Being Surprised Can Be Bad Or Pleasant

by Steve Brown

Britain's decision to leave the European Union (EU) was a big surprise. After all, other European countries had become used to English temper tantrums. Heads of State even remembered Margaret Thatcher's special requirements to join way back when. That's why the Brexit idea was so out of left field that betting markets gave the "remain" vote an 88% chance to win. When the June 23rd referendum showed Brexit - the markets freaked out. Even the political leaders calling for the Brexit (Boris Johnson and Nigel Farage) were surprised. In fact, they were so sure that they would lose, that they didn't even have a prepared plan to properly manage England's exit. Both of these clowns announced that they wouldn't be the next prime minister. What a horrible surprise to the Brits.

Fortunately, banking is usually not quite this surprising. Nevertheless, there are sometimes bad surprises despite years of preparation. Consider card networks, for example. Long ago Visa and Mastercard decided that by October 2015, they would switch to the famous EMV (Europay, Mastercard, Visa) system.

Logically, they also asked merchants to accept chip cards. Retailers were supposed to install new readers, but many have simply balked at the idea. In fact, the National Retail Federation projects it will cost more than $30B to switch to EMV.

Despite years of noise leading up to the changeover date, many merchants were not ready. Merchants who didn't switch to the new technology discovered that counterfeit transactions were on the rise and suddenly in some cases they were on the hook for the costs of fraud.

To induce Target, Walmart, pharmacies, department stores and others to embrace chip and PIN technology to cut fraud risk, retailers were told to make the change or be responsible for certain charge-backs.

Retailers have had plenty of reasonable excuses for not making the shift and many implausible ones as well. Some believed that the shift was not mandatory. Maybe that is why a recent survey by Boston Retail Partners found only 22% of retailers could process chip cards.

The same survey also found more than 50% of merchants planned to quickly install new systems but when they did, they discovered that there was a long wait to get certified. Here, some stores reported they had to test the functionality of their new equipment at least 3x before it was up and running. Certification time could last as long as a couple of weeks. Thus, many merchants rebelled against the certification bottleneck.

To ease their pain, Visa and MasterCard announced that they will speed up the adoption process. They will, for example, certify reading machines faster. Here, the testing time will be reduced to 2 hours.

They will also lower the price of equipment installation and limit the price vendors can be charged for bad transactions. Visa has promised that there will be no charge on small transactions of $25 or less. In addition, charge-backs will even be limited to 10 transactions per account.

Perhaps the surprise for retailers and consumers is about the same size as the one the Brits had when they said yes to Brexit. Once everybody has the right chip card and the right reader, the Fed KC estimates fraud could be reduced by 40%. Now that is indeed a pleasant surprise.

BANK NEWS

Cyber Director Training

A survey by Navex Global finds 69% of companies train their employees about cybersecurity, but only 22% do so for board members.

Branch Closures

SNL Financial reports the number of US bank and thrift branches declined by a net 353 in Q2 to 92,231. This follows the trend of prior quarters of -327 (Q1 2016), -330 (Q4 2015), -591 (Q3 2015).

Hacked

Bitcoin reported unknown hackers have stolen $65mm in digital currency from it.

Retail Risk

Bankers should check loan portfolios for exposure to Office Depot and conduct additional stress testing as needed, given the company indicates it plans to close 300 more stores in the next 2Ys on top of the 400 stores it had already reported.

Rate Hikes

A Reuters poll finds just over 50% of pundits argue that if the Fed is going to raise rates again this year, they will only do so in Dec after the presidential election.

Loan Defaults

We thought you might be interested to know that Moody's has published its speculative corporate credit quality default rates for Q2. Long term debt ratings with maturities of 1Y or more for speculative grade credits are: Ba1, Ba2, Ba3 (have speculative elements); B1, B2, B3 (subject to high credit risk); Caa1, Caa2, Caa3 (bonds of poor standing); Ca (highly speculative, or near default); and C (lowest rating, bonds typically in default with little prospect for recovery of principal or interest). The speculative corporate credit quality default rates as of Q2 are: 5.1% overall vs. 4.4% in Q1, but excluding commodities companies, the overall default rate was 2.3% vs. 2.0% in Q1. The commodity sector speculative grade default rate reached 23.9% in Q2 vs. 19.9% in Q1.