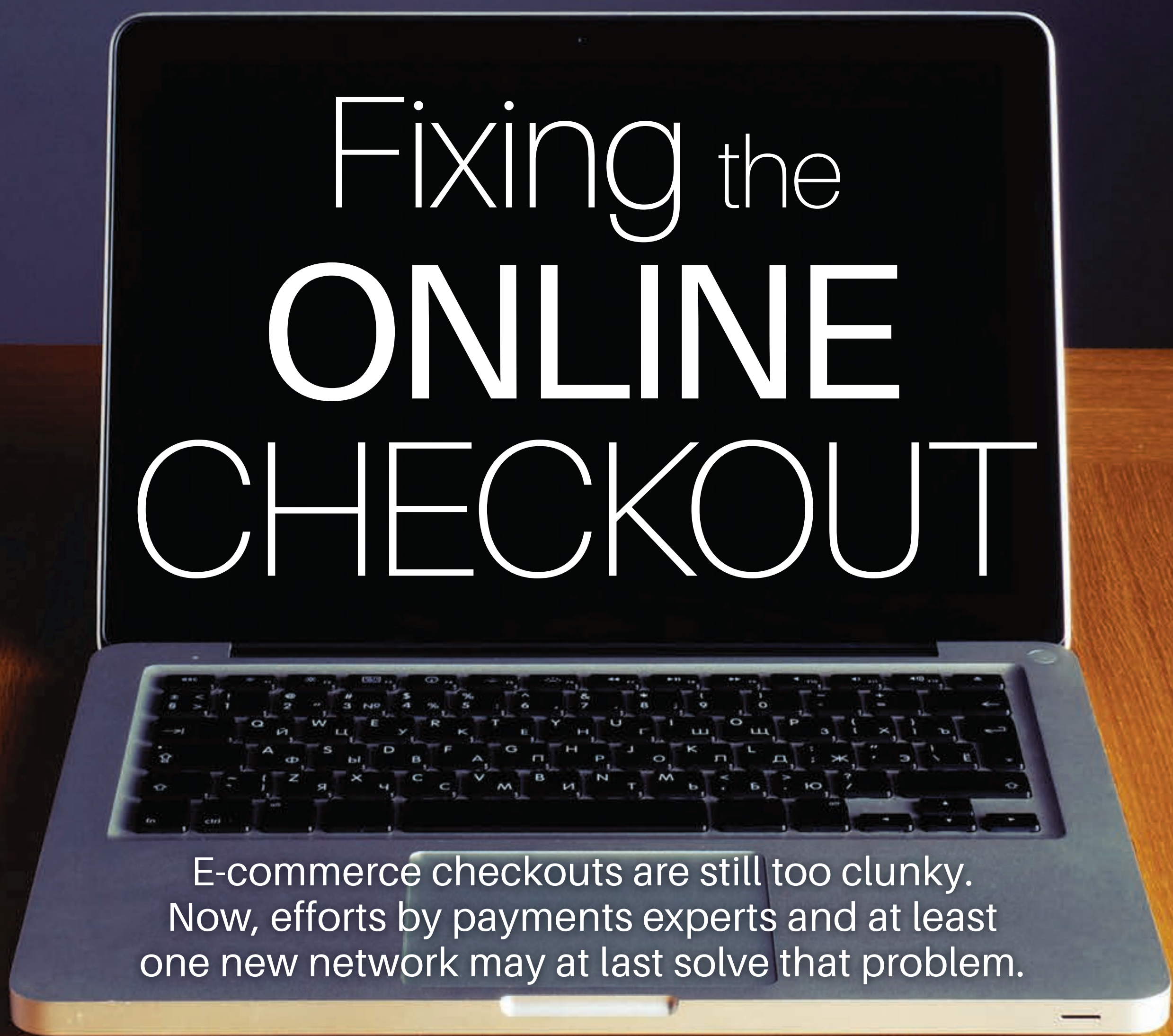
DIGITAL TRANSACTIONS

Trends in the Electronic Exchange of Value



Fixing the ONLINE CHECKOUT

E-commerce checkouts are still too clunky. Now, efforts by payments experts and at least one new network may at last solve that problem.

Volume Twenty, Number Twelve • DigitalTransactions.net • December 2023

ALSO IN THIS ISSUE:


NETEVIA
Join the ISO revolution
STOP LEAVING MILLIONS ON THE TABLE
Become a Netevia Banking Services Certified ISO and generate new residual income by providing banking services to your merchants. Earn residuals from balances, card transactions, and deposit bonuses.
(866)668 6529 x 131
netevia.com/iso-banking/
marketing@netevia.com
Netevia is not a bank. Banking services are provided by Sutton Bank, Member FDIC. Should the member bank holding your balance fail, you are insured for up to $250,000 of your money in the account.

contents

DECEMBER 2023 • VOLUME 20, NUMBER 12

Cover Illustration: Elizabeth Novak, 123rf.com, Shutterstock

Digital Transactions (USPS 024-247) is published monthly by Boland Hill Media LLC, 800 Roosevelt Road, Building B, Suite 212, Glen Ellyn, IL, 60137. Periodicals Postage Paid at Glen Ellyn, IL, and at additional mailing offices. POSTMASTER: Send address changes to Digital Transactions, P.O. Box 493, Northbrook, IL 60065-3553.

the gimlet eye

WHO WILL FILL IN FOR VISA AND MASTERCARD?

EVER SINCE U.S. SENATORS Dick Durbin of Illinois and Roger Marshall of Kansas introduced the Credit Card Competition Act last year, we haven't been surprised at the bipartisan support the legislation has received. After all, the bill promises to contain credit card acceptance costs for merchants, and to do it by means of making networks compete for volume. That sounds reasonable, pleases merchants, and placates free-market types who object to government mandates, particularly when it comes to pricing.

The bill, known as "Durbin 2.0" because it follows by a decade the veteran lawmaker's rules aimed at putting a lid on debit card acceptance costs, also seems, on the surface at least, more reasonable than the debit mandates. Those requirements provided for hard and fast caps on interchange for the nation's largest issuers. By contrast, the CCCA would encourage competition, its advocates say, and let market forces drive down debit interchange costs. How? By requiring that, for any given transaction, at least one network other than Visa or Mastercard must be made available. And the law would apply only to issuers with assets of $100 billion or more.

It sounds like a reasonable mix of legal requirement and market response, so the credit card bill has drawn its fair share of bipartisan support. After all, there are more merchants, large and small, than there are banks and credit card networks.

But there are dissenters, and they include at least some merchants. The Electronic Payments Coalition, which represents the interests of card issuers and has lobbied hard against the CCCA, has sponsored the Small Business Payments Alliance, a merchant group opposed to the bill. When our sister publication, *Digital Transactions News*, asked one of the members, a café owner, why he was against the CCCA, he said alternatives like American Express are even more expensive than Visa and would only drive up his acceptance costs. He also feared smaller networks on the eventual menu of choices would fall short on infrastructure and security.

It's hard to tell how widespread this sentiment might be. With the backing of powerful retail associations, though, the CCCA likely has the support of most big chains and probably a majority of mid-size sellers.

But even if this upstart SBPA embraces a scattered few merchants, it may behoove legislators to hear its point of view. The debit networks, which are often mooted as alternatives to Visa and Mastercard, may well be fit to fill that role. They likely have the technical chops to pull it off. But no one can say how keen they are to step in, since they shun all opportunities to address the topic.

John Stewart, Editor | john@digitaltransactions.net

DECEMBER 2023 • VOL. 20, NO. 12

DIGITAL TRANSACTIONS
Trends in the Electronic Exchange of Value

PUBLISHER Robert A. Jenisch

EDITOR-IN-CHIEF John Stewart

SENIOR EDITOR, DIGITAL
Kevin Woodward

CORRESPONDENTS
Jim Daly, Peter Lucas

ART DIRECTOR/PRODUCTION EDITOR
Elizabeth Novak

DIRECTOR OF ADVERTISING
Robert A. Jenisch, 630-547-2887
bob@digitaltransactions.net

ADVERTISING SALES REPRESENTATIVES
Robert Mitchell, 630-547-2887, x7
bmitchell@digitaltransactions.net
Rob Akert, 630-547-2887, x6
rakert@digitaltransactions.net

Digital Transactions, Digital Transactions News, and DigitalTransactions.net are publications of Boland Hill Media LLC, 800 Roosevelt Road, Suite B212, Glen Ellyn, IL 60137

John Stewart, Managing Director
Robert A. Jenisch, Managing Director

For advertising information, call 630-547-2887. To subscribe or give us a change of address, go to www.digitaltransactions.net and click on "Subscriber Care" or call 630-547-2887.

MAKE REAL MONEY.

SignaPay was built by experienced salespeople who know what ISOs and Agents need: better **support**, **compensation**, and **service**. That's why we're offering our ISO and Agent partners precisely what they want. With a card-brand-compliant **Dual Pricing** program and custom marketing to stay ahead of the competition, SignaPay has every solution you need to sign more merchants.

- Up to **90% Residual Splits**
- Up to **$1,000 Activation Bonus**
- Only **2¢ per Authorization**
- **Free Terminals**
- **Free POS**
- **Business loans** and **residual purchases**

An ISO Program With What You Need

CHOOSE YOUR BUY RATES

Choose a residual payout package that fits your growth. From custom buy rates to split, you choose!

MARKETING TOOLS AND SUPPORT

Custom marketing brochures and support to attract new merchants right at your fingertips.

FREE TERMINALS & POINT-OF-SALE

Our suite of terminals and equipment helps fit any merchant's needs, from mobile payments to online.

DUAL PRICING DONE RIGHT

PayLo is Dual Pricing backed by card brand endorsement. Stop worrying about compliance and help merchants today.

SIGNAPAY | PAYLO

Call and join today.

877-231-6609 | partners@signapay.com | signapay.com

ACQUIRERS SEEK ANSWERS FROM A VISA SURCHARGING EXECUTIVE

More than 10 years after Visa Inc. wrote its rules permitting surcharging on its credit cards, questions remain among acquirers, especially those selling or considering surcharge programs for their merchants.

Now, as more merchants mull surcharge or cash-discount programs to alleviate some of their card-acceptance costs, and with recent changes put in place by Visa, the subject is getting more attention. Surcharging was enabled as part of a multibillion-dollar credit card interchange settlement in 2013.

Visa's changes to its surcharge rules surfaced earlier this year. In April, after issuing a January bulletin noting it would reduce the cap on credit card surcharges from a maximum of 4% to no more than 3%, Visa quietly put the change in place.

The move comes as Visa boosts enforcement of the cap. And it comes as more merchants turn to surcharge and cash-discount programs to recoup their card-acceptance costs. Surcharging is not allowed on debit cards, though some government entities may collect a service fee with either credit or debit cards.

That cap reduction drew questions last month at the Western States Acquirers Association conference in Carlsbad, Calif., as merchant-sales professionals expressed curiosity and confusion at the move. With a cash discount, card prices are posted and a discount on that price is offered to customers who pay with cash, according to a presentation during the conference. A surcharge refers to cases when cash and debit card prices are posted and customers are charged an additional fee on top of that price when paying with a credit card.

Some programs may label the fees as service fees or non-cash adjustments, but these moves are still considered a surcharge. Dual pricing may be another program. This is common at gas stations that offer a lower price for cash transactions than for those on payment cards. In a retail point-of-sale environment, a consumer might be presented with a cash price and a card price.

Visa's Rob Johnson, senior director and head of Visa rules management

for North America, told attendees during a panel on surcharging and cash discounting that there had been much concern that the 4% rate that had been pitched to merchants was not necessarily the cost of acceptance. The Visa rules allowed a surcharge that does not exceed the merchant discount rate for the card or the maximum of 4%, as originally written. Following Visa's January bulletin, that cap is now 3%.

In addition to the reduction, Visa is stepping up its enforcement. Johnson said the number of consumer complaints about surcharging—approximately 6,000 annually in the United States—is more than volume of compliance complaints from the rest of the world combined.

When asked if 6,000 is enough to warrant the boosted oversight in a nation of 350 million, Johnson said the complaints are from the most ardent consumers and that most do not file a complaint with Visa. "I would argue that 6,000 people choosing to go to Visa and complain about something is a lot," Johnson said. "I would argue it's the tip of the iceberg."

Panelist Travis Everett, chief operating officer of the National Merchants Association, a Las Vegas-based merchant-services company, said some of the responsibility for ensuring surcharge and cash-discount programs are compliant falls on the merchant-services provider.

"The goal should be to find a way to sell this in a compliant fashion," Everett said. Indeed, the goal should be a happy customer that makes a happy merchant who makes the industry happy, he added.

Visa also is ramping up its auditing of merchants found out of compliance. Johnson said Visa will validate that a noncompliant merchant has become compliant. Noncompliance can carry penalty fees, assessed to the acquiring bank and usually passed along to the merchant.

Masking a surcharge as something else, such as a Covid recovery fee, and charging more than the allowed 3%, could generate fines. "There's a lot of games going on in the industry now," Johnson said.

Still, the Visa effort is not meant to curtail an acquirer's ability to offer a surcharging program, Johnson stressed. "We are not going to take away your ability to surcharge or do cash discounting," Johnson said. "That is not on the table. However, what is in jeopardy is the ability to do it incorrectly."

—Kevin Woodward

PAZE'S BANK-CENTERED FINTECH APPROACH TO E-COMMERCE CHECKOUT

Though the official launch of the Paze online wallet from Early Warning Services LLC isn't slated until next year, Paze executives are already demonstrating the product.

As many as 150 million credit and debit cards from seven large banks could be loaded into Paze, complete with billing addresses, as Early Warning looks to address abandoned e-commerce shopping carts and reduce the manual card and address entry that can deter many consumers. Scottsdale, Ariz.-based Early Warning announced Paze in March.

"The Paze vision is ubiquity across merchants and the financial institution sides," says Matt Miller, Paze's vice president of product. "This is about addressing a problem in e-commerce that's existed since the early days." *Digital Transactions* talked to Miller in Las Vegas last month as he was demonstrating the new wallet at at the Money 20/20 conference in Las Vegas.

The problem Miller is referring to is manual entry of card data. Consumers, long accustomed to speedy online shopping, want the same sense of quickness when checking out, and merchants want to make it easier for them to do so. When it's not speedy, a sale is usually lost and the merchant's conversion rate is hampered.

Paze was designed to address that issue. Because the participating issuing banks—all Mastercard Inc. or Visa Inc. issuers in the United States—already have established relationships with consumers through their card products, card data and billing-address information will be available in the digital wallet. The user will not have to type out anything but the email address associated with the card account.

"We get away from this idea of manually keying in everything," Miller says. Consumers will be able to add different shipping addresses and store them in Paze, too. The wallet also features a card updater capability. In addition, the issuer can send a notice in the Paze wallet asking the consumer to update the expired card, after verification with a one-time password and supplying a card-security code.

Merchants choosing to adopt Paze will pay no fees for the service, Miller says. Typical card-processing fees still apply. And, to help avoid too many wallet options on the checkout page, Paze will use an auto-appearing feature after the consumer enters an email address on the page, even if the shopper uses guest checkout.

A nearly instant connection from the merchant to Paze's network will generate the option to use Paze for checkout if the address is recognized, Miller says. Merchants will have the capability to display a persistent Paze checkout button if they choose.

From there, much like expedited online checkout services from Apple Pay, Google Pay, and PayPal, Paze will present its page to confirm the transaction with the card data and address already filled in. Miller says Paze will not obstruct any other option a consumer wants to use.

As with any card-based payment product, banks, consumers, and merchants will have to want to use Paze. With the bank part solidified, merchants, followed by consumers, will be next. Already, Paze is in tests with Omaha Steaks, and it announced earlier this fall that online giant GoDaddy Inc. will integrate Paze, aiming at smaller businesses.

With several channels to reach merchants, one potential Paze selling point could be the improved conversion rate. It may help capture online sales that consumers might have abandoned.

As for consumers, participating banks will likely launch marketing materials, Miller says, including in the online and mobile-banking channels. At the launch of Zelle—Early Warning's person-to-person instant payment service that debuted in 2017 and the company's first consumer-facing payment product—the new network conducted a brand-awareness campaign. "Issuers will be a key channel because they are trusted by consumers," Miller says.

—Kevin Woodward

THE FED'S DEBIT CARD PROPOSAL ISN'T PLEASING MERCHANTS OR ISSUERS

The Federal Reserve Board's proposal earlier this fall to make a 31% reduction in the main component of its debit card interchange ceiling for large issuers touches on a longstanding sore point among merchants and has already sparked a spirited debate in the payments industry.

Merchant groups, long riled by debit card acceptance costs, contend the Fed's cut doesn't go far enough, while the banking lobby deplores the proposal as arbitrary and likely to hurt banks and consumers.

The Fed's action, which the payments industry had been expecting for some time, comes as the nation's banking regulator seeks to reduce its mandated cap on debit interchange for the first time since the current regulation became effective 12 years ago as part of the Durbin Amendment to the Dodd-Frank Act. The Fed says as part of its proposal that it will review the new cap every other year.

Under the Fed's proposal, the ceiling on the so-called base component of debit interchange would drop to 14.4 cents per transaction from 21 cents. The so-called ad valorem rate, meant to help cover issuers' fraud losses, would dip slightly from 0.05% to 0.04%. But the penny per transaction for fraud-prevention costs would rise to 1.3 cents. The Fed's Board of Governors approved the proposal by a 6-1 vote.

Merchant acquirers pay interchange to card issuers, and typically bundle the cost into the rate they charge merchants. If approved, the new limits, like the current ones, would apply to issuers with $10 billion or more in assets.

The reaction from the banking lobby was quick and emphatically negative. In one example, the Independent Community Bankers of America argues the proposal would harm even exempt smaller institutions.

"The [Fed's] cap on debit card interchange puts smaller card issuers at a disadvantage due to their smaller transaction volumes and lower negotiating power relative to larger issuers, which could cut off access to low-cost and no-cost banking services in local communities—even those served by the community banks that are intended to be exempt from the proposal," the group said in a statement.

Other associations representing bank interests were equally gloomy. "This proposal has the potential to make checking accounts, debit cards, and a range of financial products more expensive for American consumers, while delivering an unprecedented gift to big-box retailers that have shown no inclination to pass any savings along to customers," argued Rob Nichols in a statement released by the American Bankers Association. Nichols is president and chief executive of the group.

Merchant groups generally welcomed the Fed's action, as they have contended for years that debit-acceptance costs have been too high, even under the current Fed regulation. But some groups, such as the Food Industry Association, argued in a release Wednesday that the proposal doesn't cut interchange enough. The proposal, the group said, "does little to ease the economic burden on merchants and further shifts fraud prevention costs onto retailers."

Long-time industry experts, too, reacted to the Fed's action with sharply opposed opinions, with some arguing the reduction in the base limit was long overdue. "The 21[-cent] rate was 4-5 cents too high, even though the banks were self-reporting all the authorization, clearing, and settlement costs they could," argues Steve Mott, principal at payments-advisory BetterBuyDesign, in an email message to *Digital Transactions*.

But other observers, while contending cost data could have spurred the Fed to make an even deeper cut in its interchange ceiling, argue mandated price caps distort market forces, ultimately causing consumer harm.

"Even charitably administered price controls are harmful, causing systemic misallocation of resources. Interchange price caps reduce issuer innovation, fee-free banking, and a host of benefits, services, and rewards that consumers love," says payments consultant Eric Grover, principal at Intrepid Ventures.

The marketplace, even if distorted by pricing caps, will be the ultimate judge of the matter. But first, the Fed has to implement either the current proposal or a new one modified by industry reaction.

—John Stewart

ALEX CHRISS LEAVES NO DOUBT WHO'S IN CHARGE

Most new corporate chieftains keep a low profile for a time, perhaps tweaking their predecessors' strategies but announcing few major changes. Not so Alex Chriss.

PayPal Holdings Inc.'s new CEO, who took over Sept. 27 from longtime chief Dan Schulman, took the opportunity of his new company's third-quarter earnings call early last month to hammer home what he sees as important changes in direction, including a stress on profitable growth.

Among other plans, Chriss said he will reverse a decision Schulman announced in a May earnings call to lay stress on PayPal's so-called unbranded checkout service, which relies on PayPal's captive processor, Braintree, and yields lower margins than the company's traditional,

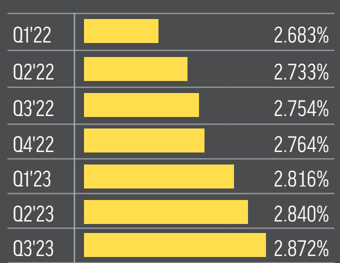
MONTHLY MERCHANT METRIC

Total Gross Processing Revenue %

This is sourced from The Strawhecker Group's merchant datawarehouse of over 4M merchants in the U.S. market. The ability to understand this data is important as SMB merchants and the payments providers that serve them are key drivers of the economy.

All data is for SMB Households defined as households with **less than $5M in annual card volume.**

Metric Definitions: (Only use definitions related to an individual month's release)
Household - Standalone Merchants are considered as a Household with one store and Chained outlets under a common ChainID are combined together and considered as one single Household
Total Gross Processing Revenue % - Sum of total discount, total transaction fee revenue and total other fee revenue divided by total volume



Note: Previous metric included all active merchants, those with positive revenue, whereas the new metric shown only includes merchants with postive revenue and volume.

branded checkout service. Investors hammered PayPal's stock almost immediately after that May call.

Indeed, Chriss made it plain he will underscore profit growth in every niche of the company's sprawling product line. Meanwhile, cost cutting will be a priority, the former Intuit Inc. executive said. "Our cost base remains too high and is slowing us down," he told equity analysts during the call. "We will become leaner, more effective, and more efficient. We will be guided by margin-accretive revenue growth."

Branded checkout, Chriss said, offers opportunities to leverage PayPal's vast transaction data stores to enhance profitability. "The biggest surprise" he encountered on taking over, he said, "is the data, and how we can prioritize branded checkout. It drives conversion for our merchants, and we're just scratching the surface there." Branded-checkout dollar volume growth slowed to 6% in the quarter year-over-year, compared to 7.5% in the third quarter last year.

Nor is Chriss wasting any time with divestitures. PayPal said earlier this week its sale of its Happy Returns unit to United Parcel Service will close this quarter. PayPal acquired the company, which automates product returns, in 2021.

Another top priority, Chriss said, is to orchestrate ways to leverage PayPal's vast stores of transaction data to raise conversion rates for the company's 35 million merchant accounts—most of them small businesses. Part of that gambit, he said, is the rollout of a new checkout technology, PayPal Complete Pay.

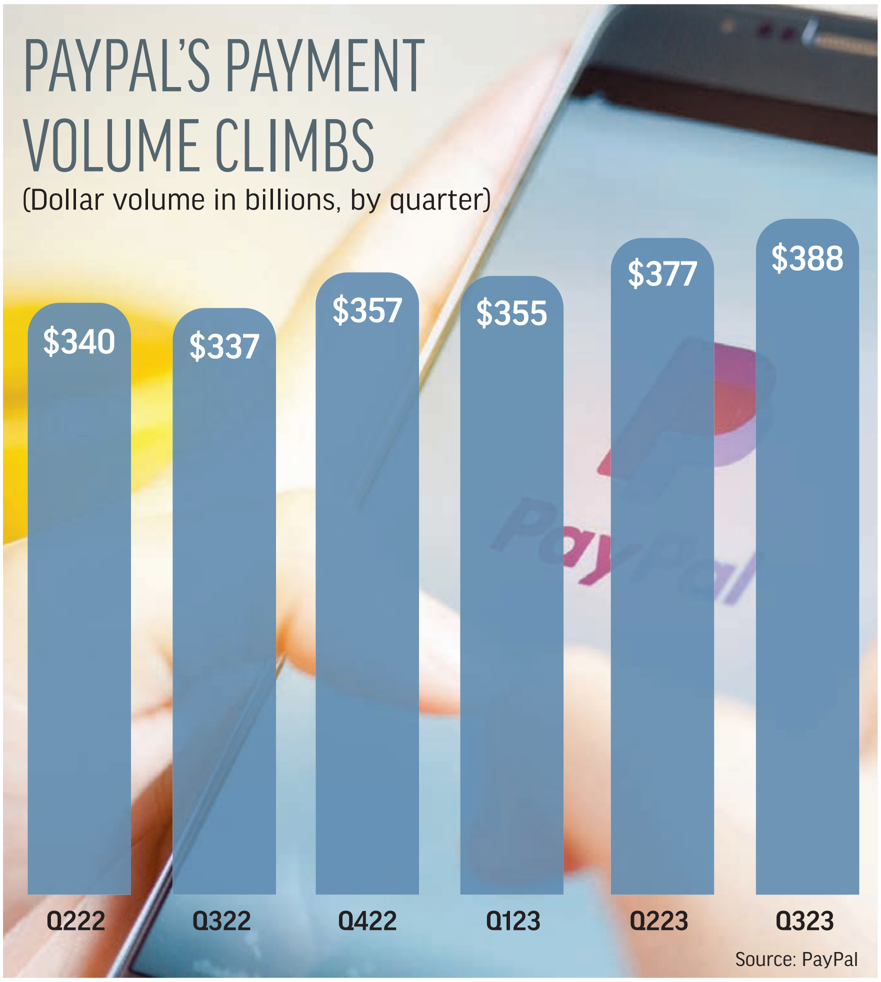
Overall, Chriss said he will seek greater automation within the company to further his goal. "On the expense side, we have a lot of duplication and a lot of manual work," he noted. "We have the opportunity to invest in automation."

As if he hadn't driven home how serious his intentions are for PayPal, Chriss ended the day's presentation with a sweeping declaration. "We are future-proofing this business," he noted. "We are playing to win."

A 19-year veteran at Mountain View, Calif.-based Intuit, the 46-year-old Chriss took over at PayPal upon Schulman's retirement. Since early 2019, Chriss had been executive vice president and general manager of Intuit's small business and self-employed group, controlling more than half the company's revenue, according to PayPal's release in August announcing he was Schulman's successor. Schulman said in February he expected to retire after having turned 65 the previous month.

For the quarter, PayPal registered $387.7 billion total payment volume, up 15% year-over-year (chart), yielding net revenue of $7.4 billion, an 8% increase. GAAP operating income came to $1.2 billion, up 4%. The company generated 6.3 billion payment transactions, up 11%, with 56.6 transactions per active account over the previous 12 months, a 13% rise over the previous year. Active accounts slid slightly to 428 million from 432 million in 2022's third quarter.

—John Stewart



HOW DIGITAL PAYMENTS CAN COMBAT ANTISEMITISM

BY
GIDEON SAMID
gideon@bitmint.com

PAYMENTS IS AN ever-present social activity that reflects values, preferences, and customs. Hence, by imposing payment dynamics, one can achieve social change—especially so when payment has migrated to cyberspace, first as a mirror of material money and soon as a cyber-native digital coin. The possibilities are far-reaching, waiting for a daring imagination to bring them forth.

Case in point: antisemitism. October's worldwide pro-Hamas protests have shown that this vile prejudice is alive and well. The sentiments that brought about the horror of the Nazi holocaust are raging hot. Jews and Israel are condemned and regarded as unworthy of existence. It is not criticism of Israel's policies, nor complaining about Jewish deeds, all of which is fair game. It is condemnation of an ethnic entity for being who they were born to be. Now, how can payments play a role in the combatting antisemitism?

We can use payments to keep the danger of antisemitism front and center. Consider three examples.

Ongoing support. Quite a few merchants announce their denunciation of antisemitism. This may be reflected by a policy that takes a cut from all proceeds, to be contributed toward restoring disfigured synagogues and to compensate victims of antisemitic hate crimes. This cut may be substantial, establishing these merchants as respected members of society.

This will work even if the cut is minuscule, with negligible impact on the bottom line, as long as it is exchanged for a receipt with a statement: *"We are proud to be part of the campaign to combat antisemitism, and we thank you for your contribution".* People enraged by antisemitism will think more favorably of this merchant, and neutral people won't care, but antisemites will find it hard to shop there. Maybe they like this store, this airline, this restaurant, and so they either feel banished from places they like, or suffer the humiliation of contributing to combat the antisemitism they support.

Merchants would not like to lose their antisemitic customers, understandably, but once a critical mass of anti-antisemitism stores is apparent, antisemitic customers will have a narrow choice. Jewish-owned establishments and German owned establishments are the most likely starting points for this campaign, the latter in light of Germany's historic record.

Pay and Play: Let a mint issue digital claim checks against a par-value dollar sum. Let the money so collected be added to a fixed-interest-bearing fund, and let the claim check be redeemable 24/7, and also be splitable phone-to-phone. The interest on the money in the fund would be dedicated to support antisemitism victims.

Holders of such a digital-money claim check will offer it as payment to honor any invoice. Recipients of the claim check may redeem it right away at par value, or keep the money in the fund to bear more interest for the cause—the idea being that rejecting such a claim check as payment is tantamount to announcing. "I am an antisemite." And hence one expects restaurants and other establishments could hang signs saying, *"We accept antisemitism combatting digital money."*

Individuals and organizations convicted of antisemitic hate crimes could be required to make monthly payments to antisemitism-combatting outlets, in lieu of prison time. This repetitive act will keep the convicted antisemite considering his beliefs, and will spare the state the cost of incarceration.

This is only the beginning. Digital payments has become a well-managed, fine-tuned social dynamic. There are countless ways to use this new technology to bring about social change. Success in combatting antisemitism will evolve, aiding similar campaigns to combat other social hatreds, say against gay people. DT

THE FED'S DUBIOUS DEBIT PROPOSAL

BY BEN JACKSON

bjackson@pa.org

THE LATEST ROUND in the fight over interchange fees began Oct. 25. That's when the Federal Reserve released its latest proposal on debit interchange.

To recap, the Fed's proposed rule would reduce the interchange that banks with more than $10 billion in assets would receive when their customers pay with a debit card. The current cap—21 cents, plus 5 basis points of the cost of the transaction and a one-cent fraud-prevention adjustment—would drop to a base of 14.4 cents, plus 4 basis points of the cost of the transaction, and a slight increase to 1.3 cents for fraud prevention.

The proposal also establishes a review of the interchange cap every other year as data comes in from bank surveys on transaction costs. (This is the first time the board has revisited the fee cap since it was first put in place in 2011.)

But the big question is, who benefits? The Durbin Amendment in the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act requires that the Fed set a cap on fees charged by issuers with more than $10 billion in assets, and it mandates that the Fed revisit the cap from time to time. So, while there is a legislative reason to revisit the cap, it's not clear how the average American benefits.

The National Retail Federation suggested, in a press release published a week before the Fed's meeting, that shoppers would benefit.

"Debit and credit card swipe fees have doubled over the past decade and totaled $160.7 billion in 2022, according to the Nilson Report," said the release. "The fees are among most merchants' highest operating costs and drive up prices paid by consumers by more than $1,000 a year for the average family. Debit card swipe fees account for $34.4 billion of the total."

But, large-issuer debit interchange has been capped for more than a decade, so it is not likely that debit fees drove that increase. And, while debit cards are popular, the Federal Reserve Bank of San Francisco's 2023 "Findings from the Diary of Consumer Payment Choice" found they made up only 29% of all payments.

So, it is not clear that debit interchange caps will save the average shopper any money. When the Fed Governors asked the staff about changes to consumer prices, they responded that research shows merchants pass card-processing costs onto shoppers, but it isn't clear that caps reduce prices.

"Empirically, I think the question of merchant-cost pass-through is one of those that is well-recognized to be very difficult. Partly because prices are well-known to be sticky, especially when the underlying cost changes are relatively small," said Kriss Wozniak, section chief of the Payment System Studies Section at the Federal Reserve.

In a speech at the 2023 Ohio Bankers League "Main Event," Fed Governor, Michelle Bowman—who asked the question about the benefits to consumers—expressed skepticism about the proposal. She noted interchange fees help banks offer low-cost and no-cost products to customers.

"If finalized as proposed, this revision may force banks to discontinue their lowest-margin products, including options designed to increase financial inclusion and access for [low or moderate-income] individuals and families," she said.

The Federal Reserve says on its Web site that it exists "to promote the effective operation of the U.S. economy and, more generally, the public interest."

If prices are sticky, merchants' bottom lines will increase, but household bottom lines will stay the same. Low- and moderate-income people could end up with fewer payment options. It's not clear, then, how this proposal promotes effective economic operation or the public interest. DT

WHO'S AFRAID OF SOFTPOS?

The technology is building momentum as merchants of all sizes displace POS terminals with commercial off-the-shelf devices. There are some issues.

BY **PETER LUCAS**

IT WASN'T ALL that long ago that the idea of turning an ordinary smart phone into a point-of-sale terminal seemed like a pipe dream. But more than a decade after its introduction, software point of sale, or softPOS for short, is riding a growing wave of adoption.

Mobile and small merchants, such as in-home fitness trainers and home-services providers, are embracing the technology, as might be expected. But so are large sellers. They see the technology as a way to bring the point of sale to the point of interaction with the customer within the store.

Retailers, for example, are turning to softPOS as a line buster, while restaurants are adopting the technology to enable payment at the table. Other merchants adopting the technology include food-truck operators, sellers at festivals or farmer's markets, pop-up stores, and taxi drivers.

SoftPOS is an application that allows contactless payment cards or digital wallets to be tapped or waved on or at a smart phone to pay for a purchase.

Once merchants are introduced to the technology, they quickly embrace it, payments experts say. The number of merchants using softPOS is expected to explode in the coming years to more than 34.5 million worldwide by 2027, up from 6 million in 2022, according to a report released last year by Juniper Research.

Increased merchant adoption of the technology is also expected propel contactless payments volume to $10 trillion annually in 2027, up from $4.6 trillion in 2022, Juniper says.

"Where merchants that deployed softPOS were seeing two to three transactions a day a few years ago, they are now seeing 20 or more a day," says Sam Shawki, chief executive for MagicCube Inc., which partnered with ACI Worldwide Inc. in April to make its iAccept softPOS platform available to small and mid-size merchants. That move came less than a year after MagicCube offered ts platform to big-box merchants.

"We are also seeing softPOS alongside traditional POS terminals among merchants in Europe," Shawki adds.

'THE GLOBAL STANDARD'

A key reason merchants are supplementing their traditional POS terminals with softPOS devices is that the technology is a low-cost alternative to adding more POS devices in a store or chain. Merchants need only download the softPOS app onto a smart phone or tablet to convert the device into a POS terminal. No additional hardware, such as a dongle, is required.

SoftPOS applications are typically bank and acquirer agnostic, and, in the case of a device running the Android operating system, device agnostic. SoftPOS apps developed for iPhones or Apple Inc. tablets are specific to those devices.

"SoftPOS eliminates the need for additional hardware to accept card-based payments, so it's simple and inexpensive for merchants to implement. In most cases, it's as easy as downloading an app and then registering with the payment provider," says Thad Peterson, a strategic advisor for the financial-services research firm Datos Insights.

Now, "with contactless cards becoming the global standard, there are no barriers to the growth of SoftPOS usage," Peterson adds.

While installing softPOS can be as easy as downloading an app, the installation path for large merchants can involve more steps, depending on their technology stack and intended use cases, says Pratap Gautam, head of GBS (global business services) product strategy for the big processor Fiserv Inc.

To make it easier for large merchants to install softPOS, Fiserv's Carat point-of-sale platform offers a software developer kit that allows the merchant to integrate capabilities within their own point-of-sale applications, for example.

Leveraging an existing smart phone or tablet as a POS terminal can be an obvious cost benefit to merchants, particularly those that deploy multiple lanes or points of sale in each store. But small merchants can save significant hardware sums, as well, observers say, particularly as the business grows.

"Adding a new payment device that can accept payments without requiring the purchase of additional POS hardware can be compelling for small merchants that may not ... have the means to invest in additional tech," Gautam says.

NEW MARKETS

But large merchants are picking up on the benefits, as well, and not just big-box stores. In November, Alaska Airlines began rolling out softPOS for in-flight purchases of food and beverages. The air carrier is using Tap to Pay for iPhone through Stripe Inc.'s Terminal app, which it is adding to its company-issued iPhones to accept contactless payments. More than 7,000 Alaska Airlines flight attendants currently use the devices to monitor seat assignments, offer upgrades, and track dietary preferences.

The airline says it sees the adoption of Tap to Pay on iPhone as creating a more seamless payments workflow that requires no new devices. It's also easy for employees to set up and operate, the carrier says. Alaska Airlines will initially roll out Tap to Pay on iPhone on select flights and plans to expand the technology across its entire fleet in the coming months.

Apple Inc.'s launch of Tap to Pay on iPhone last year significantly expanded the market or softPOS. But it also opened up new markets for payments providers like Stripe, Block Inc.'s Square point-of-sale unit, and Adyen, all of which quickly signed on to offer Tap to Pay for iPhone.

Prior to Apple's entry in the softPOS arena, the technology was only available on Android-based devices. Stripe added softPOS for Android in February, and Square added Tap to Pay for Android to its tech stack in April.

"The flexibility and ease-of-use of Tap to Pay solutions make them an appealing technology for businesses of all sizes," a Square spokesperson says, "We've seen sellers of all types benefit from


Gray

Gray: "The softPOS wave is a great wave to ride, but it can be tricky to stay atop it right now."

Square's Tap to Pay offerings."

Square says its sellers that have storefronts and existing Square hardware are using the technology to customize in-store commerce for customers. The technology, Square says, showcases that tap-to-pay solutions can function as both a standalone payment-acceptance method and as an additive tool for existing commerce setups.

"We've seen strong adoption of our Tap to Pay technology domestically and abroad, including among new-to-Square sellers who gravitate towards it as their first payment-acceptance method when signing up for Square," the spokesperson says.

DRAWBACKS

While Apple's entry into softPOS expanded the market for the technology by enabling it to be installed on more commercial off-the-shelf (COTS) devices, MagicCube's Shawki sees Android devices as a larger market for the software. "[Our platform can] run on a wide variety of devices such as TV monitors, whereas Apple limits software development to its devices," he says.

One point of differentiation between softPOS on Apple and Android devices, Shawki says, is that Apple ties security for the primary account number (PAN) to the secure element in its devices, while MagicCube embeds security for the PAN within its platform. That approach opens the door for merchants to access a wider range of Android devices as softPOS terminals. "Our [secure element] is a virtual chip that can be loaded onto any device, which makes our software device-independent," Shawki says.

That distinction aside, softPOS in general has drawbacks, including transaction latency and the lack of a printed receipt. "That could make the customer experience less convenient or more cumbersome than a transaction done on a traditional in-store POS terminal," Peterson says.

One barrier to merchant adoption is that softPOS applications need to be MPoC-certified by the PCI Security Standards Council, the governing body for the payment card industry data-security standards. MPoC is a testing and approval program for payment technologies that use commercial off-the-shelf devices and an app to accept payments, rather than a dedicated POS terminal.

"There's currently a backlog for certification and there are only a few labs authorized to certify solutions," Peterson adds.

Another barrier is that it's not always easy to persuade merchants to start using a new POS device, even if it happens to be one they habitually carry around. "Terminals are a sticky part of the payments-processing business, so it can be hard to get merchants to switch POS devices," says Cliff Gray, a senior associate for the consultancy TSG, formerly The Strawhecker Group.

Also, while smart phones may be ubiquitous technology, when used as COTS devices they are not hardened to keep out hackers the way dedicated POS terminals are, Gray adds. One potential security risk is that other apps loaded on the device can create a backdoor for hackers to gain access to the device and the payment information that passes through it.

The risk of such occurrences is greater on Android devices than on Apple technology, observers say, since application development for Android apps is open-source, which means the code is readily available and may be redistributed and modified.

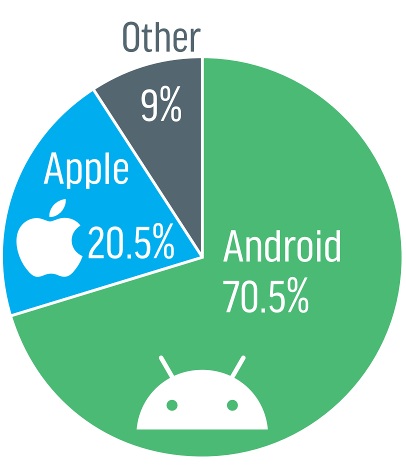
"App development for Android devices is kind of like the Wild West, whereas app development for Apple is more controlled," says Gray. "If you develop apps for an Apple device, you follow their rules."

'A BETTER EXPERIENCE'

For COTS devices to truly become secure payment terminals, card data passing through the device should be tokenized, Gray argues.

ANDROID DOMINATES IN SMART PHONES

(Sales market share worldwide)



Source: Statista

"If the only card data that passes through the phone is tokenized, then the PAN is taken out of the ecosystem and it does not matter whether you are using the latest version of the phone or an older model [that may have weaker data security features]," Gray says. "Removing the PAN from the ecosystem removes the incentive for criminals to beat your defenses." "PAN" refers to the payment account number.

Still, Gray remains confident the payments industry will overcome obstacles to COTS adoption over time.


Peterson

Peterson: "With contactless cards becoming the global standard,there are no barriers to the growth of SoftPOS usage."

"There are limitations to softPOS, but the draw to the technology is that merchants can bring the device to where the customer is, as opposed to making her go to the checkout counter, which makes for a better customer experience," says Gray.

"The softPOS wave is a great wave to ride, but it can be tricky to stay atop it right now," he adds. "A lot of obstacles still remain to adoption, but there are a lot of benefits, too, and the payments industry will eventually overcome the challenges the technology faces." DT

IMPLEMENTING FEDNOW: FOUR CONSIDERATIONS

It will take some time and effort, but with proper planning and research financial institutions can minimize the hassles.

BY MURTHY VEERAGHANTA

Murthy Veeraghanta is chairman and chief executive of VSoft.

MANY PEOPLE IN banking and financial technology aren't aware that the word "core" in "core banking provider" started out as an acronym for "Centralized Online Real-time Exchange" (or "Environment"). This "real-time" technology allowed consumers to deposit money and see the balance reflected immediately. Consumers could also withdraw cash from any of the bank's branches. The CORE system of banking cut the processing time for deposits from 24 hours down to minutes.

The recent launch of the Federal Reserve's FedNow Service promises to make a similarly radical change to the world of digital payments.

For the average consumer, real-time payments happen all the time using Venmo, Cash App, Apple Pay, PayPal, and Google Pay. Behind the scenes, these services create the impression of instant payment by floating the money while the actual transaction clears over several days.

The difference with FedNow is that it will allow banks to implement a true, real-time payments mechanism in their digital-banking environments, which brings us to our first consideration.

1. How Do Faster Payments Fit into Your Digital Experience?

The FedNow service will help to level the playing field for financial institutions competing with certain fintechs. Consumers and businesses will be able to use the capabilities of FedNow only through a bank or credit union.

That means you can incorporate an excellent new product or "feature" into your digital-banking experience without developing it in-house.

However, your technology team will still need to work with your digital banking provider to ensure the user experience for both employees and account holders is smooth and intuitive.

As you are probably aware, the ability to send and receive payments faster is a major selling point, especially in the commercial banking space. While consumers will likely use the service, real-time payments will be a much bigger boon for businesses and other organizations that use commercial-banking services. This brings us to the next consideration: use cases.

2. Which Specific Use Cases Does Your Institution Want to Support?

The financial-services industry is littered with pundits overstating how XYZ digital technology will "change everything." That kind of language makes for grabby headlines and poor strategic thinking.

As of this summer, only a small cohort of institutions had adopted FedNow. It's safe to assume that many more institutions will soon follow suit. The best way for your institution to engage with FedNow is to set aside time to plan and list all the specific use cases that your teams can identify. Some will be obvious. Others may apply to individual clients or partnerships.

Start by listing all the ways that your institution relies on "slow" payments. Then list the more imaginative or untested use cases where real-time payments could create revenue or improve the account-holder experience.

These lists will probably include product and service updates that impact online banking, mobile banking, text banking, and Interactive Voice Response (IVR) systems. Account opening and funding is another area that could be improved. You may also need to change the processes for statements, reports, data extracts, and other data-driven tasks.

Veeraghanta: "FedNow ... will allow banks to implement a true, real-time payments mechanism in their digital-banking environments."

3. What Other Questions Should You Should Ask Your Team?

FedNow is a tool that only financial institutions can access. The Federal Reserve permits financial institutions to function as middlemen, offering real-time payments to their account hold-ers. They've also published several helpful resources to help your institution understand the new service.

This means that much of the experience will be hidden within your existing technology stack. That sets up an easy mistake: implementing FedNow in ways that serve your staff but fail to consider the account holder's experience, or vice versa.

It may help to think of FedNow as a new product your institution is adopting, so someone in your organization needs to "own" it. This person, or team, will be responsible for analyzing and optimizing the user experience for staff and account holders.

Here are a few questions that will jumpstart your FedNow implementation strategy:

What data will the FedNow Service require?

Much has already been written on the ISO 20022 standard that FedNow uses, but there may be other ways your data ecosystem and workflows will need to change.

Will your current digital banking and back-office interfaces make it easy to report fraud or erroneous payments?

One of the risks of instant payments is the potential for fraud. Although inconvenient, slow payments make it harder for consumers to have large sums stolen without recourse. Your institution will need protocols to help mitigate fraud and its effects.

What reporting needs will your retail and commercial customers have for real-time payments?

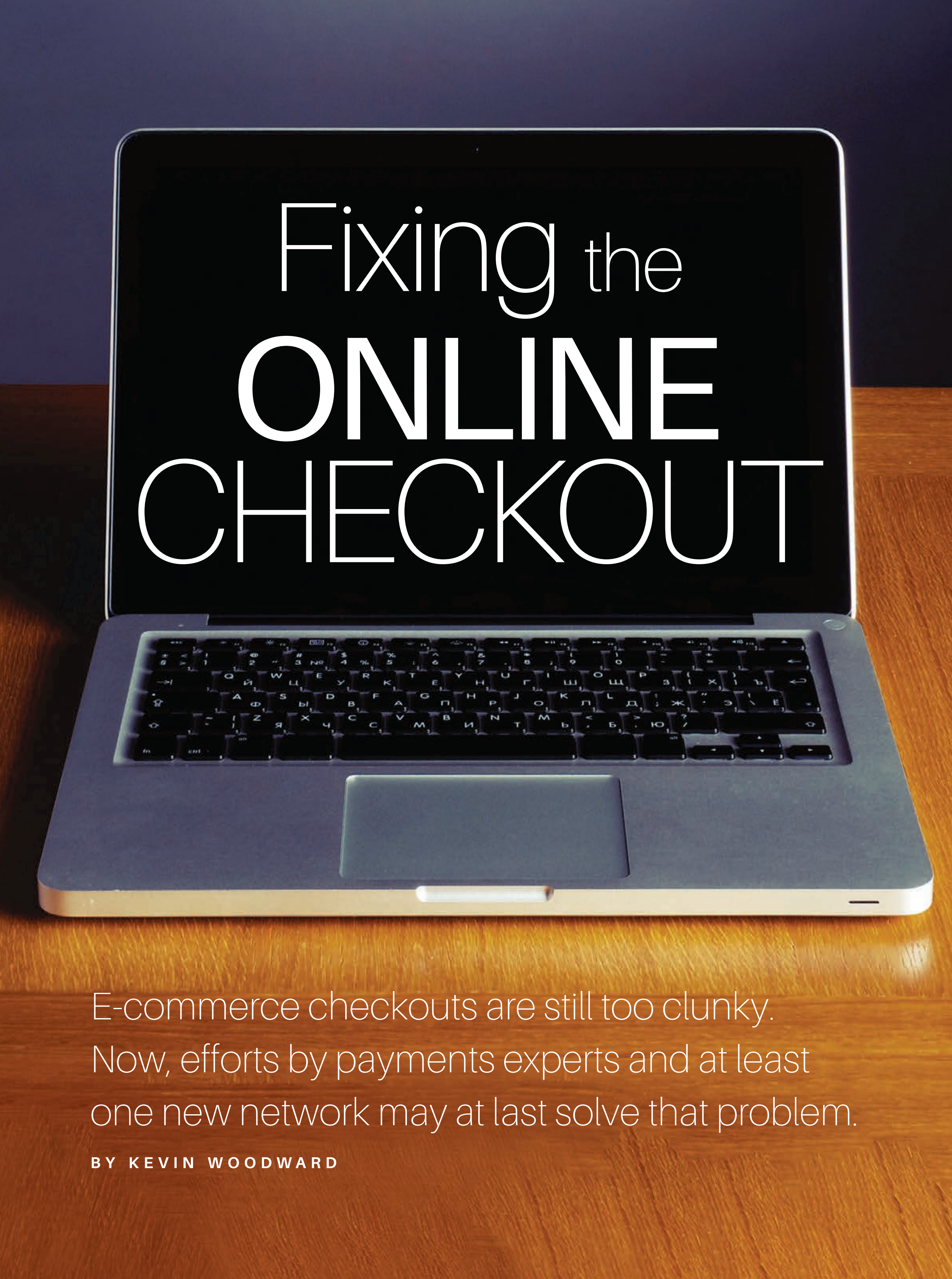
These changes may be minor, but they shouldn't be an afterthought. Create a fictional retail account and commercial account. Then, walk through multiple reporting scenarios. Take a report from an existing account and reimagine it with real-time payments supported.

4. FedNow Can Be a Powerful Tool

In some ways, implementing FedNow may feel like a huge undertaking for your staff and a long-overdue upgrade for your account holders. Remember, their expectations have been set by the fintech apps on their smart phones.

However, with a little forethought and strategic planning, you can equip your staff to navigate the changes. If an account holder responds to the new feature by saying "Finally!" and starts paying in real time with your digital banking app instead of Venmo, that's a win.

If all goes well, your account holders will embrace real-time payments through your institution and forget why they used separate third-party payment apps in the first place. DT



Fixing the ONLINE CHECKOUT

E-commerce checkouts are still too clunky. Now, efforts by payments experts and at least one new network may at last solve that problem.

BY KEVIN WOODWARD

In the battle for the e-commerce checkout—with a successful sale counting as a win—the accelerated checkout is gaining favor. **One contender that's not even available yet may have a jump on others.**

In the e-commerce arena, friction is the big no-no, the one element not to introduce, strengthen, or ignore. It's the element that keeps conversion rates—the percentage of site visitors who purchase from an online store—low and can disrupt the consumer's checkout experience.

But, new advances and approaches to the online checkout are diligently cutting away at checkout friction, and payments providers are helping. With the 2023 holiday-shopping season peaking, merchants and consumers are hoping for easy checkouts and little disruption to transactions.

With an average e-commerce conversion rate ranging from 2.5% to 3%, according to Shopify Inc., online retailers look to the checkout flow to capture more sales and not impede purchases. As e-commerce sales picked up during the pandemic, especially among those who had not shopped online before and among those using their smart phones more often, the impetus for a better checkout experience ballooned.

The goal has been to increase the conversion rate and thereby boost revenue. Among the approaches many retailers and e-commerce platform providers have taken is to reduce surprises and widen customer choices among payment methods. The goal is to eliminate as many disruptions as possible in the checkout process.

One tactic along these lines is to implement accelerated checkouts. Think Apple Pay, Google Pay, or PayPal, where not only is the payment information stored, but shipping details, too. Accelerated checkout is already a trend, but will gain even broader use, says Alex Hoffman, senior vice president of payments at BigCommerce Pty. Ltd. "It's really happening," he says.

'Delightful And Secure'

An expected new entrant hopes to tap that trend toward speed.

Paze, the upcoming digital wallet from Early Warning Services LLC, is another accelerated-checkout example. Though Hoffman has no announcement regarding Paze and BigCommerce, he calls the new wallet the equivalent of Zelle for e-commerce. Scottsdale, Ariz.-based Early Warning also created Zelle, the person-to-person payment service.

Announced in March, Paze is a multi-bank wallet that could have as many as 150 million credit and debit cards automatically eligible for inclusion when it launches, which it is expected to do in 2024. Paze is now in testing. It could have the crucial element of critical mass by the time it hits the market, observers says.

HOFFMAN: **ACCELERATED CHECKOUT** "IS REALLY HAPPENING."

Aimed at easing online checkout and lowering cart abandonment, Paze would eliminate manual card entry, still a frequent checkout requirement for many consumers.

"This reliance on manual input not only introduced the potential for errors but also results in abandoned carts and lost sales, all of which drives the need for a smoother and better-engineered checkout process," says James Anderson, managing director of Paze.

"Manual card entry at guest checkout must become a thing of the past," he adds. "Unfortunately, it's still very much an option that consumers end up using, despite the fact it is loaded with friction. It forces consumers to have their physical card close by and leaves room for errors. It also relies on static data. which is intrinsically less secure."

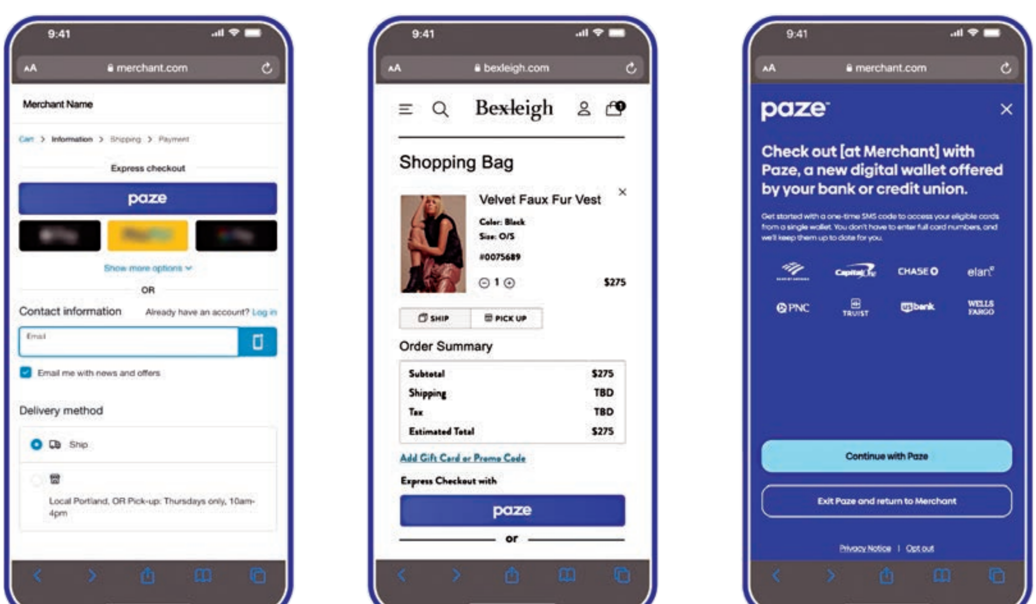
"Concurrently, merchants face their own set of hurdles in this fragmented e-commerce payments system," Anderson continues. "They've struggled to validate consumers effectively, relying on static data from physical cards. This approach harms the customer experience and causes missed revenue opportunities.

"Finally, financial institutions [are] extremely limited [in authorizing] e-commerce transactions, relying on the limited information they receive for card authorization," Anderson adds. That "limited information, he says, consists of the transaction amount and merchant name.

Anderson says Paze could be an ideal checkout service. "We think the answer to achieving the ideal checkout is a digital payment method embedded in the merchant's checkout, offered to consumers by the banks and credit unions they already trust," he says.

Paze's network of financial institutions and merchants—Omaha Steaks is an early partner, as is GoDaddy Inc., which is testing a simple integration for small businesses—will help ease e-commerce checkout, Anderson says.

Caption



"With the scale we have on the financial-institution side, at our launch in the first half of next year we will bring more than 150 million e-commerce active consumer credit and debit cards to the online checkout of participating merchants. Our goal is a ubiquitous, delightful, and secure checkout solution available to all consumers and merchants in the United States," he says.

"The Paze vision is ubiquity across merchants and the financial institution sides," says Matt Miller, Paze's vice president of product. "This is about addressing a problem in e-commerce that's existed since the early days."

No Manual **Keying**

Consumers, long accustomed to speedy online shopping, want the same sense of quickness when checking out, and merchants want to make it easier for them to do so. When it's not speedy, a sale is typically lost and the merchant's conversion rate takes a beating.

Paze's backers say it was designed to help alleviate that issue. Because the participating issuing banks—all Mastercard or Visa issuers in the United States¬—already have established relationships with consumers through their card products, card data and billing-address information will be available in the digital wallet without the consumer having to type out anything but the email address associated with the card account. "We get away from this idea of manually keying in everything," Miller says.

Consumers will be able to add different shipping addresses and store them in Paze, too. The wallet also features a card-updater capability. The issuer can send a notice in the Paze wallet asking the consumer to update the expired card, after verification with a one-time password and supplying a card-security code.

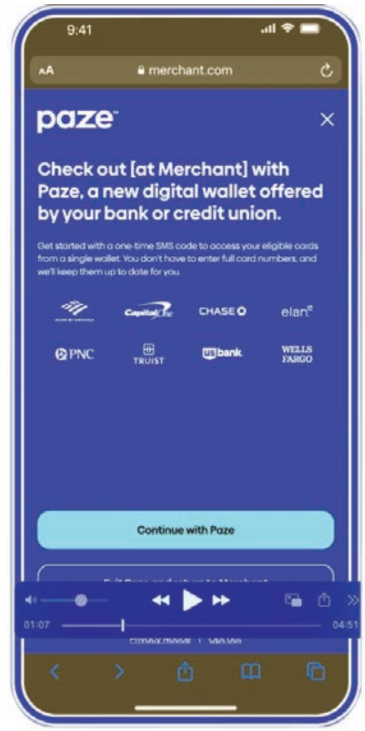
Merchants choosing to adopt Paze will pay no fees for the service, Miller says, though typical card-processing fees will still apply. To help avoid too many wallet options on the checkout page, Paze will use an auto-appearing feature after the consumer enters an email address on the page, even if the shopper uses guest checkout.

A nearly instant connection from the merchant to Paze's network will generate the option to use Paze for checkout if the address is recognized, Miller says. Merchants will have the capability to display a persistent Paze checkout button if they choose.

As with any card-based payment product, banks, consumers, and merchants will have to want to use Paze. With the bank part solidified, merchants, followed by consumers, will be next for recruitment.

With several channels to reach merchants, one potential Paze selling point could be that expected improvement in conversion rates. It may help capture online sales that consumers might have abandoned.

As for consumers, participating banks will likely launch marketing materials for Paze, Miller says, including in the online and mobile-banking channels. At the 2017 launch of Zelle, Early Warning's first



Caption

MILLER: "WE GET AWAY FROM THIS IDEA OF **MANUALLY KEYING IN** EVERYTHING."

BISHOPP: "CONSUMERS WANT QUICK, EASY, **FRICTIONLESS PAYMENT OPTIONS**, AND EMBEDDED PAYMENTS ARE KEY TO GETTING THERE."

consumer-facing payment product, the new network conducted a brand-awareness campaign.

"Issuers will be a key channel because they are trusted by consumers," Miller says. Chase already is sending emails touting Paze as secure and convenient.

From there, much like expedited online-checkout services from Apple Pay, Google Pay, and PayPal, Paze will present its page to confirm the transaction with the card data and address already filled in. Miller says Paze will not obstruct any other option a consumer wants to use.

No Surprises

While online checkout is generally in a better state today than in the past, improvements such as accelerated checkout are needed, Hoffman says. "For the consumers, shopping is fun. Payments is not."

That doesn't mean payments providers haven't been working on improving their part of the checkout experience. "Today, we have excellent core payment providers," Hoffman says. Also important in smoothing checkout, he says, is offering alternative payment methods. This is "not a new development, but continues to be super important," he says. Another big change affecting the checkout is the advent of buy now, pay later options, he adds.

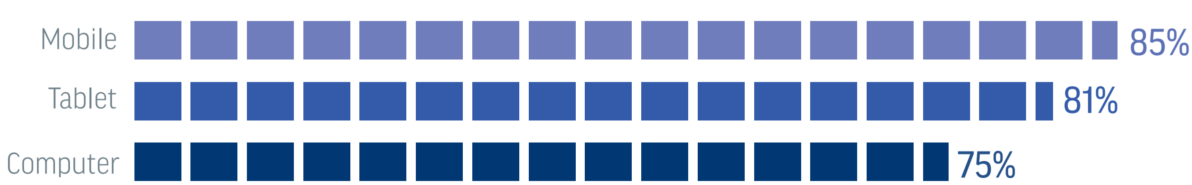
Alternative payment methods—think Apple Pay or PayPal—have the benefit of already being trusted by consumers who load their payment details and shipping addresses into them.

They can be used in some instances in a one-page checkout. The goal of a one-page checkout is closely tied to accelerated checkout use. How effective might this be? In a BigCommerce conversion report released in July, a test group of sites that offered both PayPal and Apple Pay had a conversion rate of 61.9%.

Accelerated checkout allows consumers to be recognized by their emails or phone numbers, even as a guest on a Web site they haven't shopped at before, Hoffman says. Using this checkout option enables consumers to select their payment and shipping information in a single step, reducing keystrokes and the number of pages they must use.

WALKING AWAY

(U.S. cart abandonment rate by device, third quarter 2023)



Note: Abandonment defined as baskets created that did not result in a completed order. Source: Statista

"We want to get rid of surprises," he says. That could be a fee that was explained only prior to the checkout or shipping costs and taxes unmentioned early in the checkout process. The online shopping process should be very transparent by the time the consumer arrives at the checkout page so she can use her preferred payment method without thinking about it, he says.

"The ideal online checkout combines simplicity with efficiency, minimizing typing, clicks, and decisions," says Tom Wall, founder of TheModernBack.com, a Sarasota, Fla.-based massage and related chair retailer. "Thus, discouraging factors like complex forms or confusing navigation should be eliminated for a smooth transaction."

'Quick And Simplified'

Another key piece of the ideal online checkout is offering embedded payments, says Mark Bishopp, senior vice president of embedded commerce and partnerships at Fortis Payment Systems LLC, Novi, Mich. "Consumers want quick, easy, frictionless payment options, and embedded payments are key getting there," Bishopp says.

As Alex Kantor, owner of Perfect Plants Nursery of Monticello, Fla., sees it, the ideal online checkout consists of the product page, the shopping cart, and then the checkout phase. "This traditional flow has proven effective in guiding customers through the checkout process," Kantor says.

The checkout should include express payment methods, Kantor says, though merchants may prefer that customers complete the checkout within their platforms so the merchant can obtain proper tracking data.

And there are yet other ways payments companies can contribute to better checkout experiences, says Jared Drieling, chief innovation officer at TSG, an Omaha, Neb.-based payments advisory. Some basic support could help, whether providing a little education or providing advice for those merchants, he says.

Some of that may have to do with teaching them about the role of artificial intelligence in e-commerce. As Hoffman says, the challenges of personalization, that is, adapting Web page content to each customer's unique interests, may be aided by AI.

For example, an AI-assisted checkout page might be able to present two or three payment options based on the customer's past use without overwhelming the customer with checkout options. Someone shopping using an Apple computer might be presented with an Apple Pay checkout option, for example.

The checkout of today and those coming tomorrow are striving toward eliminating surprises and giving consumers choice of payment methods. As Kantor says, "The future of online checkout will likely revolve around the continued popularity of express payment methods, which provide a quick and simplified experience for consumers."

ANDERSON: "MERCHANTS FACE THEIR OWN SET OF HURDLES IN THIS **FRAGMENTED E-COMMERCE** PAYMENTS SYSTEM."

A RECKONING ON WALL STREET

The payments market is enjoying more vitality and growth than most can remember. So what's behind the recent market rout?

BY **ERIC GROVER**

THE PAYMENTS MARKET is enormous and growing. Capgemini forecasts a 15% compound annual growth rate for global noncash digital payments through 2027. The Boston Consulting Group estimates global acquiring revenue will reach $100 billion by 2027, and total payments-industry revenue will be $2.2 trillion by the same year.

Low-cost capital, worldwide electronic payments growth, the one-time Covid boost, business models based on naturally increasing recurring revenue streams, intrinsic operating leverage, and the industry increasingly finding ways to add and charge for value around payments—all these factors turbocharged the flow of capital pouring into the sector, driving up valuations.

Investors wanted to believe in growth and that transaction and account economics are sustainable. Sometimes they are. The payments sector was hot until it wasn't.

As of Nov. 3, the S&P 500 was down 8.56% from its high. That's more than explained by a higher cost of capital and fears of a possible recession in 2024. Easy money inflates valuations and makes it possible for less-robust businesses to survive. From 2008 until 2022, the Fed's real benchmark interest rate was negative.

However, the reign of easy money is over. In October, the Federal Funds Effective Rate was 5.33%, while inflation in October was 3.2%. In The Wall Street Journal's most recent poll, 48% of academic and business economists surveyed forecast a recession within the next 12 months.

PLUNGING PROCESSORS

Market agita about the payment sector, however, is more severe.

Paraphrasing Ernest Hemingway in The Sun Also Rises, we can say richly valued payments firms lost value gradually and then suddenly.

Many payment processors were priced to perfection, and beyond. Then the spell broke. Triggered by growth misses and reduced guidance, Dutch payment-processing phenom Adyen's and consolidator Worldline's stock prices experienced jaw-dropping one-day drops of 36% on Aug. 17 and 59% on Oct. 25, respectively.

Over the last several years, valuations across the payments industry have been devastated. As of Nov. 3, Worldline was down 86% from its high, Adyen 76%, Block 82%, Nuvei 88%, Paysafe 94%, Cielo 89%, PagSeguro 87%, Stone 87%, FIS 66%, Global Payments 53%, Nexi 67%, and Shift4 52%. A sector-wide collapse of this magnitude should alarm shareholders, management, employees, and customers.

Nose-bleed private-payments valuations have fallen as well. Last year, ballyhooed buy now, pay later network Klarna saw its valuation plummet 85% to $6.7 billion from $45.6 billion in 2021. Klarna demonstrated there's an enormous market for low-friction, short-term, often fee-free consumer credit. But that's not enough. Generating profits is necessary just to justify even its reduced valuation. In March 2023, high-flying Stripe raised $6.5 billion at a $50-billion valuation, down 47% from its $95-billion valuation in 2021.

With pricier capital and a challenging environment, many of the more than 5,000 fintechs in payments won't survive.

Semi-open general-purpose payment networks American Express and Discover have weathered the storm somewhat better than the processors, and are only down 21.5% and 32%, respectively.


Grover

Grover: "Many payment processors were priced to perfection, and beyond. Then the spell broke."

Icarus-like PayPal, however, lost its way and is down a whopping 81% from its apogee. Complacency, management virtue-signaling, and being characterized as, and acting too much like, a processor rather than a branded retail and peer-to-peer payments network are largely to blame. Building branded network mass abroad and at the physical point of sale would be the better bet to boost long-term profitable growth, and, therefore, enterprise value.

Venture and private-equity investment in payments has also declined dramatically. KPMG's "Pulse of Fintech H1 2023" reported that global fintech funding activity (venture capital, private equity, and M&A) crested in 2021 at 1,026 deals valued at $57.5 billion. In 2022, it ebbed to 878 deals totaling $56.3 billion. In the first half of 2023, fintech payments funding plummeted to 243 deals totaling $16.2 billion.

RISK…AND REWARD

Payments businesses need credible stories of sustainable, profitable growth. And they need to deliver. There is a range of not-mutually-exclusive approaches.

Being cheapest is rarely the best strategy unless you have other powerful levers with which to monetize payments. All merchants and financial institutions, all other things being equal, would like to pay less for payments. It's a price-competitive market, particularly for large enterprises. Gargantuan merchants like Amazon and Walmart, financial titans such as Bank of America, Capital One, and Citi, and tech giants like Apple, all squeeze fees.

Small and mid-size enterprises and small financial institutions, however, pay vastly higher fees. So, notwithstanding costing more to originate and service, SME portfolios, if sticky, can be very attractive. But even there, software companies, marketplaces, and tech platforms are capturing an increasing share of transaction economics. Mobile-app stores charge up to 30% for payments, paying processors a sliver, and highlighting the dynamics and power of scale in two-sided-market platforms.

While it's challenging, processors participating at multiple points across the value chain can create synergies, deliver more value, and, consequently, command better economics.

Industrial-strength consolidatorsFIS, Fiserv, Global Payments, Nexi, and Worldline are practiced at cutting costs. But they have failed to generate compelling revenue synergies across their issuer-processing, payment-network, and merchant-acquiring-and-processing assets—even while touting their ability to do so. And while these processing colossi enjoy advantages in scale, breadth of services, and delivery footprints, they often suffer management and innovation diseconomies of complexity and scale.

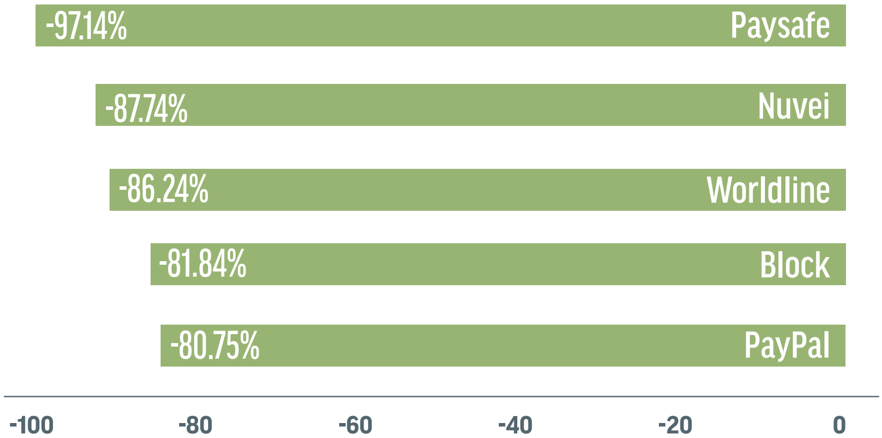
Entry barriers and the risks of building payment networks and the concomitant rewards are enormous. PayPal is a powerful two-sided payment network with critical mass online in many markets, serving consumers and businesses. Processor Block, too, has a leading P2P network and an interesting nascent, semi-open, retail-payment network in Cash App Pay.

Merchant processors Adyen and Stripe crossed the Rubicon to support issuance and issuer processing, rightly thinking serving large enterprises' acceptance, payout, and issuing needs provides greater value.

Payment processing for large enterprises is an oligopoly of scale play, and, while profitable, it's thin gruel. Entry barriers in serving smaller merchants, FIs, and fintechs can be relatively modest. While there are more competitors, asymmetries between sellers and buyers enable richer fees.

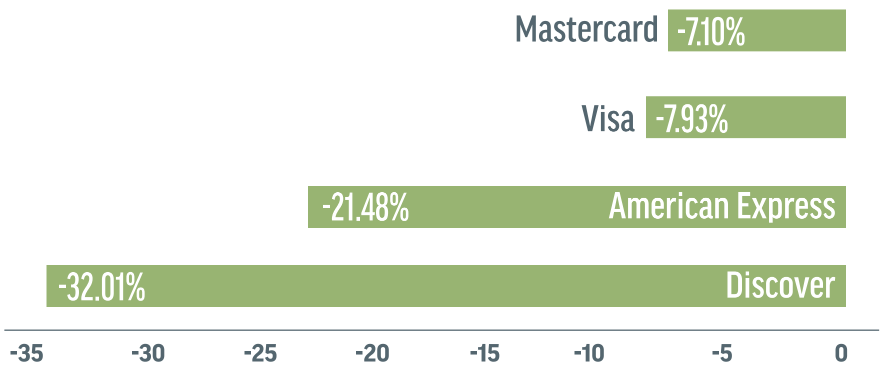
HOW THE MIGHTY ARE FALLEN...

(EXTENT OF DROP FROM ALL-TIME MARKET HIGH FOR FIVE MAJOR PROCESSORS, AS OF EARLY NOVEMBER)



...WHILE NETWORKS CONTAIN THE DAMAGE

(EXTENT OF DROP FROM ALL-TIME MARKET HIGH FOR FOUR PRINCIPAL PAYMENT NETWORKS, AS OF EARLY NOVEMBER)



Source: Equity market reports; the author

A FLY-WHEEL EFFECT

With better mousetraps addressing particular niches, proprietary and sticky origination channels, and/or a bundling of additional services around payments, payment processing can be quite lucrative.

Dispersed client share benefits processors and networks alike enormously. In the overall market plunge, outliers Fiserv, Mastercard, and Visa are only down 5.2%, 7.1%, and 7.9%, respectively, from their highs.

At first blush, Fiserv's immunity to investor skittishness is a head-scratcher. Its portfolio of payments assets is similar to other consolidators whose valuations have been devastated. But, net, Fiserv has delivered solid revenue and earnings growth. It's met expectations.

And its branded Clover platform is enjoying double-digit growth and flywheel effects from more merchants attracting more software and service providers that in turn attract more merchants. While it owns debit and bill-pay networks, Fiserv is best understood as a processing behemoth.

Mastercard's and Visa's resilient valuations are easier to fathom. They're the only two genuinely global retail-payment networks, and they enjoy ever-increasing network effects. For many would-be disruptors, plugging into and leveraging the global payment networks is the best path to maximizing value.

Fiserv's, Mastercard's, and Visa's revenue-valuation multiples of 3.9, 15.1, and 15.6, respectively, testify the market still understands and values Fiserv as a processor and Mastercard and Visa as networks. Payment networks at scale have pricing power. Processors at scale are often interchangeable.

INDISPENSABLE

Concerns over BNPL systems, digital currencies, and instant interbank-payment systems, while real, aren't new and in most markets they're hardly existential threats to the reigning payments ecosystem.

Most BNPL networks generate transactions for incumbent payment networks and processors. Meanwhile, cryptocurrencies aren't fit for purpose. Stablecoins and central bank digital currencies have yet to find compelling use cases and a path to network critical mass. And, even where real-time payment systems serve retailers, as is the case with the Brazilian Pix system, they rely on traditional payment processors.

Notwithstanding battered valuations, payment processors are still an indispensable part of the payments ecosystem. Capital will be continually reallocated to its best uses. Payment processors and networks demonstrating robust, sustainable, profitable growth will be rewarded by the market. DT

CUTTING FRAUD DOWN TO SIZE

These days, fighting bad actors without automation is worse than useless. It's dangerous to the bottom line.

BY **BAPTISTE COLLOT**

Baptiste Collot is cofounder and chief executive at Trustpair

AUTOMATION IS OFTEN thought of as a threat to humans' jobs. I'd argue that mindset is very limiting. Technology and humans are complementary. Automation is here to enhance human actions and increase their effectiveness, not replace them.

In fact, when it comes to critical business imperatives, such as payment-fraud prevention, you can't effectively defend your company without both forces in play. A balance of humans and cutting-edge technology is required, especially as the threat of payment fraud becomes more pervasive.

In the United States, 56% of companies were targeted by payments fraud at least once in 2022. It's a big and growing concern for corporations. Fraudsters are more and more sophisticated and use advanced technology to infiltrate companies. In fact, most fraud is perpetrated through changes in supplier credentials and information on legitimate payments.

It's also getting harder and harder to identify fraud when it happens. Account validation is therefore a key step to prevent fraud. Continuously monitoring supplier information to make sure fraudsters haven't infiltrated your third-party data is the only way to block payment fraud efficiently.

PHONE TAG WITH PHONIES

Seventy percent of companies still use human callbacks to confirm vendors' bank accounts and validate suppliers' credential changes before payment. Human-only account validation is insufficient and out of date.

Think about it: Seventy percent of companies have someone picking up the phone to confirm the new banking details of their supplier are accurate. International companies work with thousands of suppliers, making human-only account validation a flawed and unsustainable process.

If you use callback as your main method to check credential changes, you might not get an answer immediately. You'll need to call back. When you do and someone answers, you might still not have the right contact on the phone.

Even if you do get someone on the phone, who's to say you're actually talking to your supplier and not a fraudster impersonating your supplier? The rise of generative artificial intelligence and ChatGPT has made deepfakes and impersonations much more believable and common.

Fraudsters have reached an unprecedented level of sophistication. Modern fraudsters are no longer

VISA ENHANCES MERCHANT SECURITY IN THE ERA OF DIGITAL FRAUD

As the digital economy continues to grow, people are relying on virtual transactions more than ever. But with the expansion of digital money movement comes new opportunities for fraudsters to exploit merchants and their customers.

In today's economy, fraudulent activity can happen anywhere, to just about anyone. Digital cybercriminals are continually adopting new tactics to find new ways to scam consumers and merchants. And when those evolving tactics succeed against merchants, they can have serious consequences – from lost sales to lost customers and long-term reputational harm.

Sacrificing reliability or security isn't a sustainable option for merchants when processing transactions, and not all networks are created equally. While fraudsters continue to look for new methods, Visa is working to protect merchants by keeping all types of fraud out of the payments ecosystem.

THE MANY FORMS OF FRAUD

Fraud takes many forms in today's digital economy, and it doesn't always require a high level of sophistication to be successful, as revealed in Visa's recent Biannual Threats Report. Simpler fraud schemes such as skimming operations and ransomware-as-a-service exist to sell pre-packaged stolen data or threat software to individuals and make fraudulent charges or launching an attack easier.

More sophisticated fraud schemes like enumeration attacks increased 40% between January and July of this year, with the U.S. being the most heavily targeted region globally from both the acquiring side (54% of total acquiring enumeration) and issuing side (39% of total issuer enumeration). The Visa Account Attack Intelligence (VAAI) capability monitors for these enumeration attacks and notifies affected acquiring banks and merchants instantly, helping them avoid losses.

Not all fraud is as sinister as stolen account numbers or identity theft. Friendly fraud, or first-party misuse, is a common scheme where cardholding customers dispute legitimate purchases with a merchant or issuer. Friendly fraud accounts can look as simple as disputing a valid purchase, charges for a forgotten subscription plan or failing to return within the policy window. Merchants can often absorb the loss regardless of whether the customer who is disputing the charge has bad or honest intentions.

Earlier this year, Visa took action to help merchants fight back against friendly fraud by implementing new parameters to its dispute program. With these changes, merchants can provide additional data and evidence to prove a valid charge against the disputer, which could save small businesses over $1 billion dollars globally over the next five years.

VISA'S PRIORITY: PAVING A FRICTIONLESS PATH TO SECURE PAYMENTS

End-to-end digital transactions are becoming the new normal as consumer preferences shift to online purchases, contactless payments and smartphone wallets. Taking extra precautions to secure accounts, using tokenized payments and digital wallets and isolating payment systems from other programs are all ways merchants can protect themselves. However, to keep up with the revolving door of cybercrime, payment networks need to invest their own resources – dollars, brain power and technology – to keep transactions secure.

Over the past five years, Visa has invested more than $10B in network security and artificial intelligence, with more than 1,000 dedicated specialists monitoring payment activities 24/7. And those investments are already paying off. Last year, Visa's technology helped to prevent an estimated $27 billion in fraud, and an additional $30 billion in the first half of this year alone. Today, less than one tenth of one percent of volume transacted on Visa's network is lost to fraud. That means merchants can keep their businesses running smoothly and at peak performance, allowing them to close more sales and provide their customers with the great buying experiences they expect.

sending poorly crafted emails out of the blue asking for wire transfers. Fraudsters use their own cutting-edge tools to penetrate systems and impersonate whomever they want.

This means they can penetrate your supplier's system and send an email from your supplier's actual email address asking for banking-information changes. In this case, it's almost impossible to detect the attempted fraud with manual processes. Yet, falling victim to this type of fraud can cost your organization millions.

On top of all this, manually checking supplier data for account validation can be a tiresome and low-value task for finance professionals who, after all, got into the industry to do interesting and strategic work.

Considering how frequently supplier data needs to be monitored—not just when onboarding a new supplier but throughout the entire relationship with that vendor—it's clear that a human-only approach won't cut it. Finance professionals need technology as support.

THINKING STRATEGICALLY

Automation gives you the confidence you're paying the right vendor and bank account every single time, no matter what's happening inside or outside your four walls.

Account validation can be 100% effective and secure only when supported by automation. Automation is the only way to ensure systematic account validation of supplier credentials throughout the entire procure-to-pay journey, from onboarding a new supplier and throughout the whole supplier lifecycle.

Automation also removes the risk of mistakes and oversights humans naturally make in manual and time-consuming processes. Even your best people on their best days can make mistakes.

However, using fraud technology isn't about replacing humans, it's about supporting them. Automation removes manual tasks that don't add value for the company or the employee. Fraud-prevention software detects and highlights the riskiest suppliers and scenarios.

If an account-validation status is delivered that indicates there could be fraud, it's up to the finance team to determine the next steps and best course of action. It's also up to finance teams to review their supplier policies and choices when detecting certain patterns of fraudulent behavior.

Meanwhile, the accounts-payable teams who used to pick up the phone to check supplier information can spend more time handling risky cases and setting-up strategies to prevent fraud attempts in the first place.

TALENT PLUS SOFTWARE

Automation helps companies focus on where risk really is and where human intelligence is needed to resolve a situation. Technology frees up humans' schedules for strategic planning by letting them spend less time on manual and time-consuming processes.

The prospect of high-value work and a more stimulating work environment increases workers' job satisfaction and puts organizations in a better position to attract and retain talent.

Fighting fraud takes more than just talented finance teams or cutting-edge software. It takes a combination of the two. When both forces are in play, you can do much more to protect your organization and have the utmost confidence in your ability to defend against fraud. DT

Digital Transactions News

We deliver the **payments industry news** to your email inbox daily!

- We have been delivering the payments industry news to your email inbox every day for 20 years
- Digital Transactions News is packed with news and information from the 164.3 billion transactions industry
- Two original stories every issue
- Trending stories, so you know what the industry is reading
- Links to Digital Transactions monthly magazine
- Calendar of events
- Plus "In other News" The most complete listing of announcements from the payment community

Subscribe today at **bolandhill.omeda.com/dtr/**
or email **Bob Jenisch** at **Bob@digitaltransactions.net**