. As a result of these reports I believe there is a much stronger focus on improving the fraud situation.

Plastic card fraud comes in at £341 million and telecommunications fraud comes in at £972 million in the report, why are these forms of payment so high risk? Although we have made a lot of good progress with initiatives such as Chip and PIN, the reality is that we like to use new and inventive technologies quickly and with these new technologies come new fraud risks. There is a tendency to use these technologies before we know what the new fraud risks might be. If you take Chip and PIN for example we are still using the magstripe as a fall back and there are still major markets like the US that are still to come on board with Chip and PIN so although it has reduced one kind of fraud, cards are still being skimmed and cloned and used in jurisdictions without Chip and PIN. A particular fraud measure tends to displace the fraud somewhere else. Especially with online transactions there is a lot of scope for committing fraud. While there are tools available to help combat this, strong fraud strategies are needed to authenticate that a user is who they say they are in an effective manner. But I think over the next few years we will see new and improved tools to help this problem.

Are there any products on the market or coming to market that will help? There are a number of different products. Many of the credit bureaus now offer online authentification services whereby you can verify the data the user is supplying. It can be set up that random questions are asked of the user that only the user would know, because of the richness of the data held by the credit bureaus. There are various solutions surrounding verifying online identity. There is one based in Edinburgh called MiiCard My Internet Identity that works by you as a consumer registering your details with them, they authenticate your details, and you then have a digital passport for transacting safely online. That's a new solution, I wouldn't say it is the definitive solution but it is one to watch out for.

As a fraud consultant are there any recurring problems you come across? I'm working with a number of new entrants to the market at the moment, within pay day loans and one of the challenges they face is the constantly changing regulations. Often new entrants are new to financial services as a whole and not completely aware of their obligations. I think there is a tendency not to think about fraud early enough in every sector.

Do you think the focus is on fraud detection or fraud prevention? Both. There is a misnomer in business that a fraud strategy is a barrier to good business - that is not the case. A good strategy is actually a business enabler it enables you to conduct business with confidence. The right controls enable you to prevent and detect fraud early and increase business confidence.

Are companies prioritising the development of a fraud strategy? Certainly, especially in financial services they are well established already. An interesting area for me is around data sharing for fraud prevention. In the UK we are in a strong position in regards to our approach to data sharing.

Is financial services the only sector currently sharing information? Many sectors are doing some level of information sharing particularly organisations transacting wholly online. They may not share the information about the account holders or the individuals but they are often sharing information about the devices connecting to websites. That is very simple to do because you are not sharing any personal information.

What is the value of that? The value is that quite often when it is an organised fraud you will find that the same devices are hitting multiple services multiple times and by having a data sharing solution in place you can quickly identify a device that has acted badly and block that device. A solution that I think is particularly powerful in this space is Iovation's ReputationManager 360, which is a shared database solution. So when a user hits a website a fingerprint is taken of the device which can then be matched with previous transactions, across the globe and across sectors. If you combine that with an online identification solution you have both pieces of the jigsaw.

A number of well established financial service providers and banks have suffered serious security breaches recently what are they doing wrong? I think for some of them they are not doing anything wrong, it is just the reality that the fraudsters are still one step ahead of us when it comes to their techniques and ability to infiltrate.

So they are too naive and too slow? Sometimes it's naivety. If you were to take the incident with Sony and the PlayStation network, as a direct result they now have a much stronger team in place. Sometimes it takes a serious breach to make a company proactive. Sony will certainly not be the last.

Are well-established companies better at fraud prevention than young companies? Some companies are really innovative, I was at a conference where Skype presented their approach to fraud. They have a clear and innovative strategy in place, whereas some companies don't treat it with the level of priority it needs.

Alot of very well established institutions are well aware of fraud issues, but have very complex IT infrastructure, so making alterations can take a very long time. That is where there is a window of opportunity for the organised criminal who will recognise that a particular institution has a weakness and exploit it.

If you were a fraudster which company would you target, what would the profile of the organisation be? Well I would be spreading myself across a number of companies identifying the weak companies and testing them out. Fraudsters will systematically test for weaknesses especially when a new product or service is launched. New entrants are always at risk particularly in emerging markets where organisations want to grab market share. I saw this in the gambling sector when a lot of the high street bookies went online, they were actually very naive in there approach to going online, offering incentives for new customers to sign up without having any controls in place, which led to a huge amount of bonus abuse in the special offers they were giving out.

How much of fraud is commited by the opportunist taking advantage of a situation and how much is down to career criminals? That's a tough one. A lot of the work I have done with high street banks involves soft fraud, where applicants are credit hungry. Having said that when there is an organised fraud they tend to hit fast and hard when they find a weakness and that is where substantial losses occur. It is hard to accurately judge the division between the two because they are two ends of the spectrum.

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US: The transformation and regulation of crowdfunding

Crowdfunding, the collective pooling of resources to support efforts such as the funding of new business, is not new. However with the support of the internet, crowdfunding has been transformed and sites are popping up more and more, particularly in the United States, dedicated to crowdfunding. Following the amendment of the US Securities Act in April of this year raising capital through crowdfunding is set to really make a difference, as Bennet Kelley, Founder of the Internet Law Center, discusses.

The 'Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012' ('Crowdfund Act') was enacted as part of the 'Jumpstart Our Business Startups Act' signed by President Obama on 5 April 2012[1]. The Crowdfund Act amended the Securities Act of 1933 ('1933 Act'), which generally limited the pool of investors from which private companies may raise capital, to permit private companies to raise capital through crowdfunding.

In signing the legislation, President Obama stressed that "a lot has changed in 80 years, and it is time our laws did as well". President Obama called the legislation "a potential game changer" since "start-ups and small business will now have access to a big, new pool of potential investors, namely, the American people [who will now] be able to go online and invest in entrepreneurs that they believe in"[2].

Crowdfunding and the 1933 Act

While crowdfunding is not a new phenomenon, as anyone who has attended a service in which a collection basket was passed or watched a telethon can attest, its emergence as a potential source of capital for businesses stems from two breakthroughs and one breakdown.

The two breakthroughs are the commercialisation of the internet that in turn provided the scale for the open-source software movement that tapped a community of knowledge to find solutions through what became known as crowdsourcing. Crowdsourcing soon evolved into crowdfunding with the launch of ArtistShare.com in 2000 to provide funding for recording artists. This trend accelerated with the launch of sites such as Kiva.org, a microlending platform that has provided financing to developing countries since 2005, a model which Prosper.com and LendingClub.com followed to serve borrowers in the United States.

Crowdfunding's growth may also have been due to a market breakdown, as the venture capital market dried up, dropping by a third over 2009-2010 compared to 2007-2008. As this was occurring, sites such as Kickstarter.com and IndieGoGo.com expanded the ArtistShare model to a broad range of creative endeavors fueling the growth of the crowdfunding market from $32 million in 2010 to $123 million in 2011[3].

Kickstarter

While the average Kickstarter project received between $2,602 for photography projects and $16,727 for design projects, to date six projects have raised in excess of $1 million on the site with the Pebble E-Paper Watch raising $8,997,710 through 6 May 2012[4].

The millions raised through Kickstarter, however, do not involve equity due to restrictions imposed by the 1933 Act, which requires that securities be registered with the Securities and Exchange Commission (SEC) absent certain limited exemptions from the registration requirements. Regulation D to the 1933 Act, provides an exemption for limited private offerings of up to $5 million provided the offering is not generally advertised and limited to accredited investors and no more than 35 non-accredited investors who are purchasing for investment purposes and not resale[5]. Accredited investors include banks, trusts, and businesses with assets in excess of $5 million; and people with net worth in excess of $1 million or income in excess of $200,000[6].

Crowdfunding comes to Washington

One of the most significant projects funded through crowdfunding was the Sustainable Economies Law Center's (SELC) IndieGoGo.com proposal to fund a Securities and Exchange Commission petition for rulemaking for a crowdfunding exemption to permit offerings of up to $100,000 with investors limited to $100 maximum investment[7]. The SELC petition stressed that small businesses cannot absorb the costs associated with the current regulatory structure. Registering a securities offering can be 'an absolute bar to the very smallest offerings and a substantial impediment to slightly larger offerings.' Registration costs and even costs to conduct an offering under an existing exemption involve legal fees, accounting fees, printing costs, filing fees, and substantial time for company employees preparing the offering. Because many of these costs are fixed, they consume a larger portion of the funds raised for small offerings. Though the actual time span varies, there is also a significant delay between the filing of a registration statement and the date it becomes effective. New and small businesses are often unable to withstand the financial pressure of this forced delay[8].

By September 2011 both President Obama and Congressional Republicans had embraced crowdfunding[9]. The proposal, however, was not without its critics.

Lynn E. Turner, a former SEC chief accountant, argued that the proposal 'won't create jobs, but it will simplify fraud. This would be better known as the bucket-shop and penny-stock fraud reauthorisation act of 2012'. State securities regulators emphasised that '[i]nvestment fraud is real [and] can be particularly pervasive in small exempted offerings,' while other critics suggested the legislation would 'make it easier for future Bernie Madoffs'[10].

President Obama called the legislation "a potential game changer" since "start-ups and small business will now have access to a big, new pool of potential investors, namely, the American people [who will now] be able to go online and invest in entrepreneurs that they believe in."

The Crowdfund Act in detail

As enacted, the Crowdfund Act adds an exemption to the 1933 Act to permit raising equity from crowdfunding. The Act has several key provisions:

- what offerings may be made to whom;
- what disclosures must be made by the issuer; and
- the role and regulation of funding portals.

Offerings under the Crowdfund Act

Under the Act, an issuer may raise up to $1 million over a twelve-month period (or some lesser amount to the extent there is prior fundraising) while investors are limited to:

- a maximum of $2,000 or five percent of annual income or net worth for investors with income or net worth less than $100,000; or
- 10 percent of annual income or net worth up to $100,000 for investors whose net worth or income exceeds $100,000[11].

Issuer Obligations

Companies issuing securities under the exemption must be organised under US law and provide to the SEC, the funding portal and investors:

- the company name, legal status, address and website;
- the names of the directors and officers and persons holding more than 20 percent of the shares of the issuer;
- a description of their business, financial condition and capital structure;
- a description of the stated purpose of the offering;
- the target offering amount and deadline to reach the target;
- the terms of the offering; and
- risks involved.

The issuer must also provide with such disclosures either:

- their tax returns and financial statements certified by the chief executive officer (for issuances of $100,000 or less);
- financial statements reviewed by an independent accountant for offerings between $101,000 and $500,000; or
- audited financial statements for offerings in excess of $500,000[12].

Thereafter, the issuer also must provide annual reports to the investors.

As with other offerings, the issuers may not advertise the terms of the offering (although no such restriction is imposed on intermediaries) or compensate a promoter or funding portal without disclosure as may be proscribed by the SEC and must comply with periodic reporting requirements. Issuers and their directors and officers may be liable for any material misstatements and/or misleading omissions in its disclosures.

Funding Portal Obligations

The legislation creates a new intermediary - the Funding Portal who not only facilitates the transaction but also must:

- 'provide such disclosures, including disclosures related to risks and other investor education materials' as the SEC determines appropriate;
- obtain investor questionnaires from purchasers;
- 'take such measures to reduce the risk of fraud' (including elimination of any conflict of interests) as established by the SEC;
- ensure that offering proceeds are not distributed until funding target is met; and
- institute investor privacy

protections[13].

The Funding Portal is to be exempt from registration as a broker-dealer, but must otherwise be subject to SEC examination, enforcement and other rulemaking authority; and be a member of a self-regulatory body. A funding portal, however, may not include any entity that:

- offers investment advice or recommendations;
- solicits purchases, sales, or offers to buy the securities offered or displayed on its website or portal;
- compensates employees, agents or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal; or
- holds, manages, possesses, or otherwise handles investor funds or securities.

Already, groups have organised to form the 'Crowdfund Intermediary Regulatory Association' (CIRA) whose stated goal is to 'pursue the development of self-regulation for the crowdfunding industry.' One of CIRA's members is the Crowdfunding Accreditation for Platform Standards (CAPS) which will enable sites to demonstrate they have been accredited based on qualification criteria in four areas:

- operational transparency;
- security of information and payments;
- platform functionality; and
- operational procedures.

The Act requires the Commission to adopt rules to implement a new exemption that will allow crowdfunding. Until then...any offers or sales of securities purporting to rely on the crowdfunding exemption would be unlawful under the federal securities laws.

SEC Rulemaking

The Crowdfund Act requires the SEC to complete its rulemaking within 270 days of passage, which would not be until approximately 31 December 2012. The SEC has already issued a notice reminding the market that the new Act requires the Commission to adopt rules to implement a new exemption that will allow crowdfunding. Until then, we are reminding issuers that any offers or sales of securities purporting to rely on the crowdfunding exemption would be unlawful under the federal securities laws[14].

When that day comes, there are millions of dollars ready to invest in startup companies, as Crowdfunder alone reports having approximately $15 million ready to invest. The question remains, however, whether the success of non-equity fundraising and recovery of venture capital funding will dampen the parties' ardor for crowdfunded equity transactions.

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