INCENTIVISTING SCAM PREVENTION: Improving the safety of the payments system

Background Brief – December 2022

KEY POINTS

- Scam victims are victims of financial crime. We need better systems to protect and support victims of crime.
- The exploitation of bank accounts and payment systems are central to the scam business model.
- Banks need to be financially incentivised to invest in scam prevention.
- A UK-style reimbursement scheme does not mean every scam victim is reimbursed—but it would have positive effects by:
    - building community confidence in Australia's payments system;
    - saving banks money; and
    - promoting a cultural shift to improve banking systems.

Efforts to disrupt scam activity

Australia's existing methods to combat financial crime related to scams are failing. Scams are becoming increasingly complex. Some are near impossible for individuals to identify, particularly when scammers make use of known behavioural biases or refer to their target's personal information they have maliciously obtained.

The Federal Government's current focus on scam disruption across the economy is a welcome opportunity—telecommunications companies, online platforms, as well as financial institutions, all need to play a role.

Among these, the role of banks and payment systems providers must be a priority. This is because fraudsters behind scams hold or control bank accounts. The exploitation of bank accounts and payment systems is central to the scam business model. Banks and payment system providers are central to efforts to protect against losses.

What's wrong with the current situation?

Unfortunately, there are currently no clear standards that oblige banks to detect or prevent scam activity. This has led to inconsistency in how banks approach this issue—both in prevention, and in handling the losses suffered by customers. When a consumer falls victim to a scam there is no consistent response from banks as to how much, if any, of the losses are reimbursed to the consumer. We even see great variation in outcomes depending on the staff member handling the issue at the bank.

Furthermore, the complaints function of the Australian Financial Complaints Authority (**AFCA**) is not improving standards of scam detection, prevention, and reimbursement by Australia's banks. This is despite banks being required to remediate their customer if they fail in their duty to act provide services with care and skill.

While we see instances of bank reimbursing customers, it is not consistent. AFCA's final determinations are rarely made in the consumers' favour, deterring consumers from engaging in the reporting process further.[1] This is despite scam-related complaints to AFCA increasing by 28 percent in 2021-22 compared to the prior year, one of the fastest growing areas of complaint.[2]

Banks need to be financially invested

As the Federal Government implements its proposals for

[1] Consumer Action's analysis of AFCA determinations relating to scams between September 2021 and February 2022 found less than 5% in favour of consumers: https://consumeraction.org.au/more-than-2billion-lost-as-redress-system-fails-scammed-aussies/

[2] AFCA Annual Review 2021-22, page 58.

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a new industry code for the finance sector, we encourage consideration of recent reforms in the United Kingdom.

The CRM Code

In 2019, a voluntary Contingent Reimbursement Model (**CRM Code**) setting standards for banks to meet regarding scams was introduced.[3] The CRM Code seeks to ensure better consumer outcomes are at the centre of the fight against scams. It incorporates a range of consumer protection standards to detect, prevent and respond to scams.

A fundamental principle is that consumers who are blameless for scam losses should be reimbursed by code signatories. This does not mean that every scam victim is reimbursed; for example, consumers who are involved with fraud themselves, or have acted with gross negligence, are not eligible for reimbursement.

Policy justification

The key policy justification supporting a reimbursement scheme is that it creates efficient incentives for banks to develop systems to better manage risks, through identifying and checking high risk payments. Such an approach aligns banks' liability for scams with unauthorised transaction fraud, such as card fraud.

Industry data shows that losses from card fraud have fallen dramatically over recent years, as the industry have faced a growing incentive to reduce their losses. Card fraud in 2021-22 was 54.7 cents per $1,000 spent, down from 73.8 cents in 2017-18, a drop of 25 percent, largely due to the industry's investment in a card-not-present Fraud Mitigation Framework.[4] It is reasonable to suspect that a financial incentive can serve to encourage the industry to similar invest in fraud mitigation relating to scam activity.

A reimbursement scheme may also have the following impacts:

- it would build community confidence in Australia's payment system. We know that victims of scams lose confidence in transacting electronically, sometimes not wanting to use electronic payments again. Diminishing consumer confidence in the payment system will have negative impacts on consumers' welfare and the economy.
- there is evidence that a reimbursement scheme can save banks money. One UK bank, TSB, provides its own "Fraud Refund Guarantee", meaning that it will refund an innocent victim of fraud for any money lost on their account, including where they have been tricked into making a transaction. TSB reports that it saves money through reduced complaint costs, and customer reimbursement has helped them gather better and more detailed information to improve fraud defences for the benefit of all customers.[5] TSB have also told us that effective scams losses are now lower for their customers than across other UK banks.
- it can promote a cultural shift within banking institutions to improve their systems, incorporating customer feedback on how they fell victim to a scam. This can promote trust between consumers and their bank, making a coordinated approach to scam prevention in the future easier.

Not just reimbursement

The CRM Code is not solely about reimbursement, and includes other important standards including:

- firms should participate in coordinated general consumer education and awareness campaigns;
- firms should have processes and procedures in place to help with 'aftercare', for example, tools that help victims protect themselves;
- firms should take appropriate action to identify customers and payment authorisations that run a higher risk of being associated with a scam;
- firms should provide customers with effective warnings that are understandable, clear, impactful, timely and specific; and
- firms should take reasonable steps to prevent accounts being opened for criminal accounts and detect accounts which may be, or are being, used for criminal purposes.

UK is mandating standards

Following the CRM code demonstrating some positive

[3] CRM Code, available at: https://www.lendingstandardsboard.org.uk/crm-code/

[4] AusPayNet, Media Release, 14 November 2022: https://auspaynet.com.au/insights/Media-Release/FraudStats_Jul2021_To_Jun2022

[5] See: https://committees.parliament.uk/writtenevidence/18464/pdf/

impact [6], the UK Government will soon make the standards mandatory for all banks and firms involved in the payment system, not just the ten firms that have voluntarily signed the code. The UK Payments Systems Regulator has proposed a mandatory reimbursement scheme which would:[7]

- provide reimbursement for customers for payment scams unless there was 'gross negligence' by the customer;
- ensure vulnerable customers are reimbursed—a customer is vulnerable if it would not be reasonable to expect that they could have protected themselves;
- require costs of reimbursement to be shared 50:50 between sending and receiving banks, ensuring that both parties face a financial incentive—it is often the receiving bank that is well-placed to take action when it sees deposits that indicate fraud, however there are no standards at all currently on receiving banks; and
- allow firms to withhold an excess of no more than £35 and set a time limit for claims—to help firms ensure their customers take care in making small payments, minimise claims for civil disputes and maintain proportionate costs, while protecting customers appropriately.

This approach does not prescribe the specific measures banks should take to detect and prevent scams. Rather, it provides them with the appropriate incentive to design protection measures in line with risk assessments. Given scams are forever innovating, this is appropriate, as banks are better placed to address the risks arising compared to customers.

Potential negative consequences

It has been suggested that a reimbursement requirement may incentivise fraudsters to enhance scam activity, in the knowledge that any losses will be fully reimbursed.

In its recent consultation, the UK Payment Systems Regulator has rejected this proposition noting that "we are not aware of conclusive evidence that, if consumers are more confident of being reimbursed, they will take less care in ensuring that their payee is not a fraudster". This aligns with our experiencing supporting consumers—there are psychological costs involved in falling victim to a scam and, even where full reimbursement is expected, there may be financial costs (while the victim waits for a refund) and costs in terms of time and effort to pursue a claim.

Fraudsters are also likely to focus on jurisdictions where there are the weakest systems to protect against financial crime. Incentivising banks to improve their systems will strengthen Australia's resilience against financial crime. The approach will not encourage fraudsters to target Australia, but have the opposite effect.

It has also been suggested that in response to a reimbursement requirement, some banks may consider restricting services to certain consumers, such as older consumers or consumers with a disability. We acknowledge this risk, but consider it can be appropriately managed through the design of a regulatory scheme. For example, there should be a requirement for banks and financial firms to treat all prospective customers equally.

Urgent need to act

There is no quick fix to scam prevention, but losses will continue to exponentially increase without greater effort and investment in detection and prevention. A coordinated holistic cross-industry approach would be welcomed by consumer groups if delivered quickly. The UK is also concurrently working to establish standards for online platforms and telcos, but this work is not delaying progress in banking and payments—nor should it here.

As part of this, a reimbursement model would drive investment by banks in fraud protection systems, and would incentivise the sharing of more information by scammed consumers about their losses. This would, in turn, aid the Federal Government's proposed cross-government efforts through the proposed National Anti-Scams Centre.

Further information

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[6] A 2021 review of the CRM Code found it was effective in protecting customers from scams when implemented correctly, but that there was inconsistent application across signatory firms.

[7] Payment Systems Regulator, Consultation Paper 22/4: https://www.psr.org.uk/publications/consultations/cp22-4-app-scams-requiring-reimbursement/