New Payment Form Shifts Fraud Liability

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Cold, hard cash and magnetic-strip credit/debit cards took on a more antiquated look in November as Apple Pay instantly out-performed all other mobile wallet services and positioned itself as the Pied Piper of wireless point-of-sale payments. Meanwhile, in less than a year, credit/debit cards will be "dipped" or "tapped" instead of "swiped" because they will have built-in computer chips and wireless antennas. The immediate future of in-store payments appears to be electromagnetic waves.

For several years, near-field communication (NFC) terminals have all but gathered dust on retailers' counters as services like Google Wallet and Softcard (f/k/a ISIS) failed to win consumer confidence. On Oct. 20, 2014, Apple Pay debuted and took the market by storm, racking up unprecedented mobile wallet transaction counts at retailers like McDonalds, Whole Foods, and Walgreens.

CultOfMac, a blog dedicated to all things Apple, reports that iPhone owners added one million credit cards to Apple Pay in the first 72 hours after the service's launch, and Visa and MasterCard have announced that Apple Pay already accounts for more mobile wallets than all the other options combined. Even the other mobile wallet companies admit benefiting from Apple Pay's sudden success.

But not everyone is cheering Apple. CVS and Rite Aid accepted Apple Pay at first, but overnight turned off NFC support to block Apple Pay because of exclusivity commitments to CurrentC, a rival mobile wallet service coming in 2015. Backed by the merchant consortium MCX, lead primarily by Walmart, CurrentC caters to merchants because it uses low-cost ACH processing

rather than relying on credit cards, which charge merchants from 1 to 5 percent of every transaction. Apple Pay relies on the user's credit card.

MCX CEO Dekkers Davidson said that the retailers in the consortium are bound to exclusively support CurrentC, but only for "months, not years." He said the purpose of the exclusivity provision was to give CurrentC "breathing room" to grow in its early stages.

But CurrentC is off to a rocky start. At least one class action law firm is investigating a possible antitrust suit against CVS and Rite Aid for abruptly disabling Apple Pay acceptance at their stores. More painful is consumer reaction—CurrentC has thousands of one-star reviews in the App Store even though it is still in private beta. The app is currently QR-code based, although MCX has expressed willingness to exploring NFC and Bluetooth as possible communication methods.

On the other hand, Apple Pay enjoyed sudden success even though its current reach is limited. Apple Pay only works on iPhone 6 and iPhone 6 Plus because those are the only iPhones equipped with the required NFC radio antenna. Also, users need Apple's Touch ID sensor to confirm their identity. The operating system must be updated to iOS 8.1 or newer. And a host of big retailers paid up-front fees of between $250,000 and $500,000 to join the MCX consortium, binding themselves to an exclusivity clause that leaves Apple Pay out of the near-term picture.

Lee Scott, ex-CEO of Walmart and a member of MCX, is reported as saying that he doesn't know whether MCX will succeed, and he doesn't care, "as long as Visa suffers."

Cards Moving to Chip

In addition to high credit card fees, part of Scott's angst might grow out of recent pressure from Visa and other major payment networks to force merchants to acquire new point-of-sale equipment for chip-based credit/debit cards by October 2015. United States merchants are expected to spend $6.75 billion replacing their terminals to comply with the chip-based requirements, and innovators are moving quickly to take advantage of this new market. One example is Poynt, a Palo Alto, Calif., startup marketing a new terminal with the same name, which will target neighborhood merchants with annual sales ranging from $50,000 to $1 million. Meanwhile, long-time industry leaders such as VeriFone Systems, and First Data Corp. already are producing compliant systems.

The United States is the last major market to still use the old-fashioned swipe-and-sign system, which some claim is why almost half the world's credit card fraud now happens in America, despite the country being home to only about a quarter of all credit card transactions.

This new chip-based payment system, known as EMV, was adopted in other countries more quickly than the United States in part because of telephone networks. EMV works offline, without a connection to bank systems. In countries with poor telecom systems, this was attractive.

EMV also makes credit card fraud more difficult. Data on magnetic strips doesn't change, but chip cards generate a new code for each transaction—tough for fraudsters to clone. "Contact" chip cards must be "dipped" into a new machine that places the chip in contact with the terminal, while the "contactless" version comes equipped with a wireless antenna so it can be "tapped" on an NFC reader. Either way, the dynamic authentication data of a chip card transaction is considered far more secure.

Which is why Visa (in 2011) and MasterCard (in 2012) announced that liability for credit card fraud, now largely absorbed by card issuers, would start shifting to merchants beginning Oct. 1, 2015. After then, a merchant who has not adopted contact chip terminals could be held responsible for fraud losses if presented with a chip card at the point of sale.

Luckily, the consumer need not earn a double-E master's to buy a Big Mac. Apple Pay and other mobile wallets generally offer easy setup and use, and with chip-based cards the user's top priority will be remembering to remove the card from the "dipping" terminal.

The nostalgic comfort of paper bills and jingling coins likely won't pass soon, but contact chips and invisible waves are the wave of the future of physical payment.

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