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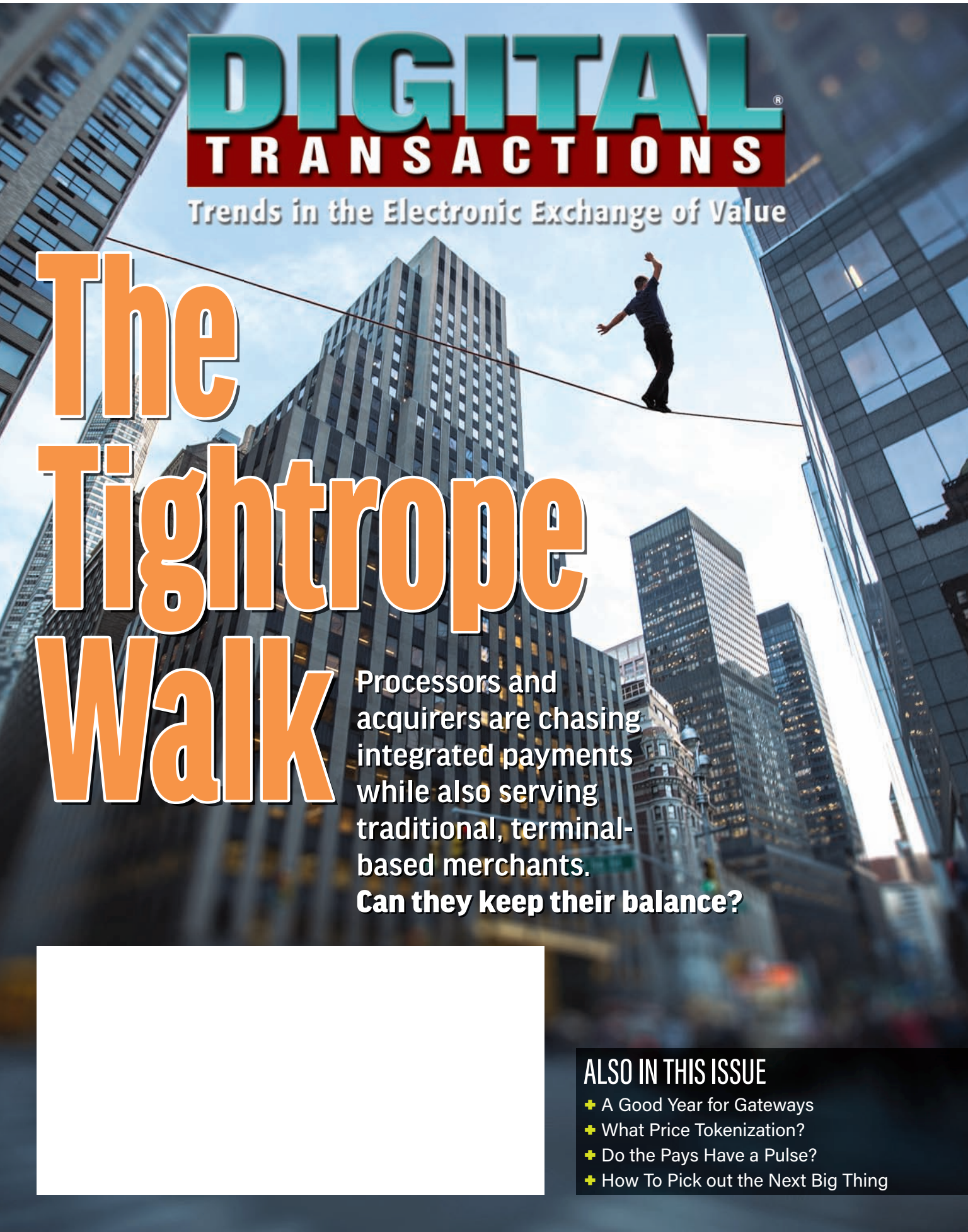

DIGITAL TRANSACTIONS

Trends in the Electronic Exchange of Value

The Tightrope Walk

Processors and acquirers are chasing integrated payments while also serving traditional, terminal-based merchants. **Can they keep their balance?**

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DIGITAL TRANSACTIONS
Trends in the Electronic Exchange of Value

The incessant quest for better profit margins, lower attrition, and more transaction volume is driving these companies, and investors, to what has turned into a lucrative market for integrated payments.

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THE GIMLET EYE

You Just Can't Please Everyone

We were just wrapping up this issue when word came of the proposed $6.24 billion monetary settlement of the big federal antitrust case that has, for more than a decade, pitted merchants against card networks and major banks. The deal, however, only settles the money question—how much merchants will get as a cash settlement. It doesn't touch on the other aspect of the case—the network rules by which, merchants say, they are made to pay above-market rates to accept network-branded card transactions.

Barring another settlement, that latter question will no doubt keep lawyers on both sides of the issue busy for years to come in what has been without question the most contentious issue the electronic-payments industry has had to grapple with.

But an interesting twist emerged in the immediate aftermath of the monetary settlement in the case, known as MDL 1720. As senior editor Jim Daly reported in a story in our email news service, *Digital Transactions News,* this latest agreement exposes, not for the first time, the diverging interests of the big merchants and those of the smaller ones. "[I]ndependent businesses, which in 2005 filed the original class action in the consolidated litigation now known as MDL 1720, are more likely to endorse the pending settlement than big ones," Jim reported.

Indeed, while retail trade associations dismissed the settlement as a relative pittance against the sums the banks, Visa Inc., and Mastercard Inc. have reaped on card transactions, small sellers seemed pleased. Mitch Goldstone, president and chief executive of ScanMyPhotos.com, lauded this latest settlement as "extremely gratifying." We know Mitch. We have spoken to him a number of times over the years. He's no slouch in his criticism of network interchange rates. Indeed, ScanMyPhotos.com is the lead named plaintiff in the main MDL 1720 class action, which names Visa, Mastercard, and a dozen banks as defendants.

This case has had a tortured history, originating in 2005 with individual suits filed by merchants against the networks and the nation's largest banks. An epic $7.25 billion settlement was finally reached in 2012, only to be tossed out in 2016 by a federal appeals court. In the meantime, opt-outs by large merchants had reduced the settlement amount to $5.7 billion. Now this latest deal is before Judge Margo K. Brodie of the U.S. District Court in Brooklyn, N.Y., awaiting her blessing.

In a bitterly contested case like this, her decision won't please everyone. What's more interesting is that her ruling is likely to meet with a mixed reception even among merchants, some of whom, at least, are apparently willing to call it a victory and take the cash.

John Stewart, Editor | john@digitaltransactions.net

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Trends in the Electronic Exchange of Value

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Gateways Cut Transaction Times While Boosting Up-Times

Speed is of the essence in e-commerce, which is why a recent report is welcome news for gateway providers.

Omaha, Neb.-based research and consulting firm The Strawhecker Group says U.S. gateway operators have cut the average transaction time in half, to 1.6 seconds from 3.2 seconds only a year ago. Derived from the firm's Gateway Enterprise Metrics platform that debuted in 2017, the results also show that the 12 participating gateways had an average uptime of 99.997% in August. That means GEM gateways had an authorization-fail rate of 27 basis points (0.27%) of total transactions processed.

The measurement service uses anonymous transaction data to calculate the gateways' performance.

"What GEM does is it shows you the merchant experience with the gateway, which is not always the same as internal monitoring would show," says John Kirkpatrick, senior associate at Strawhecker. "That is important because if a transaction never gets to a gateway they have nothing to monitor."

Gateways are taking on increasing importance in payments because of the growth in online transactions as e-commerce sales build and more payments companies target integrated payments. A typical gateway transaction starts at the merchant account, moves to the gateway, and from there goes to the merchant acquirer, processor, network, and card issuer, in that order, before returning down the line following the authorization decision.

"The importance of the gateway is increasing in the payment infrastructure," Kirkpatrick tells *Digital Transactions*. "They're becoming more critical with each generational change in the payments industry."

A tool like GEM helps gateways measure their performance against others. Results, for example, might indicate a gateway's boarding is on par with its competitors, but it has a performance issue. GEM can help gateway operators fine tune their systems, Kirkpatrick says.

Critically, the service also examines authorization failures. For example, an extrapolation from Strawhecker's data indicates there were 15 million credit and debit transactions that failed in August because of

(Photo: The Strawhecker Group)

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reasons not related to the cardholder account. A technology hiccup somewhere in the process could have disrupted the transaction. These failed transactions equate to $1.2 billion in lost sales. Strawhecker forecasts there will be more than 80 million failed credit and debit transactions in 2018 because of technology glitches.

A hiccup might be a timeout in the transaction, if, possibly, the gateway's database is locked, Kirkpatrick says. Strawhecker uses actual debit cards loaded with funds to measure gateway performance.

Participating gateways can see comparative data from other participants, but identifiable information is not shared, says Al Novacek, GEM operations manager. For example, Strawhecker can measure the merchant-onboarding process in seven areas, Novacek says. "We're doing it without any involvement from the gateway," he says.

While some retailers have asked to view the GEM reports, Strawhecker will not disclose which gateways participate. Instead, it intends awards—for best performance, for example—it doles out to provide some insight for merchants, Novacek says.

—Kevin Woodward

As Volume Grows, NACHA Smooths Out the Same-Day ACH Road

With same-day automated clearing house transaction volumes building, the governing body of the big network that links virtually all U.S. financial institutions last month announced a trio of enhancements.

The changes are aimed at, among other things, raising the dollar limit on same-day transfers and making credit funds available faster during the processing day. The new features will take effect at different times, Herndon, Va.-based NACHA says.

One of the most important changes is a quadrupling of the dollar limit. Effective March 20, 2020, the limit on same-day transactions will jump from $25,000 to $100,000. This change will be especially important to institutions looking to handle more business-to-business payments, many of which were ruled out by the existing cap.

"We've been hearing from end-users," says Jane Larimer, NACHA's chief operating officer. "It's the first thing they bring up. Twenty-five thousand dollars is too low for them."

Another change gives institutions more time during the day to submit ACH transactions by extending the deadline by two hours to 4:45 p.m. Eastern Time. This move, which adds a third processing window, will be effective Sept. 18, 2020, and will be supported by the two ACH network operators, not only NACHA itself but also The Clearing House, a New York City-based processor owned by many of the nation's largest banks.

'There was a need to make funds available [sooner]. That's a big benefit.'

—JANE LARIMER, CHIEF OPERATING OFFICER, NACHA

(Photo: NACHA)

"The Mountain [time zone] and the West Coast are really excited about [this change]," says Larimer. "It's something we've been hearing about. As we move West, there was a need to add a third window later in the day."

And in yet another change, NACHA says it will speed up same-day funds availability by mandating that funds for certain same-day and next-day credit transactions be available by 1:30 p.m., fully three-and-one-half hours sooner than under the existing rules. This move takes effect on Sept. 20, 2019, before the other two.

"There was a need to make funds available [sooner]," says Larimer. "That's a big benefit."

Larimer says it's too soon to contemplate any further enhancements to same-day ACH, which the 44-year-old ACH network introduced for credits two years ago and for debits in September of last year. "Right now

we'll be focused on getting these [enhancements] into production," she says.

Still, one possible candidate for a future change, Larimer says, has to do with processing for holidays and weekends. "It's early days," she adds. "Right now, our job is to get these [new changes] implemented as seamlessly as possible."

The latest data from NACHA indicates there were almost 41 million same-day transactions in the quarter ended June 30, a 244% jump over the same period in 2017. Before the introduction of same-day processing, which is part of a faster-payment trend in the U.S. and world markets, ACH transactions typically settled the next day.

—John Stewart

Processors Continue To Add and Subtract Business Units

Big merchant acquirers continue to get bigger, but sometimes processors also decide it's time to lop off old, slow-growth businesses, as recent payments-industry deals attest.

Merchant acquirer Elavon Inc. has acquired Electronic Transactions Systems Corp., an independent sales organization and business-software provider, Elavon parent company U.S. Bancorp announced Sept. 4. That same day, payment processor Fidelity National Information Services Inc. (FIS) disclosed that it sold the assets of its Certegy Check Services unit to a private-equity firm.

U.S. Bancorp is one of two sponsor banks for ETS, the other being Merrick Bank, according to ETS's Web site. Ashburn, Va.-based ETS brings to Elavon an undisclosed number of merchants for which it provides payment processing, bill payments, gift cards, e-commerce services, mobile transit and parking payments, and other services. The acquisition will enhance Elavon's e-commerce offerings, enable the processor to integrate payment processing into ETS's software, and give merchants a way to easily access Elavon's services, Minneapolis-based U.S. Bancorp said.

"ETS has an innovative approach to merchant payments that fits well within Elavon's strategy to provide businesses the ability to safely and quickly integrate into our system,"

Jamie Walker, chief executive of Atlanta-based Elavon, said in a news release. "ETS is a successful, dynamic company, and we look forward to growing our business together."

The deal also expands the international reach of Elavon, which already operates in parts of Europe. ETS says it serves merchants in 23 countries in North America and Europe.

"We are thrilled to join with Elavon and become part of U.S. Bank," Ed Vaughan, CEO of ETS, said in the release. "We have worked with U.S. Bank for the 20 years that we've been growing our company."

Financial terms of the deal were not disclosed.

In a divestiture, meanwhile, FIS said in a brief announcement that it "has sold substantially all of the assets" of Certegy Check Services to an affiliate of Los Angeles-based Variant Equity Advisors LLC. The company, which provides check-authorization and cashing services, formerly was part of the check and payment-processing unit of credit-reporting agency Equifax Inc., which spun Certegy off as a public company in 2001. In 2005, the parent company of FIS at the time acquired Certegy.

"The divestiture is consistent with FIS' strategic focus on providing software-based solutions to its financial-institution, corporate, and other clients," Jacksonville, Fla.-based FIS said in its announcement, which did not list terms. The deal closed Aug. 31.

Another portfolio company of Variant is Curb Mobility, which offers a mobile-payment platform and related services for taxis and other for-hire transportation providers.

—Jim Daly

Mobile Devices Move to the Front Lines of Fraud Attacks

The suspicion among risk-control executives at payments firms that mobile devices are playing an increasing role in fraud now have confirmation. Fraud attacks via mobile devices worldwide soared to 151 million in 2018's first half, up 24% from the same period in 2017.

In the United States alone, the increase was much worse, fully 44%, according to the Q2 Cybercrime Report released Sept. 12 by San Jose, Calif.-based ThreatMetrix, a unit of LexisNexis Risk Solutions.

What's more, bot attacks proliferated in the year's first half, according to the report, which analyzes data from the company's Digital Identity Network. These are bits of code that swarm the Internet looking for real customer accounts they can log into with the aid of pilfered credentials.

Large retailers are a favorite target, according to the report. Bot attacks totaled 2.6 billion in the first half of the year, with the number jumping 60% in the second quarter from 1 billion in the first.

Here, too, the mobile channel plays a role. Of 1.6 billion bot attacks detected by the network in the second quarter, 70 million came from mobile devices, the report says. Some 170 million originated from mobile devices in the first half.

The rising prominence of mobile is such that smart phones and tablets now account for 58% of all traffic monitored by the network. "Traffic" in this sense includes logins, account creations, and payments. Mobile technology has also become a key means by which sites identify users.

"Mobile is quickly becoming the predominant way people access online goods and services, and as a result organizations need to anticipate that the barrage of mobile attacks will only increase," warned Alisdair Faulkner, chief identity officer at LexisNexis Risk Solutions, in a statement.

Despite the jump in mobile-fraud attacks, desktop commerce still generates two-thirds of all detected attacks, the report says.

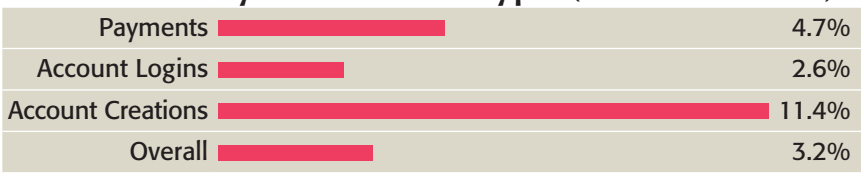
"The good news is that as mobile usage continues to increase, so too does overall customer recognition rates, as mobile apps offer a wealth of techniques to authenticate returning customers with a very high degree of accuracy," Faulkner said. "The key point of vulnerability, however, is at the app registration and account-creation stage."

Heightened concerns about mobile fraud led last month to a new standard governing mobile commerce from the Accredited Standards Committee X9, an Annapolis, Md.-based non-profit that specializes in technical standards for the financial industry. The standard applies to device manufacturers, app developers, and financial-services providers.

All told, ThreatMetrix's network examined 8.3 billion transactions in the second quarter, stopping 151 million attacks, the company says.

—John Stewart

Attack Rate by Transaction Type (Second Quarter, 2018)



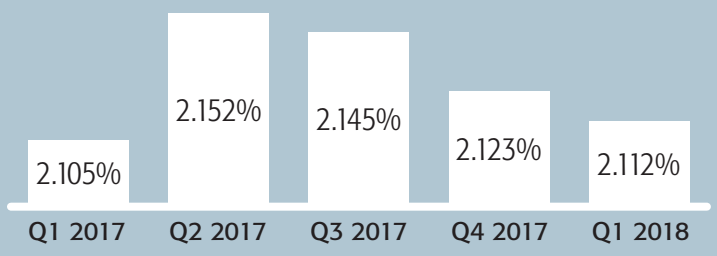
Note: Attack rate is percentage of transactions identified as high-risk and classified as attacks. Attacks totaled 151 million in the second quarter.

Source: ThreatMetrix

MONTHLY MERCHANT METRIC

Total Gross Processing Revenue, in Percent

Sum of total discount, total transaction fee revenue, and total other fee revenue divided by total volume



Note: This is sourced from The Strawhecker Group's merchant data warehouse of over 3 million merchants in the U.S. market. The ability to understand this data is important as small and medium-size businesses (SMBs) and the payments providers that serve them are key drivers of the economy.
All data are for SMB merchants defined as merchants with less than $5 million in annual card volume.

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Surcharging And Cash-Discount Programs Continue To Attract ISOs

They're not the newest kids on the pricing block, but surcharges and discounts for cash continue to generate interest among independent sales organizations even though only a small minority of merchants actually implement them. The likely reasons are falling legal barriers and a growing recognition of the potential profits.

Repeated sessions about the topic were packed Sept. 13 at the Western States Acquirers Association annual conference in Scottsdale, Ariz. The presenter was Ryan Sills, director of risk and compliance at Pivotal Payments, a Plano, Texas-based ISO that has a surcharging program.

"We are seeing a lot of merchants, and a lot of ISOs selling the program," Sills said. "There's definitely been more recent pushes on the merchant side [who feel] like they're always being trapped with fees, and how they can combat that."

Presentations about surcharging and cash discounts have drawn strong attendance at other ISO trade shows this year, including the Southeast Acquirers Association's March conference in Orlando, Fla.

A surcharge, or cash-discount program, can not only reduce a merchant's expenses, giving the merchant a reason to at least consider it, but also pad the profit margins of the ISO that sells it to the merchant, according to Sills. Plus, only seven states now have surcharge bans, down from 10 about a year ago. The reduction is a result of court actions in recent months in New York, Florida, and California, he said.

Surcharges typically are assessed as a percentage of the sale and can only be applied to credit card transactions, not debit purchases. They're capped at the merchant's discount rate, with a maximum of 4% of the pre sales-tax amount. Surcharging can be done with online purchases as well as in-store sales, but merchants have to apply the surcharge to all their all credit card transactions. "If you're going to surcharge you're not allowed to pick and choose by card brand or by card issuer," Sills said.

> 'If you're going to surcharge you're not allowed to pick and choose by card brand or by card issuer.'

Discounts for cash are permissible in all 50 states, and they can be offered with debit cards.

With either a surcharge or discount for cash, ISOs and merchants have to be careful with implementation so as not to run afoul of network rules. The rules require prominent disclosure and clear wording to distinguish a surcharge from a cash discount. If the price goes up at checkout, "the card brands will view that as a surcharge," despite what the merchant calls it, Sills said.

Merchants sometimes have confusing signage regarding surcharges and discounts, and Sills noted that enforcement of applicable rules has been uneven. "You're going to get some merchants who just get away with it, you're going to get some ISOs who get away with it," he said. But if a notice of violation comes down to an ISO through a card network and the ISO's sponsor bank, the offending merchant will have to sign an attestation that it will comply with the rules within 30 days "or you risk losing the merchant account," he said.

So-called convenience fees are separate under the network rules from surcharges and discounts for cash, according to Sills. Such fees typically apply to certain merchant categories, such as utilities and government, and usually involve flat fees no matter the purchase amount.

—Jim Daly

American Express Heads to the Lab

The post-plastic world is coming, and it's spurred American Express Co. to head to the lab to test new payment forms and new ways to attract cardholders and merchants.

AmEx formed its Digital Labs unit less than a year ago, and it has plenty to do as it evaluates digital payments, digital ways of engaging with cardholders and merchants, and research and development, according to Patrick Dostal, vice president of product development in the unit. Dostal headlined a session dubbed "Payments—Not on Plastic" at September's Western States Acquirers Association annual conference in Scottsdale, Ariz.

Experiments in the Digital Labs involve wearables (the company at the recent US Open Tennis Championships unveiled its Amex Band,

a wristband enabled for contactless payments), the Internet of Things, augmented reality, and other concepts on the frontiers of payments and loyalty programs.

"We're very keen on experiences for our cardholders, not just processing payments, not just lending," Dostal said. He added that AmEx is working with merchant acquirers, independent software vendors, and other firms to develop new services.

"More often than not we don't own the distribution of payments or technology at the point of sale," he said. "That's owned by other parts of the ecosystem. If we're not partnering in that area of the business there's a lot of opportunity that's missed beyond just processing payments."

Some of the stuff the Labs unit is investigating is not always cutting edge technologically, like quick-response codes, but still could enhance the experiences of AmEx cardholders. Closed-loop mobile wallets from merchants such as Starbucks Corp. rely on QR codes for contactless payments, and Chinese mobile-payment firms use them extensively. But most proponents of general-purpose mobile wallets in the U.S. prefer near-field communication technology because of its speed and high security. AmEx has mobile wallets in Canada and the United Kingdom that use NFC, but the version in India uses both NFC and QR codes.

The Amex Band, a wristband for contactless payments.

(Photo: American Express)

Some may sneer at QR codes, but the technology gets the job done, especially when the telecommunications infrastructure needed for NFC isn't present, according to Dostal. "If you had asked me [earlier] that QR codes would be big, I would have laughed," he said. But "for some markets, particularly without connectivity, it's the right solution."

AmEx is trying to see if there are lessons it can learn from merchant wallets that use QR codes, such those from Starbucks and Walmart Inc., or the Chase Pay service from banking giant JPMorgan Chase & Co.

"There's examples of it happening; whether or not those things will scale, or something will surpass it, remains to be seen," Dostal said. "We have a blindfold and handful of darts, and so you just kind of like throw all of them and hope that one of them sticks."

AmEx is looking for new technologies and programs that simultaneously reward its cardholders and drive sales for AmEx-accepting businesses. But working on rewards programs with merchants, especially when more than one merchant is involved, can be a challenge, as AmEx found out with its Plenti multi-merchant rewards program. AmEx pulled the plug on the three-year-old program in July.

"It was very tough to get some traction," said Dostal. "Getting all of the retail players to play together, with us specifically, is a very tough venture." DT

—Jim Daly

CORRECTION

In "A Good Policy," September, the source of data showing that small and midsize companies are targeted 61% of the time in data breaches was misstated. The correct source is the 2018 Data Breach Investigation Report from Verizon Enterprise Solutions. *Digital Transactions* regrets the error.

Security Notes

Danger: Hidden Digital Money

Gideon Samid • *Gideon@BitMint.com*

Imagine that privacy concerns were to triumph over the Fourth Amendment, disallowing court-sanctioned search and seizure. Terrorists and criminals alike would be secure in their abode, safely preparing their misdeeds. Passengers boarding planes could pack heat, and robbers could pile up their plunder without fear of discovery.

Society would collapse under these conditions. Indeed, privacy concerns cannot be taken to their asymptotic absurdity.

Yet, so many smart and credible voices extol the celebrated and unassailable privacy right claimed by Bitcoin and its imitators. If the thought of our neighbor storing machine guns in his basement makes us uncomfortable, why are we so blasé about the guy across the street whose secret fund pays a host of unscrupulous characters to make false legal claims against us, or otherwise make our life miserable? We cannot "follow the money" because the money and its movement are protected by modern technology. Secret wealth that can be paid out without detection is as powerful as firearms. Even more so, because secret money can kill from a distance.

Every day, the news is replete with stories about how corrupt politicians trade favors for money. How many never get caught? Now imagine that political influence could be paid for by unsuspected sources, and the payment leaves no footprints. Our elected representatives would simply become puppets controlled by hidden power brokers.

Last November, this column pointed to the growing threat of ransomware, and it predicted escalation of the threat based on the hallowed privacy of Bitcoin. That was one correct prediction! What's more, everybody pays! Why? Because hackers became businessmen. They learned to charge their victims a sum so low that the cost to fight back is way too high. And, upon payment, the victim is made whole again to build the "brand."

There's only one way to put a dent in this practice: Give society the means to crack open financial doors the way authorities burst into a criminal suspect's house.

Cancer starts small and develops for a long time undetected. Often, it metastasizes before awareness of it dawns. Likewise, hidden money accumulates slowly, and then it metastasizes. Hidden wealth centers transact with each other, running an underground economy, all with digital money that does not show up anywhere in the nominal financial networks.

Unlike Bitcoin, which at least operates with a public ledger, private hidden-money protocols proliferate within a confederacy of criminals, and keep growing. Remember this: *If an algorithm can generate a currency for the good guys, it can also generate a currency tailored for bad guys.*

Digital money is created by a protocol. Protocols may be copied as many times as desired. While Bitcoin is based on mathematical complexity, which people who are smart enough can crack, the new generation of digital money (e.g., BitMint) is based on quantum-mechanical randomness, and is immunized to mathematical cryptanalysis. Digital money is secure. It is paid across the table or across the continent, with no friction, no delay—and no detection. It is the modern way to project stealth power.

About two weeks after our BitMint digital-money patent was published, we started to receive requests to build a "working copy" of this technology and write a detailed user manual, to be shipped to some address abroad. The bad guys are quick. By contrast, the U.S. government commissions endless studies to "look into it."

At the same time, we see a burst of creativity in the money-laundering business so people who are paid secretly can wash clean their ill-gotten wealth. Again, like cancer, laundering underground digital money is a slow process that moves forward unchallenged because warnings like this are so easy to ignore.

It is for this reason that a privacy hawk like myself now concludes that privacy ends at the edge of money. Hidden wealth is a mortal risk for society and should be prevented. With BitMint, we promote the fundamental notion of "Expiry Coins." BitMint digital money can be traded peer-to-peer, protecting normal behavioral anonymity, but every BitMint coin comes with an expiration date by which its holder must surface and exchange the coin for another one, or for a non-digital asset.

And by reason of this model alone, we strongly believe that the payment paradigm of the future will be based on two centralized anchors, minting and redemption, with an at-will degree of freedom in between (peer to peer). ■

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Token Economics

John Stewart

The major payments networks have been in the tokenization business for four years now. With digital payments set to explode, how long can they keep giving away the store?

The technology for rendering card-account numbers into random strings of digits has been around for decades, but with the kick-off of Apple Pay in 2014 the race was on to tokenize all the major-brand credit and debit cards that consumers could digitally cram into Apple Inc.'s spiffy new wallet.

Since then, Alphabet Inc., Samsung Electronics Co. Ltd., and dozens of others have launched their own digital wallets. And the big networks have laid plans to mine the so-called Internet of Things, which includes everything from smart watches to smart clothes and clever fridges, for yet more transaction volume.

By masking the actual 16-digit primary account number, or PAN, the token can serve multiple purposes embracing security but also smoother processing, particularly when it comes to functions as mundane as displaying card art or keeping track of cards on file.

For the time being, tokenization from the big networks remains free to merchants, acquirers, digital-wallet providers like Apple, and other token requestors. And for its part, Visa Inc., which in the late spring of 2015 famously decreed free tokenization for entities that process on its network, doesn't see that changing.

"The position we stated in 2015 still holds true. We are committed to that model," says Ansar Ansari, senior vice president for digital products at Visa.

'Nothing Is Free in Life'

But how long can the networks maintain that commitment? That's a complicated question. On the one hand, forces are building that in most businesses would exert upward pressure on pricing. To be sure, mobile-payment growth for the general-purpose wallets has fallen short of the rosy expectations of 2014, but the ranks of U.S. users—including devotees of Starbucks's app—is projected to grow at a nice 5%-to-7% clip over the next few years (chart, page 20).

Similarly, research firm Gartner Inc. projects IoT endpoints will reach nearly 13 billion in 2020, triple the number at the end of 2016 (chart, page 18). That's not to say all of these devices will be fitted for payments, but a good many will be, and not just refrigerators.

Rising transaction counts will require more token requests, exerting higher demand on token service providers. These are the 40 or so entities registered so far with EMVCo, the international standards group controlled by American Express Co., Discover Network, Mastercard Inc., Japan's JCB network, and China's UnionPay, as well as Visa. Most of these TSPs have registered only in the past two years.

"Right now, no, they're not charging, but they're chatting it up," says Steve Mott, principal at BetterBuyDesign, a Stamford, Conn.-based payments consultancy.

In industry chatter, Mott says he's heard "two to three cents [per token] bandied about" as an acquirer fee, "but also I've heard volume tiers." His opinion is that there is a "better than even chance" for this fee. Before Visa dropped the idea of pricing for tokenization, it had been planning on a 7-cent fee.

Other factors could heighten pressure on the token market, experts say. The so-called single buy button the networks are proposing for e-commerce transactions ("The Shared Checkout's Slow Check-in," June), for example, will also stimulate token demand once it finally clicks in. "As that develops, that could boost tokenization," notes Zilvinas Bareisis, a London-based senior analyst for Celent, a Boston-based financial-services advisory firm.

As demand grows, networks will need to invest in their token engines and token-vault capabilities, as well. "Nothing is free in life," says Terry

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Dooley, executive vice president and chief information officer at Shazam, the Johnston, Iowa-based electronic funds transfer network. "The ability to scale is going to require a continued investment in those vaults. A charge for service will provide revenue to invest in those services."

There could even be a wholesaling opportunity for tokenization, since not all of those TSPs registered with EMVCo operate their own vaults. Some outsource that safekeeping function, allowing those who do own vaults, like the major networks, to contemplate pricing for that service.

The Sell-By Date

Still, many observers argue it's far too soon for talk of token charges, despite the expected deluge of volume.

For one thing, it's easier to raise prices once you've been charging for something than it is to start charging for something you've been giving away, argues Rick Oglesby, principal at AZPayments Group, a Mesa, Ariz.-based consultancy.

"If I'm in the shoes of the networks, I'm not thinking about trying to charge for that yet," he says. "I'm trying to embed my tokens everywhere they can be embedded."

Similarly, while volume on the big networks is growing, traffic is rising much faster for alternative payments and in developing markets on systems that don't depend on the these networks (chart, page 20). That could slow any impulse to slap on token fees, says Thad Peterson, a senior analyst at the Aite Group, a Boston-based consulting firm.

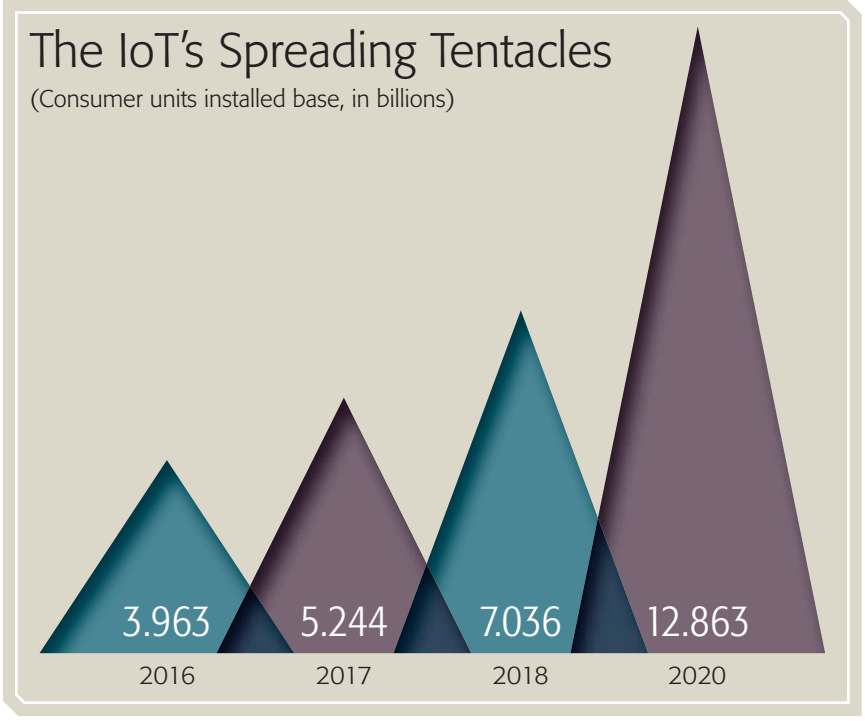
"This is probably not a great time for the networks to put their transaction volume at risk," he says.

But even Oglesby doesn't argue that tokens will remain free forever, or even, possibly, for the next five years. He gives it three to five years before pricing will be imposed.

And, in the eyes of some experts, the sell-by date could arrive even sooner. "I think 2018 is too soon," says Celent's Bareisis. "I'd say probably two to three years."

A Token 'Tidal Wave'

While sluggish consumer adoption of Apple Pay and other mobile-payments serviees has dampened expectations



Note: February 2017 estimates. *Source: Gartner*

TIMELINE

MARCH 2014

EMVCo releases token specifications

OCTOBER 2014

Apple Pay is launched

JUNE 2015

Visa makes permanent a temporary hold it had placed on token fees as long as the requestor processes with Visa

NOVEMBER 2015

EMVCo introduces a registration process for TSPs that includes a requirement that applicants own or have access to a token vault

DECEMBER 2015

The PCI Security Standards Council releases a 92-page set of requirements for TSPs

JANUARY 2016

EMVCo publishes a specification bulletin for a Payment Account Reference, or PAR, intended to tie multiple tokens back to the original primary account number

JULY 2016

PayPal strikes a landmark deal with Visa to access Visa's token engine and gain access to the physical point of sale

SEPTEMBER 2017

EMVCo publishes the technical framework of its current tokenization specification, version 2.0

SEPTEMBER 2018

Visa tokenizing transactions for 63 requestors and in 40 countries; issuers in 50 countries have integrated Mastercard's technology, enabling 75% of its cards for tokenization.

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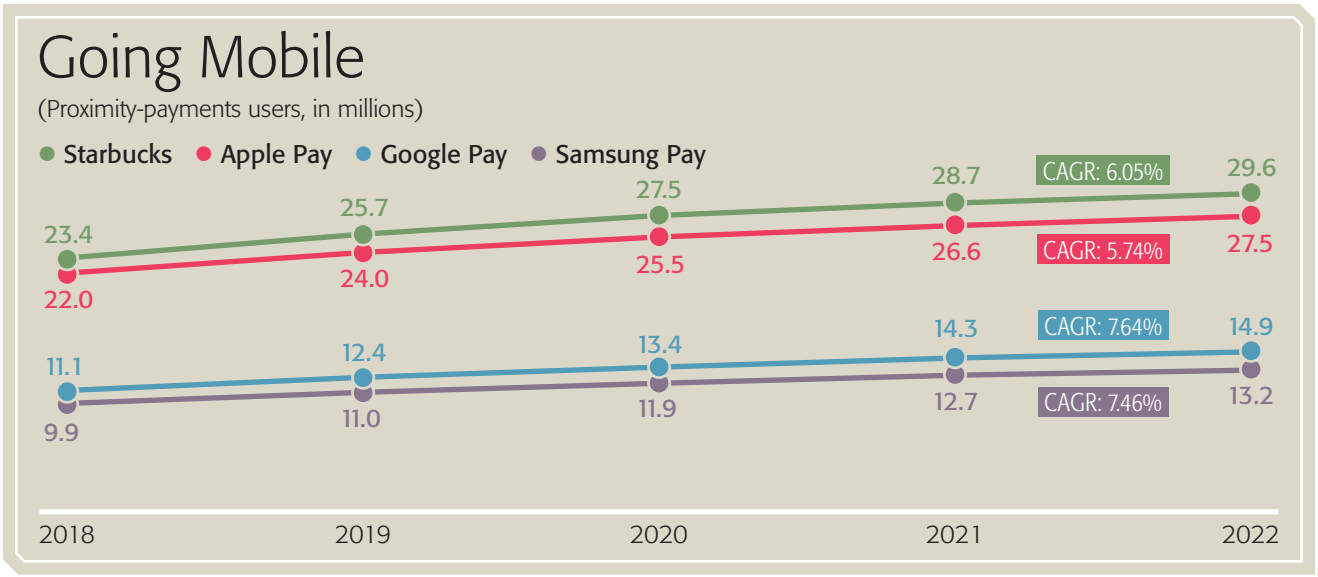


Source:eMarketer; Digital Transactions calculations

among many observers for a breakout year, the fact remains that the token factories have been busy.

Already, requestors have deployed 192.2 million EMVCo tokens in the U.S. market, which will generate more than $161 billion in payment volume by the end of the year, according to estimates calculated by Tim Sloane, vice president for payments innovation at Mercator Advisory Group, a Maynard, Mass.-based financial-services consulting firm.

"This includes mobile payments, wearables, and IoT as well as multiple tokens (cards) per device and re-issued tokens due to new or repaired phones/wearables that requires re-provisioning," says Sloane in an email message to *Digital Transactions*. "Note that this does not include payments made on mobile devices using the browser or in-app payments that utilize a card on file."

Little wonder that some processors, at least, are expecting bigger things. A recent blog post on PayPal Holdings Inc.'s Web site, for example, was headlined: "A Tokenization Tidal Wave Is Coming: Are You Ready?"

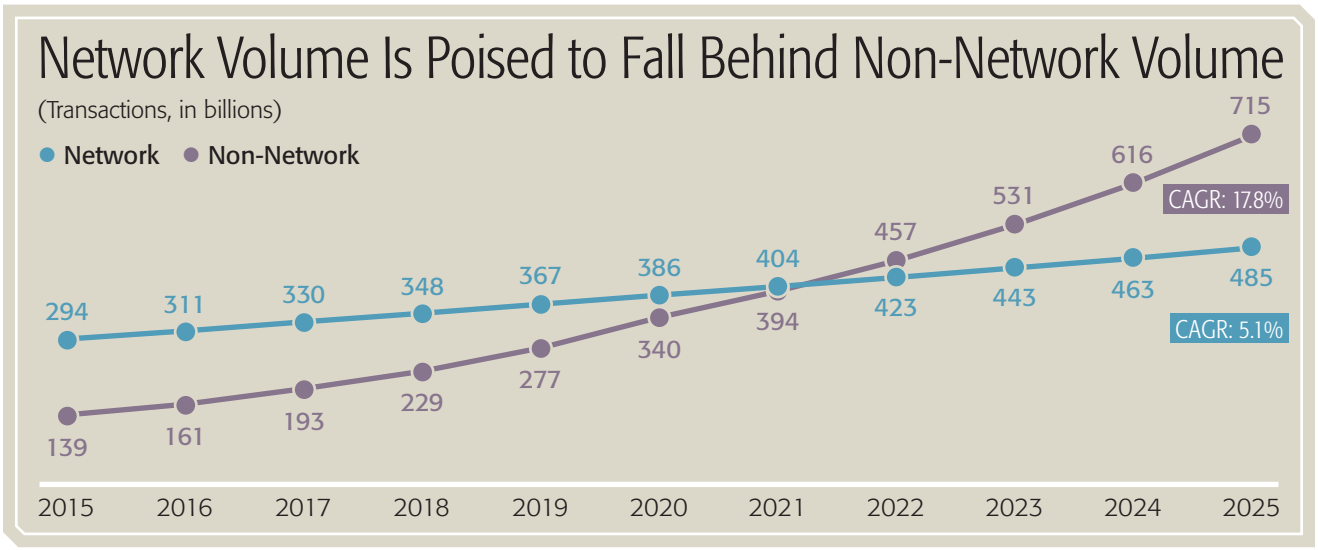
To help prepare for the "tidal wave," PayPal in 2016 negotiated a deal with Visa that gave the online processor access to Visa's token engine in return for promoting Visa cards for account funding instead of the automated clearing house system.

In the months that followed, PayPal further positioned itself by striking similar deals with Mastercard and other providers.

'A Good Pipeline'

But it was Visa that not only struck the landmark deal with PayPal but also led the way in the "free-token" movement. Since then, it has been building out its engine to the point that it now serves 63 token requestors, double the number from a year ago, and 40 countries.

"We feel good about the transaction growth we've seen," says Ansari. Visa won't release actual transaction counts, but percentage growth has been in three digits year over year, he adds.



Source: Capgemini World Payments Report; Aite Group

While Visa is looking to cultivate further growth from the IoT and the developing market for in-dash payments from automobiles, it's in existing card-not-present transactions flowing from both merchants and acquirers where Ansari sees near-term potential.

"Securing payments for the [card-not-present] channel is where we have a good pipeline, where we have commercial contracts not yet announced," he says.

Mastercard, too, is looking to the CNP channel for near-term potential. "We're seeing increased demand from merchants to bring this ... technology to their card-on-file activities," says Jorn Lambert, executive vice president of digital solutions, in an email message.

Issuers in 50 markets have integrated Mastercard's technology so far, he adds, so that now "more than seventy-five percent of all our cards are already enabled to be tokenized."

Easier transactions and better security will also help drive growth, Lambert adds. "We think these numbers will continue to grow for a number of reasons. Consumers are looking for a seamless, more convenient shopping experience. With the increased adoption of contactless and mobile payments, tokens will continue to power this experience with the same chip-level security in every purchase—in-store and online."

'Down the Road'

Another goal for both networks is to make things easy for requestors, a wide-ranging group that includes merchants, acquirers, gateways, digital platforms, and startup IoT technology players. "One of our key objectives is to ensure a client does not have to strike multiple agreements to get access to Visa cards," Ansari says.

With all that said, it doesn't look likely that token requestors will have to fret about fees any time soon. But just how long "free" will last is still the big question.

While the business is growing, the networks won't be disposed to risk dampening demand. But that doesn't mean some sort of pricing may not arrive for niche applications.

While stressing Visa's principle of no-fee tokenization, Ansari says, "There may be opportunities down the road to commercialize a set of value-added services built on tokenization." A hypothetical example would be digital issuance of prepaid products, he adds, such as gift cards.

But nothing like that is in the works now, he stresses, adding, "We are committed to the position of not charging." DT

Signs of Life at the Pays

Jim Daly

Not so long ago, mobile-payments enthusiasts were asking what ailed Apple Pay, Google Pay, and Samsung Pay. Now the Pays finally seem to be getting some traction, though their transaction market share is still minuscule.

Is there hope for the Pays? After a summer of generally positive developments, the mobile-payment services from Apple Inc., Samsung Electronics Co. Ltd., and Alphabet Inc.'s Google finally are showing signs of life.

Some of these signs are uneven, however. One researcher recently found that usage of Google Pay, formerly known as Android Pay, had declined since 2017's third quarter. Google, however, reports that after a host of changes over the past year, Google Pay is resonating with merchants as well as consumers.

There are now more than a dozen general-purpose and closed-loop mobile wallets that enable U.S. consumers to pay with their smart phones. The best-known among the latter is Starbucks Corp.'s popular app aimed at its multitude of coffee and tea drinkers, but some merchant systems, such as Walmart Inc.'s Walmart Pay, are seeing strong growth (chart, page 24).

Apple Pay, Google Pay, and Samsung Pay have come to be known as "the Pays." What they have in common is they can be used for general-purpose payments in stores and in-app, and they all use contactless near-field communication technology. Apple Pay and Samsung Pay use phone-based NFC while Google Pay uses a cloud-based variant called host card emulation. Samsung Pay also uses a technology called magnetic secure transmission (MST) that facilitates contactless transactions with traditional magnetic-stripe point-of-sale terminals.

What the Pays also have in common is that most consumers, apart from a core group of enthusiasts, just haven't been too excited about them. This indifference has persisted despite massive publicity, especially since Cupertino, Calif.-based Apple introduced Apple Pay in September 2014. Earlier this year, Visa Inc. reported that fewer than 1% of its U.S. face-to-face transactions originate on mobile phones ("Contactless II," April).

Many merchants have been reluctant to accept mobile payments because of the perceived lack of consumer demand and extra operational steps needed to enable NFC transactions. But 3.1 million merchants now accept EMV chip cards, according to Visa. The new POS terminals accept contact chip cards, but a growing number also are configured to process contactless NFC transactions.

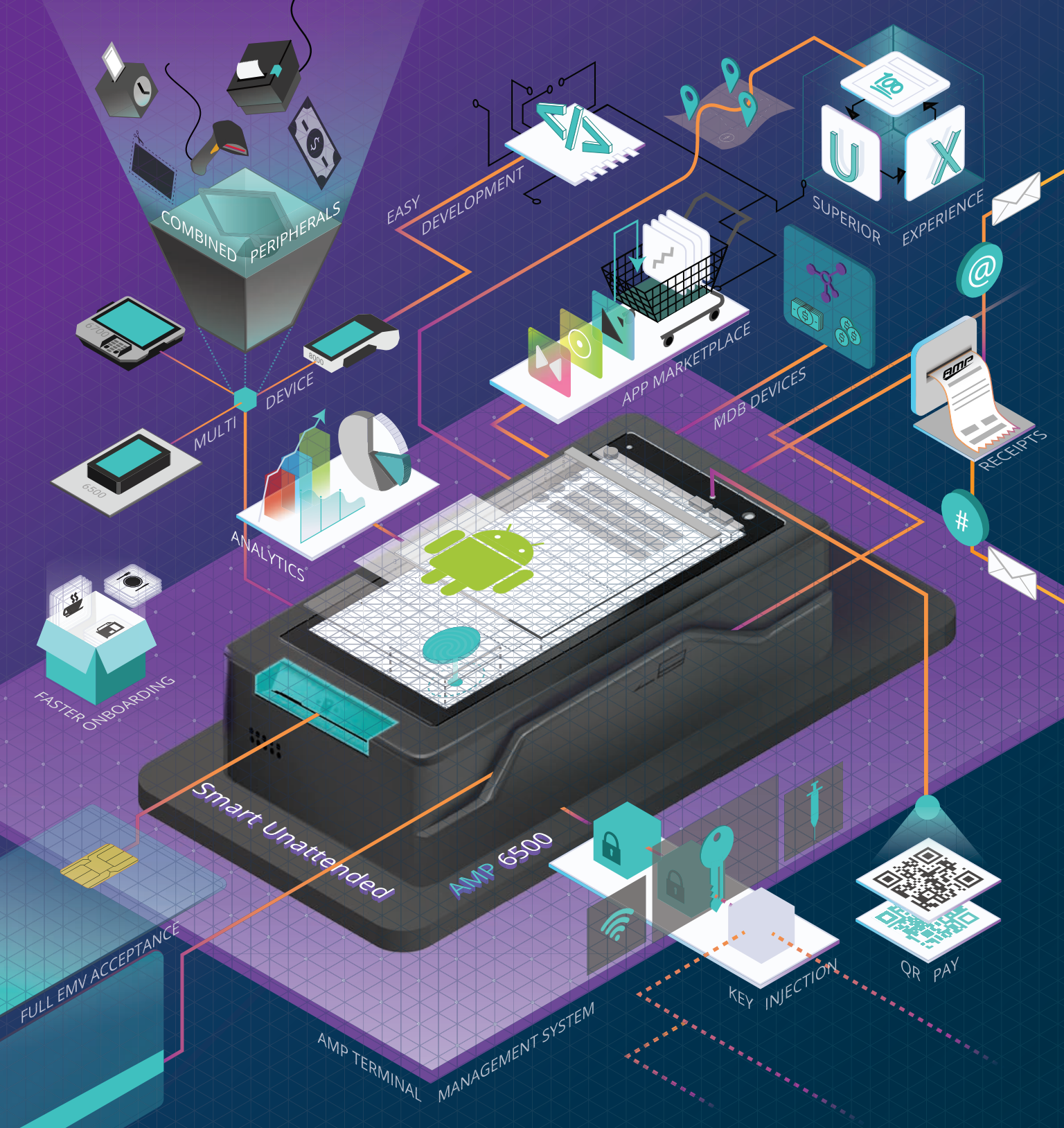
The Costco Breakthrough

In a global e-commerce and mobile-commerce forecast released in September, New York City-based 451 Research predicts that NFC-based mobile wallets will account for $65.8 billion in U.S. in-store sales this year, or 1.4% of the total. By 2022, the NFC wallets' share will hit 4.1% on $210 billion in sales, for a compounded annual growth rate of 34%, 451 Research estimates.

The surest recent sign that prospects for the Pays are brightening came in August when Costco Wholesale Corp., the nation's third-largest brick-and-mortar retailer, declared that it was now accepting Apple Pay, Google Pay, and Samsung Pay in its 519 U.S. stores.

Costco's move "speaks to the increasing demand for mobile payments by consumers," including but not confined to Millennials, says payments researcher Thad Peterson, a senior analyst at Boston-based Aite Group LLC.

Another hopeful sign: The big pharmacy chain CVS Health Corp. and convenience-store leader 7-Eleven Inc. will accept Apple Pay later this year, Apple chief executive Tim Cook told stock analysts July 31. 7-Eleven also said in September that it would accept Google Pay.



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How the Digital Wallets Rank

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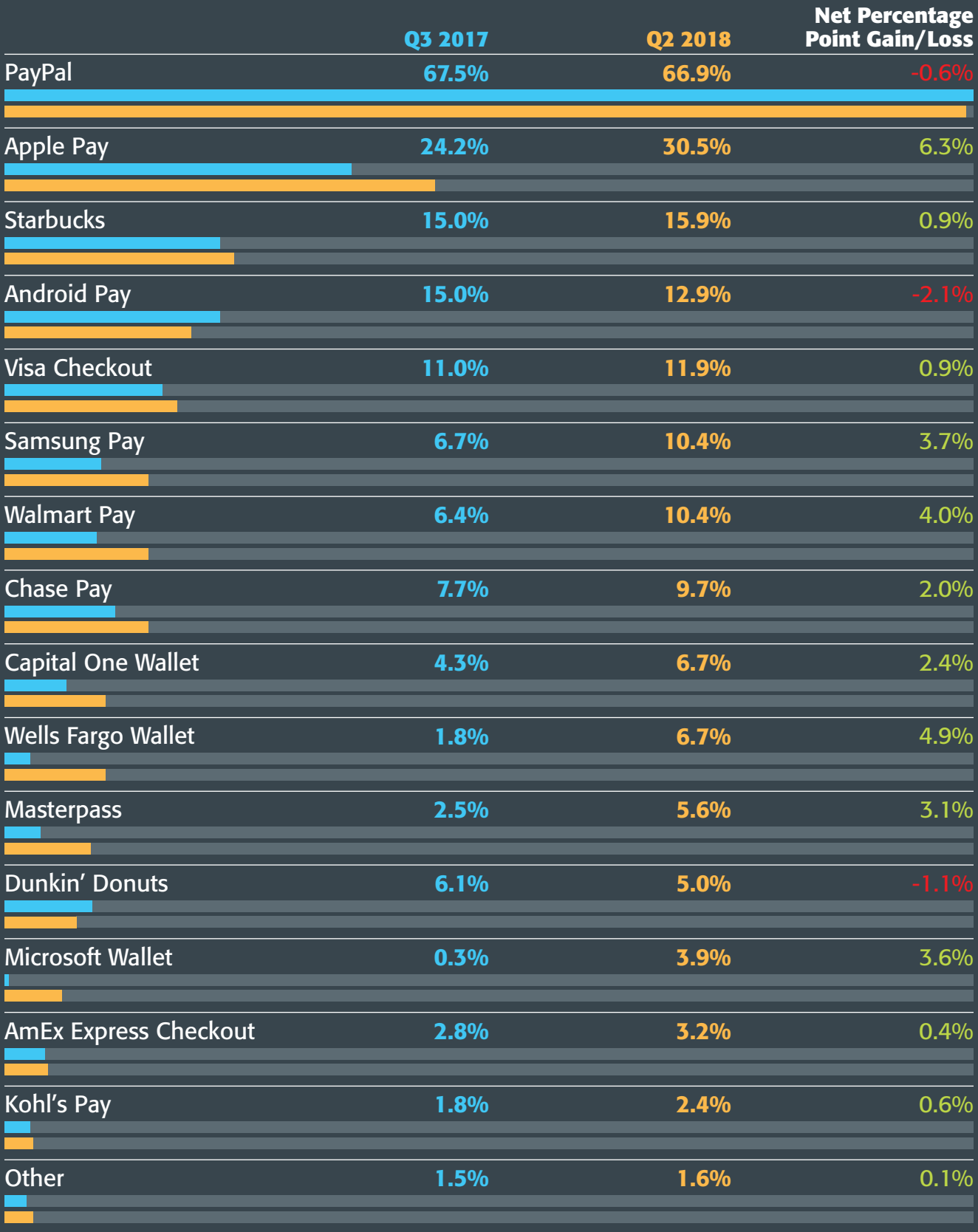

	Q3 2017	Q2 2018	Net Percentage Point Gain/Loss
PayPal	67.5%	66.9%	-0.6%
Apple Pay	24.2%	30.5%	6.3%
Starbucks	15.0%	15.9%	0.9%
Android Pay	15.0%	12.9%	-2.1%
Visa Checkout	11.0%	11.9%	0.9%
Samsung Pay	6.7%	10.4%	3.7%
Walmart Pay	6.4%	10.4%	4.0%
Chase Pay	7.7%	9.7%	2.0%
Capital One Wallet	4.3%	6.7%	2.4%
Wells Fargo Wallet	1.8%	6.7%	4.9%
Masterpass	2.5%	5.6%	3.1%
Dunkin' Donuts	6.1%	5.0%	-1.1%
Microsoft Wallet	0.3%	3.9%	3.6%
AmEx Express Checkout	2.8%	3.2%	0.4%
Kohl's Pay	1.8%	2.4%	0.6%
Other	1.5%	1.6%	0.1%

Note: 876 valid responses in Q2 18, 326 in Q3 17. *Source: 451 Research Voice of the Connected Consumer Landscape surveys*

Both retailers had been part of the now-defunct Merchant Customer Exchange LLC, a consortium that developed its own mobile-payment service dubbed CurrentC. Merchants viewed CurrentC as a way of avoiding high costs of accepting the major card brands, and of boosting their own loyalty programs accessible through mobile apps. CVS, along with rival drug-store chain Rite Aid, stirred controversy in late 2014 by shutting off NFC readers in their stores to stop customers from using Apple Pay.

The NFC boycott lasted only a short while, however. And after some testing, CurrentC's sponsors pulled the plug on the service in 2016. Instead, a number of former MCX stalwarts such as CVS and Walmart. turned their attention to their own loyalty programs and mobile apps.

While mobile-pay backers hailed Costco's move, like so many developments in payments it came with a peculiarity. Notoriously picky about which payment forms it accepts, Issaquah, Wash.-based Costco said little about why it's now embracing the mobile wallets. Its Visa cobranded credit card issued by Citigroup Inc., however, is a so-called dual-interface plastic enabled for both contact and contactless EMV transactions, and it doubles as a membership card. The retailer had recently outfitted its stores for NFC acceptance—two years after it dumped American Express Co. as its cobranded partner in favor of Citi and Visa Inc.

The peculiarity is that, because of Costco's exclusive credit card acceptance deal with Visa, which took effect in 2016 when Citi replaced AmEx, an Apple Pay user who wants to pay with credit can only use a digitized Visa credit card. A Costco spokesperson would not say if that same policy applies to digital credit card payments with Google Pay and Samsung Pay.

Despite that oddity, Costco's business goal in accepting mobile wallets and dual-interface cards isn't hard to infer, according to Richard K. Crone of San Carlos, Calif.-based Crone Consulting LLC. Even if Costco isn't taking every payment form the Pays support, fast mobile and contactless card payments will enable it to increase throughput at checkout counters, he says.

For many retailers, the coming of EMV chip cards, the vast majority of which are contact-only, over the past three years has slowed transaction speeds compared with the old magnetic-stripe cards they're replacing, despite network efforts to speed up payments, according to Crone.

"They [Costco] are a multilane national retailer, they measure the transaction checkout in milliseconds,"

Crone says. "This is about increasing store capacity, and getting rid of the EMV bottleneck."

'Muscle Memory'

The Pays so far have wrapped details about usage in a tight veil of secrecy, though they occasionally drop some hints. Analysts believe Apple Pay is the clear leader so far, and Cook revealed in July that it had surpassed 1 billion transactions in the quarter ended June 30. Cook also said consumers with Apple's iPhone and Watch can use Apple Pay to pay for public-transit rides in 12 cities. And Apple Pay Cash, the person-to-person payments variation, is "already serving millions of customers across the U.S. less than eight months following its launch," Cook said.

451 Research's most recent Voice of the Connected Consumer survey found Apple Pay solidified its second-place holding among the digital wallets. The survey asks consumers about their usage of 15 digital wallets—some of which get considerable volume through desktops and laptops, not just mobile devices—to make a purchase during the preceding 90 days. PayPal Holdings Inc.'s wallet remains by far the most popular, used by more than two-thirds of 451's respondents.

But 30.5% of the second-quarter respondents used Apple Pay, up 6.3 percentage points from 24.2% in 2017's third quarter.

Apple "has done a good job on the awareness front," says analyst Jordan McKee, a research director at 451. He adds that Apple has been "pretty aggressive in partnerships" with merchants. "Merchants are very quick to want to align with the Apple brand."

Apple Pay might be getting more volume because it is finally addressing consumers' desire to earn loyalty points and rewards, according to Aaron McPherson, vice president of research operations at Maynard, Mass.-based Mercator Advisory Group Inc. Echoing what critics have said for years, he says simply having payment capabilities built into phones is not enough to drive adoption.

"I feel that mobile wallets by themselves are just not enough of an improvement to overcome the muscle memory of pulling out a card, which is why they have been languishing for over 15 years," McPherson tells *Digital Transactions* by email. "What broke the pattern was merchant wallets with built-in rewards. Now consumers are getting used to using mobile wallets, which could be contributing to the increased success of the Pays. Just this year, we saw Apple finally doing the merchant promotions that are necessary, and that sort of activity should continue."

'You can tell there's some pretty good competition between the primary wallet platforms that exist within the Android operating system.'

—JORDAN MCKEE, RESEARCH DIRECTOR, 451 RESEARCH

Seoul, South Korea-based Samsung, the No. 2 smart-phone seller in the U.S. after Apple, according to comScore Inc., in late August trumpeted some statistics on the third anniversary of its payments service. Samsung Pay now works with about 2,000 financial institutions in 24 geographical markets. Samsung did not release a user count but said the service has processed 1.3 billion transactions since its launch. Impressive enough, but way behind Apple Pay.

"Since we launched Samsung Pay three years ago, we have been dedicated to delivering a mobile-wallet platform that is simple, secure, and works almost anywhere," said DJ Koh, president and chief executive of Samsung's IT and mobile communications division, in a statement. "And we're not limiting ourselves to a mobile wallet."

Koh cited such features as Samsung Rewards and ATM transaction capability, both of which are available in the U.S.

Samsung also has worked to gain partnerships with other mobile-payment services, including Alipay and WeChat Pay in China and PayPal in the U.S. The PayPal deal, struck in July 2017, gave Samsung Pay entrée to e-commerce merchants through PayPal's Braintree processing unit, and opened a window for PayPal into physical stores by riding in the Samsung Pay wallet.

Samsung has long recognized the importance of loyalty in generating interest in its payments service, according to McKee. Its rewards program enables users to accumulate more points at a greater rate for products from the mobile-phone and consumer-electronics giant the more they spend with Samsung Pay.

"It's all tied into the Samsung ecosystem," he says.

Its unclear how much transaction volume Samsung Pay has generated through MST, a technology it acquired when Samsung bought a Burlington, Mass.-based mobile-payments startup called LoopPay Inc. in 2015. A Samsung spokesperson did not respond to a *Digital Transactions* request for comment.

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The recent 451 Research survey uncovered diverging usage of Samsung Pay and Google Pay, the former Android Pay. Both services are grounded in Google's Android mobile-operating system. Some 10.4% of second-quarter respondents had used Samsung Pay, a 3.7 percentage-point gain in nine months from 6.7%. In contrast, Google Pay slipped from 15% to 12.9% in the same period.

"It's interesting to see Samsung Pay and Android Pay going in opposite directions," says McKee. "You can tell there's some pretty good competition between the primary wallet platforms that exist within the Android operating system."

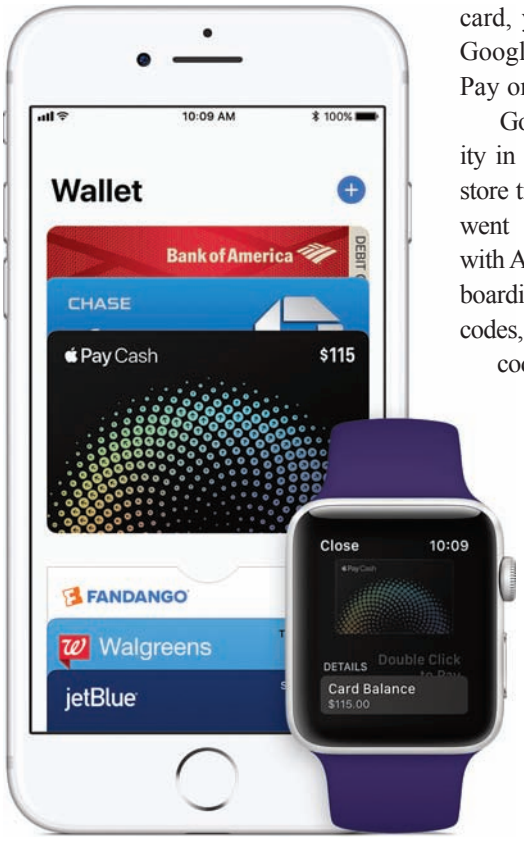
Although today's Google Pay, which debuted in February, represents a succession of rebrandings and service changes that some observers have said could be confusing to consumers, McKee attributes its decline less to anything Google has done and more to the "positive result of what Samsung has done" in promoting its mobile-payment service.

'Much More Than It Was'

Earlier iterations of Google Pay included Google Wallet and Google Checkout, the latter of which first appeared in 2006. But under the hood, Google Pay represents a unification of Google services and will make mobile payments easier and more attractive for merchants and consumers alike, according to Jack Connors, the executive who heads commerce and merchant partnerships at Google, the primary subsidiary of Mountain View, Calif.-based Alphabet.

"Google Pay is much more than it was a year ago," Connors said in August at the Mobile Payments Conference in Chicago.

In recent months, the payment service expanded to more countries, became available on Apple's Safari browser as well as on desktops running Google's Chrome browser, and added a feature to hold transit passes,



Apple Pay's new merchants include Costco, CVS, and 7-Eleven.

Connors noted. For online merchants, the new Google Pay more easily moves shoppers from search to checkout.

"The world wants a unified, seamless experience at checkout," he said. "The distance between the expression of some demand, the search, and the transaction has to collapse, has to collapse. So Google Pay is a way to give retailers who want to compete the opportunity to do their best equivalent of a one-click checkout."

Google Pay is now the payment channel for anyone with a Google account that accesses such products and services as Gmail, Chrome, YouTube, Google Maps, Waze, and other Alphabet properties. Connors noted that Google Play, the app marketplace for Android devices, has 1 billion active users. Previous payment procedures didn't make the links among Google products clear, according to Connors.

"If you have a Google account, the good news is that if you add a credit card, you can use that credit card on Google properties, and with Google Pay on non-Google properties."

Google Pay received additional utility in the summer when capabilities to store tickets and airline boarding passes went live. Whereas a similar feature with Apple's Apple Pay service displays boarding passes with quick-response codes, Google Pay not only displays QR codes, but also allows the passenger to redeem a pass faster by using NFC, according to Connors.

In the works for Google Pay are enhanced capabilities on desktop computers, improved security through mobile-device authentication, and added person-to-person payment features, including post-purchase bill splitting, Connors said. Google Pay also could find new uses through the Google Payments application programming interface that enables third-party software developers to integrate payments into smart-speaker systems such as Google Home, messaging, and other services.

'Think Outside the Card'

Clearly, the Pays are working diligently to attract merchants and consumers to their services. But the key to getting any significant market share may be something more than just making the payment experience fast and affordable for merchants, and inducing consumers with rewards.

It also might involve re-educating Americans to think first about mobile devices, as consumers have in some other countries, rather than their familiar payment cards, according to Aite's Peterson.

"We're card-based thinkers," Peterson said at the Mobile Payments Conference. "Think beyond that, think outside the card, because outside the card is where the world is going." DT

—With additional reporting by John Stewart and Kevin Woodward

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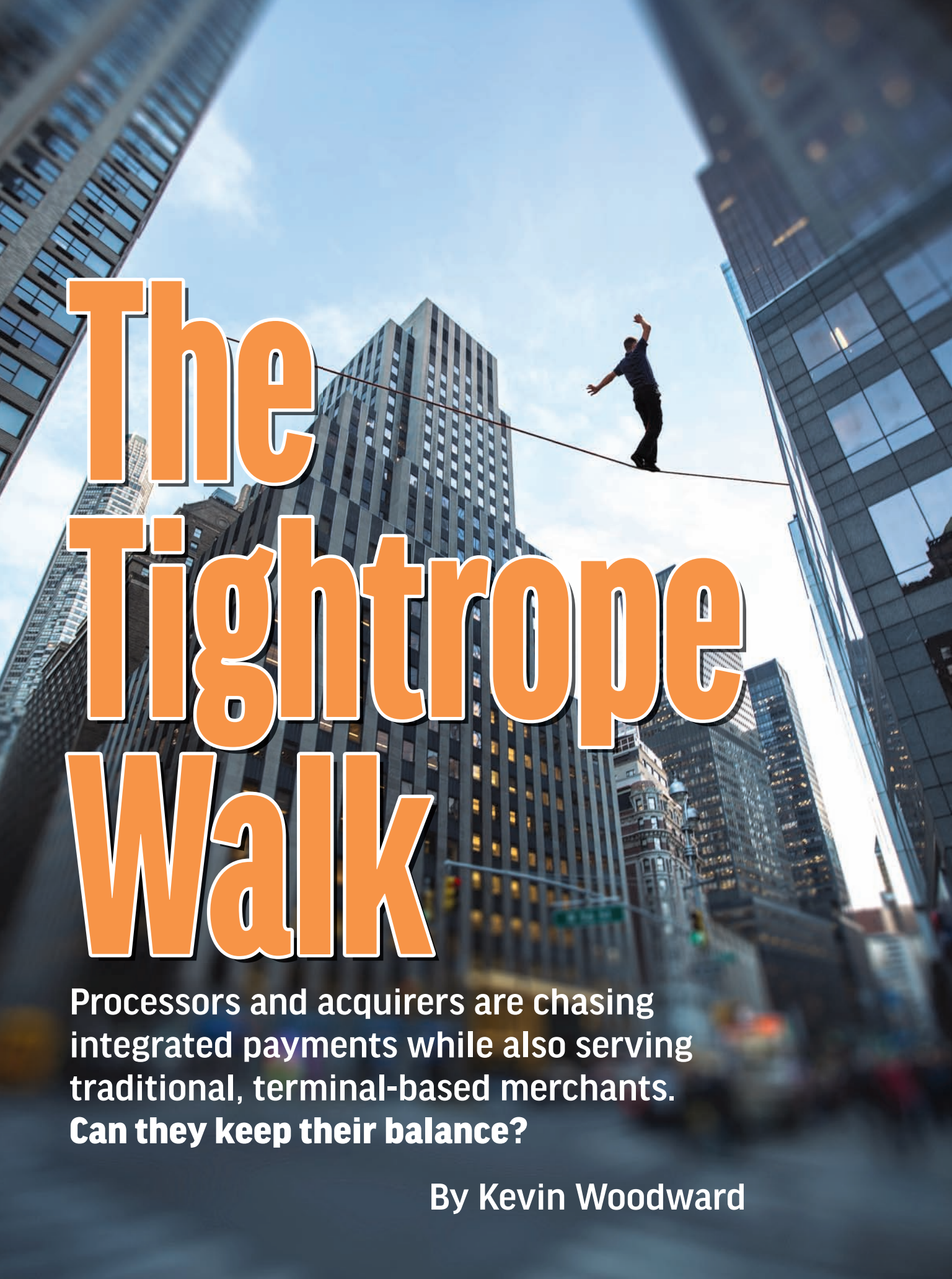


The Tightrope Walk

Processors and acquirers are chasing integrated payments while also serving traditional, terminal-based merchants. **Can they keep their balance?**

By Kevin Woodward

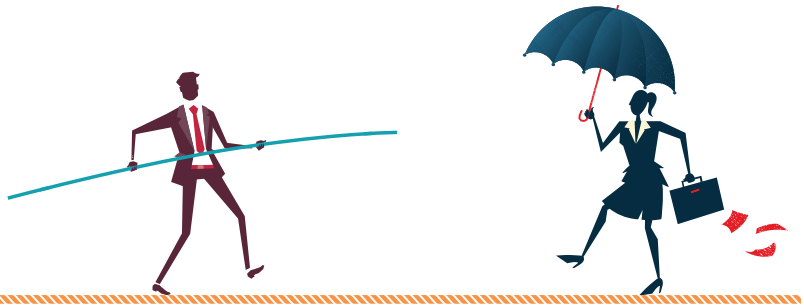
The biggest buzzword in payments today is "integrated."

While such payments—exemplified by point-of-sale software with an add-on payments capability that is supposed to be seamless to the user and the consumer—are not new, they are capturing the attention of more and more payments companies.

That's because the incessant quest for better profit margins, lower attrition, and more transaction volume is driving these companies, and investors, to what has turned into a lucrative market for integrated payments.

As more companies shell out increasing sums for integrated payments—witness Global Payments Inc.'s $700 million purchase of AdvancedMD, a medical-practice software provider in August—their attention expands to what may be new or much larger elements of their businesses.

For example, do they have enough resources to cater to this burgeoning market while ensuring their other sales channels get the attention and resources they need? What factors determine how to divvy the resources, especially when integrated payments is capturing so much of the payments spotlight now? The answer is that the best chance of benefiting from integrated payments comes from a plan for targeting integrated payments.



'ON A COLLISION COURSE'

Integrated payments were around for years before they became hot. Some payments providers, like Mercury Payment Systems LLC, which Vantiv Inc. (now Worldpay Inc.) purchased in 2014, specialized in serving software developers long before they caught the attention of many others.

Many payments companies choose to buy their way into integrated payments. An early example was First Data Corp., which bought POS system developer Clover in 2013. In September, First Data shipped the 1-millionth Clover device, having shipped the 500,000th less than two years ago. First Data launched an Integrated Solutions Group in 2017 to cater to the overall segment.

For an acquirer, the payoffs for building up integrated-payments merchants in a portfolio are numerous. For one thing, they are less likely to defect to other processors because of their need to use specific software just to operate their businesses. Beyond that, they may be more likely to use other value-added services, their cost of acquisition may be lower, and they provide steady, recurring revenue.

This is not to say that the payments industry ignored the segment. It's just that it was more difficult to serve these merchants prior to the emergence of a litany of recent technologies. This was before the breadth of the Internet and its cloud-based connectivity enveloped industries, and before EMV forced software developers to look at other ways of integrating point-of-sale acceptance into their software.

This was before the cost of POS systems started to decrease because of devices like Apple Inc.'s iPad and Android tablets. And it was before the whole notion of having as a goal making the payment not invisible, but indistinguishable from the rest of the checkout experience.

It's the ability to incorporate integrated payments into services that solve problems for merchants that makes this capability such a coveted option.

"Put simply, integrated-payments solutions simplify the lives of our merchant customers," says Brendan Tansill, president of EVO Payments Inc., North America, an Atlanta-based payments company. "The software solutions address real business needs and make business management easier and more effective."

That explains, too, why gaining market share among POS-system developers is such a coveted objective. Merchants are more likely to want to use software that helps run their businesses—not just accept payments—and are less likely, because of that necessity, to walk away from that software.

'ONE LEG OF THE STOOL'

It's this compulsion to use business software that elevates the POS system provider to the role of trusted advisor, Cohen tells *Digital Transactions.* "If this is the most trusted advisor of the merchant because everything the merchant does is around this thing, this flips the equation and payments becomes the value-add service inside a business-management solution," he says.

In this convergence, software and its cloud-based connectivity shine. "With or without integrated payments, the process is moving to the cloud and becoming embedded in other functions," says Thad Peterson, senior analyst at Aite Group, a Boston-based research firm. "While standalone solutions will be around for some time to come, the future is payments-as-a-service, and developers are a core constituency for a software-based payments ecosystem."

Helgeson: "Everybody has figured out they shouldn't have to go to a different system to handle payments."

"Software and payments are just two industries that are on a collision course," Greg Cohen, president of Paya, a Reston, Va.-based payments provider. Paya is the former Sage Payment Solutions, which was part of accounting-software giant Sage Group plc until the unit was bought by private-equity firm GTCR LLC in 2017.

That's how Henry Helgeson, president and executive vice president of integrated solutions at Total System Services Inc. (TSYS), sees it. "In today's world, it's not only mobile apps and all sorts of consumer-convenience applications, but everybody is figuring out payments should be integrated to a seamless customer experience," Helgeson says.

TSYS bought Helgeson's former company Cayan LLC in 2017 for $1.05 billion. Among Cayan's specialties was the development and subsequent offering of its Genius platform that easily integrates into POS systems.

"Everybody has figured out they shouldn't have to go to a different system to handle payments," Helgeson says. "The market has grown and become a more attractive place for payments, it makes it easy to scale distribution when the customers are very sticky. They generally don't attrite over a basis point or two."

When so much attention, and money, is allocated to integrated payments, one might wonder if the segment is getting too much attention at the expense of other ways to acquire merchants. "It's one leg of the stool," Helgeson says. "You can't neglect all these legacy distribution partners, some of which are evolving. Agents are figuring out how to get into integrated payments."

Others echo him. "We clearly see integrated payments as the future of card-present payments, but we also recognize that terminal-based merchants are a majority of the 7 million merchants in the [United States]." Tansill says.

"We strike a balance by recognizing the differences between the two channels and not asking our colleagues to operate in both arenas," he continues. "We emphasize expertise and focus by delineating two distinct strategies, thereby enhancing the experience of our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merchants and sales partners." EVO operates separate sales and supports staff for each of the two channels.

At Paysafe Holdings UK Ltd., which is based in Montreal for the North American market, balance is the operative word.

"From a distribution perspective I favor a world that focuses on integrated solutions as part of the sales process, but never losing sight that we have a large population of merchants that don't recognize or don't think there's an immediate need" for POS systems, says Todd Linden, chief executive for Paysafe's payment processing in North America. United Kingdom-based Paysafe in 2017 bought Linden's former employer, Merchants' Choice Payment Solutions.

'HIGH-CALIBER PEOPLE'

Many merchants still using standalone countertop POS terminals will eventually migrate to a POS system, such as a cloud-based one that uses common consumer devices. Some merchants may not recognize a need for such systems immediately, Linden says, but over time they realize the value such systems offer.

For payments companies, embracing integrated payments also necessitates a unique sales approach.

EVO intentionally keeps its integrated-payments focus only on these merchants, says Tansill. "We believe the expertise and focus of a dedicated integrated-payments division makes EVO a more attractive partner and payments provider," he says. "Lastly, we have retrained our direct-sales professionals to focus on integrated software to increase our capacity and accelerate growth."

Tansill: "Put simply, integrated-payments solutions simplify the lives of our merchant customers."

EVO's path to embracing integrated payments began in earnest six years ago with some acquisitions. Each brought unique qualities that the company combined into its current product offerings, Tansill says. These included payments companies Snap, Sterling Payment Technologies, and Nodus Technologies Inc.

Snap provided EVO with a single integration point for its international business, Tansill says, while "Sterling provided us with a team of more than 200 professionals with more than 10 years of experience selling and servicing integrated merchant relationships, in addition to access to the software dealer network in the United States."

Nodus brought a software tool that facilitates integrations into enterprise resource planning technology, providing a boost to EVO's business-to-business payments capabilities, he says.

"We have intentionally retained the focus of our integrated-payments team, fully separating its responsibilities [from] those of any other sales channel," Tansill says.

EVO sells it services by going direct to the independent software vendor (ISV) market and indirectly via a network of more than 1,000 software dealers, he says.

"We have been steadily increasing our headcount across our sales organizations, targeting each of these two audiences, software companies and dealers," Tansill says. "As our technology-enabled channel—e-commerce, integrated payments, and B2B—accounts for 54% of U.S. revenue in the aggregate and consistently generates the most attractive growth rates, we have been steadily adding sales resources across all subsets of this channel."

Others, too, have adapted their sales approach to the ascending importance of integrated payments.

At Paya, Cohen says the company uses a partner-centric approach, and is much more focused on businesses than retailers. One strategy is to offer products that can do more for a business than help it accept payments, he says.

Because payments companies are selling more sophisticated products that include other business functions, such as employee scheduling, inventory management, or pricing, the sales process is a bit more involved. "There is a need to find high-caliber people," says Helgeson. "They aren't easy to come by."

CLICK AND AGREE

Closely related to the sales approach is the cost of acquisition, a significant element to valuing a merchant and the merchant portfolio.

Often, the lifetime value of integrated-payments merchants could be more than other types of merchants that may have higher attrition rates or have lower profit margins. Yet, margins can be compressed with integrated-payments merchants because the software provider, often an ISV, gets a share of the revenue.

"The ISVs are sharing in the economics, depending on how big a portfolio they have to leverage," Helgeson says, and their role in the sales process.

A portfolio of many long-time merchants might command a larger percentage of the revenue than an equally sized portfolio of merchants with shorter tenures. Generally, too, the lifetime value of integrated-payments merchants should be higher than that of more conventional merchant types, Helgeson says.

"From time to time, you may see slightly lower margins, but, generally speaking, these merchants process more volume," he says.

Customer acquisition costs for integrated-payments merchants vary. When the category emerged, it was served by independent sales organizations, which focused on sales and shepherded the remaining aspects of actually boarding the merchant to a third party, such as an acquirer or processor, Cohen says.

"Then it changed," he says. "In this channel, generally speaking, the variable cost of acquisition is fairly low, other than the co-op marketing dollars you do with the channel."

What is driving down the cost of acquisition is click-and-agree capabilities, where a merchant can read the online terms and click "OK" to begin the boarding process, much like the routine with online processor Stripe, Cohen says. "The cost of acquisition is near zero."

The convergence of payments, software, and cloud connectivity is affecting the cost of acquisition to such a degree that comparisons between integrated-payments merchants and those using countertop POS terminals may not be possible.

"It's changed so much that I don't know if you can compare any more because the cost of acquisition at times can be much less than even trying to get a merchant a terminal because the fit for a merchant is a quicker sales cycle," says Paysafe's Linden.

Another factor affecting cost of acquisition is the blending of the ISV and ISO model, Linden says. An example is Mindbody, a San Louis Obispo, Calif.-based company that sells business-management software for health-and-beauty businesses. In 2010, it became an ISO in addition to an ISV. Meanwhile, some ISOs are fully adopting the ISV model.

This blurring trend shows no signs of slowing, Linden says. "The collaboration and acquisition opportunity is there. The ISV knows the software, but the ISO knows how to sell it and get traction."

'A LOT OF GREENFIELD'

This, of course, poses some challenges, such as betting on a technology. "You have to make a big bet on something, you have to make sure that's something that can't be obsoleted very quickly," Linden says.

As an example, Linden says a couple of years prior to the Merchants' Choice acquisition by Paysafe, the company looked into a social-media service for merchants. It's glad it didn't follow through. Today there are numerous ways for merchants to integrate social media.

"It's a fast-moving landscape," Linden says. The right technology at the right time, he says, "brings a whole new growth burst to payments."

Along with that come profits. Merchants reliant on integrated payments are often more profitable for a couple of reasons, Linden says. "One, they will always be more profitable if they keep their customers longer," he says. "The stability of the portfolio in an integrated environment is much better."

Second, profit margins can continue to grow with these merchants if they are sold other services. A sales agent might get an immediate monthly residual just from successfully signing the new merchant, but could see that triple or better as the merchant adopts other services, Linden says.

Profits, of course, are tempered somewhat because the software developer or sales partner will want its share. But that is nothing new for payments companies, many of which have long split the revenue. What is new is that the lucrative and largely untapped potential of integrated payments lies ahead.

"There are now verticals that didn't exist 10 years ago," Helgeson says. "There is a lot of greenfield out there," referring to merchants that have yet to adopt the integrated-payments model. And there is some opportunity to take market share from competitors, he says.

Cohen is similarly enthusiastic about the potential. "These developers are not disappearing," he says. "As businesses move to the cloud in the way they deliver their solution, you need developers to support that."

'A COMPLETE PICTURE'

It's just the early stages of this transformation, many observe. "We would expect integrated payments would replace terminal-based merchants as the preeminent payment method in the intermediate term," Tansill says. "The solutions are better for the merchant and enhance the experience of the merchants' customers." This likely will be a worldwide shift, too, he adds.

A big reason for this transformation is that merchants want and need to know more about their customers, especially as they strive to compete against online merchants that have deep insight into a customer's purchase habits.

"Merchants are working very hard to get a complete picture of their customers, and that means they need to understand their purchase behaviors in any context or venue," Aite's Peterson says. "Payments are an essential ingredient to that knowledge base, and there's almost no way to get a clear view of customer behavior if online and offline purchase behaviors are in separate silos." DT

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When Collaboration Makes Sense—And When It Doesn't

Eric Grover

Through the years, the network game hasn't changed. Payment systems need volume, and that means interoperability with other networks. The key is to be smart about it.

The payments world is a patchwork of overlapping and interdependent networks. For success, networks need a path or paths to critical mass. For most, leveraging directly competitive and adjacent systems is essential.

In payments, network effects and habit matter enormously. The most feature-rich, secure, or cheapest payment system in the world is worthless if only one consumer or business uses it. By contrast, systems with billions of users are compelling, notwithstanding imperfections.

To boost usage, networks partner, often ceding some control and economics. In free-market capitalism, no relationship, however one-sided, is consummated unless both parties calculate that they'll profit.

But payment-system relationships evolve based on changing relative power and interests. For example, imagine a world where 50% of Mastercard transactions were initiated over Apple Pay. Those able to shift payments share command better economics, so, at a minimum, Apple would take a bigger bite of interchange.

While there are hundreds of national retail-payment schemes, only a handful of systems are or aspire to be global. Mastercard and Visa are the only genuinely planetwide retail-payment systems.

They command the lion's share of cross-border retail payments in every country except China, Iran, North Korea, Sudan, Syria, and the part of Ukraine occupied by Russia. Their open model leveraging tens of thousands of banks to deliver payments to end users has been the most successful payments-system strategy ever.

The Open Approach

Visa's visionary founding chief executive, Dee Hock, evangelized a system of enforced cooperation for core delivery systems, rules, and brand, and decentralized freedom to compete and innovate for banks. For networks leveraging third parties, more partners and greater share dispersal are better than less.

Hock liked biological metaphors. In a May 21, 1985, talk given after he retired, he counseled, "The trick for an evolving organism is to assume whatever form best serves function in the changing environment."

His creation continues to evolve. In 2008, Visa changed governance, went public, and became less bank-centric and decidedly more enterprising. But it retained balance and tension between central control and licensees' decentralized competition and innovation.

In the cross-border interbank payments sphere, Swift took a similar open approach. The Swift network, and correspondent banking, enjoy near ubiquity worldwide and a near monopoly.

As was the case with Mastercard and Visa, an initial public offering transforming Swift from a bank cooperative into a commercial public enterprise would unleash value and wouldn't have to alter the balance between central control of delivery systems and rules, on the one hand, and decentralized competition and innovation, on the other.

Adjacent networks could encroach on Swift's turf. For example, Mastercard's ownership of a real-time automated clearing house system, Vocalink, suggests a path to real-time interoperability between the world's interbank-payments networks.

Google Vs. PayPal

Alipay, American Express, China UnionPay, Discover, JCB, PayPal, and WeChat Pay are tier-two, or aspiring, global retail-payment systems. All have opened up, working with third-party networks, processors, issuers, and/or wallets to extend their reach.

And, powerful technology platforms are wading into payments, leveraging existing networks and processors. Tech colossi Google, Apple, Facebook,

and Amazon have further ambitions in payments to enhance their platforms.

However, Google's Tez, launched in India in September 2017, is a payment scheme in its own right. It's free for merchants and consumers and harnesses the National Payment Corporation of India's real-time ACH and Unified Payments Interface scheme.

It's being rebranded Google Pay for international expansion. Existing payment systems, as well as banks, should worry. If arguably the world's most powerful tech platform could scale a payments network monetized through advertising, it would be a scary competitor.

The European Union's PSD2 regulation mandates that banks provide free payments and harvesting of consumers' payments data. Most businesses aren't going to be able to persuade consumers to let them initiate payments against their current accounts and harvest their data. But Google likely will. Amazon too.

Moreover, directly or more likely through existing payment systems, these companies have the wherewithal to exploit the coming pan-EU patchwork of application programming interfaces for initiating payments and data harvesting. If Google Pay (Tez) gets traction beyond India—say, within the EU—it would roil the reigning payments ecosystem.

To be sure, notwithstanding its enormous success elsewhere, Google's payments efforts have underwhelmed since Google Checkout's 2006 launch. Still, with its portfolio of globally dominant search, smart-phone-operating-system, browser, online-video, and email assets, the tech giant's payments efforts shouldn't be taken lightly. Perhaps Google Pay will be the charm.

> Systems with billions of users are compelling, notwithstanding imperfections.

E-commerce phenom PayPal has been on a tear, embracing interoperability. Originally, PayPal was a closed-loop general-purpose payment system, relying, however, on card and ACH networks, and ultimately banks, to fund transactions. To increase network mass, it's been opening up, though in fits and starts and not always successfully.

PayPal's initial attempts, in 2012, to deliver acceptance through U.S. acquirers and the Discover network came to naught. Finally, in 2016, PayPal reached a modus vivendi with Mastercard and Visa, agreeing not to discourage their use and to use their tokens for proximity payments at the physical point of sale.

Now it's working with giant credit card issuers like Bank of America, Chase, and Citi to enroll new PayPal subscribers. Chase and Citi cardholders will be able to spend their reward points at PayPal merchants. In August, it cinched a deal with Brazil's Bank Itau to promote PayPal to its cardholders and offer PayPal acceptance through Itau Unibanco's Redecard multibrand acquirer.

It's established interoperability with mobile-payment system M-Pesa and massively extended its money-transfer delivery footprint with a deal with competitor Euronet.

PayPal also agreed to accept China's Baidu Wallet, which claims 100 million users. However, as China's dominant e-commerce payments dragons Alipay and WeChat Pay build acceptance abroad, the Baidu relationship's promise diminishes.

Some of these relationships are close calculations. Is there any doubt what Mastercard chief executive Ajay Banga or Visa CEO Al Kelly would do with an "Extinguish PayPal" button, with no antitrust risk?

> Is there any doubt what Mastercard chief executive Ajay Banga or Visa CEO Al Kelly would do with an "Extinguish PayPal" button, with no antitrust risk?

The Fly in the Ointment

America's number-four card network, Discover, for more than a decade has doggedly pursued a strategy of network reciprocity and transforming itself into a semi-open-loop system. It has reciprocal acceptance with a host of networks including China UnionPay, JCB, Rupay, PayPal, Elo, and Eufiserv, for which in 2017 it processed $14.2 billion in total volume.

The fly in the ointment is that, absent cobranding and co-signage, consumers and merchants are unaware.

When there's uncertainty, transactions don't happen. Connected mobile wallets could enable acceptance alerts for cardholders and merchants to signal acceptance. Some network relationships will lose value regardless. Notably, UnionPay is expanding U.S. acceptance, reducing its need for Discover.

Even cogent partnering will struggle to overcome network effects enjoyed by larger payment systems in well-served markets. Since 2006, Discover has used third-party acquirers to provide acceptance, enabling a U.S. acceptance network that is close to parity with Mastercard and Visa.

As the weaker network, however, while still growing, Discover is losing share, dropping from 5.5% of general-purpose U.S. credit-card purchase volume in 2006 to 3.8% in 2017. At the same time, though, Discover's open, brand-neutered Pulse debit network, generating 11 basis points of yield on payment volume, increased share from 2.2% of purchase volume in 2006 to 4.2% of total volume in 2016.

Like Discover, American Express is semi-open, but because of higher interchange and cardholder spend, it's enjoyed greater success in rewarding third-party issuance.

Initially closed-loop systems Alipay and WeChat Pay built momentum on Alibaba and Tencent, respectively. Outside China, however, like UnionPay, they're partnering with third-party merchant acquirers.

Promiscuous Partnering

Challenger cross-border systems and free domestic person-to-person platforms have chipped away at traditional money-transfer networks' transaction economics. Western Union's, MoneyGram's, and Euronet's compliance coverage and promiscuous partnering on the send and receive sides of their networks give them moats for now.

No cryptocurrency has achieved critical mass or relevance in retail or P2P payments. Cryptocurrencies' best path to building usage is to leverage established systems. For example, Xapo cleverly enabled users to spend Bitcoin in fiat currency with a debit card using Visa's network.

However, in January, 2018, Visa killed the program. Ripple is trying to get in the door by providing cross-border payments messaging to banks, with a view to their ultimately using its XRP currency.

Payment hubs' raison d'être is to lower the cost and time to mass payment-system interoperability. For example, ModoPay enables banks, processors, and merchants to plug into a host of traditional payment networks and nontraditional currencies, such as loyalty points—all with one connection.

The Final Lesson

But many payments coalitions fail.

The Euro Alliance of Payment Schemes attempted unsuccessfully to build critical mass in Western Europe by interoperability between national networks Electronic Cash, PagoBancomat, Multibanco, Euro 6000, and Link, and pan-European Eufiserv. None of the stakeholders, however, was willing to invest meaningful resources building EAPS's value proposition and brand. None had skin in the game.

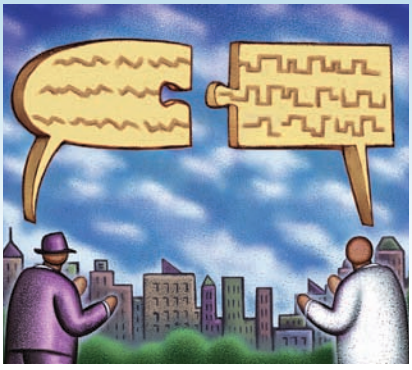
The grand coalition of U.S. merchants, MCX, had Money2020 keynotes three years running. It attempted to build a merchant-centric payment system, CurrentC, to take a pound of flesh from American Express, Discover, Mastercard, PayPal, and Visa. There were several problems.

Notwithstanding the zeal of MCX members—Walmart in particular—to reduce payment-acceptance costs, there was never a compelling use case for CurrentC. Additionally, merchants don't play well together. While many have their own highly successful retail credit card programs, they have no history of successful collaboration in general-purpose payment systems.

Similarly, the joint venture of giant carriers AT&T, T-Mobile US, and Verizon, Softcard, which was piloted in Austin and Salt Lake City, fizzled. The venture sold the remnants to Google. While some carriers individually have developed successful payment systems in emerging markets—for example, M-Pesa, Airtel Money, and Ecocash—their efforts in mature payments markets, individually and collectively, have largely failed.

In 2003, the behemoth European mobile network operators Vodafone, Orange, Telefónica, and Deutsche Telekom's T-Mobile, and the world's largest payment processor, First Data, attempted to develop a payment network called Simpay. It never found a path(s) to spend-and-acceptance critical mass. In 2005, they pulled the plug.

Still, the final lesson is that even the world's most powerful payment networks can benefit from astute collaboration with facially competing systems. And for weaker systems, it's critical. If interoperability boosts network reach and transactions and maintains, or better yet enhances, brand visibility, it's worthwhile even at the cost of sharing economics. DT



How to Tell Which Next-Great-Thing Will Be the Next Great Thing

Rick Oglesby

Separating probable success from probable failure, in four handy rules.

Every October, the payments hype machine goes wild. A variety of next-great-things are about to dominate headlines and conference agendas. Most will die off quickly, so here are four rules you can use to focus in the right places:

Talk isn't just cheap, it's a red flag

Speculative business models fail frequently

Transformation is a rare event

Big companies speculate

Let's take these one at a time:

TALK ISN'T JUST CHEAP, IT'S A RED FLAG

Hype is inversely correlated with demand. Companies in demand don't need it. Hype follows a cycle:

STEP 1
Launch a new product or company.

STEP 2
Be as visible as possible in every conference, trade magazine, social network, and market-research report. Produce white papers outlining how your product will be transformative. Outlandish claims get attention, so be grandiose.

STEP 3
Stop spending money on hype and do some deals.

Many companies never make it to step 3. The companies worth your time are step-3 companies.

SPECULATIVE BUSINESS MODELS FAIL FREQUENTLY

Always remember these two tests:

TEST 1
If the company can't clearly explain what it does, and do so in a few sentences with examples, that company will not make it to step 3.

TEST 2
If the examples it provides are not current, tangible, and monetizable, it's likely to fail even if it does make it to step 3.

Companies that tout technology, but can't describe a clear target market, or a clear problem that it is solving, or a simple use case that makes sense and aligns with real, monetizable needs, are extremely common and not worth your time.

TRANSFORMATION IS A RARE EVENT

The big payments success stories of the recent past—Adyen, AliPay, PayPal, Square, Stripe, M-Pesa, and Tencent/WeChat Pay—result from filling previously underserved needs, not from transforming well-served needs. Adyen made selling internationally accessible at the same time that Google, Facebook, and Twitter were making global marketing more achievable. AliPay and PayPal made e-commerce payments accessible at the same time that e-commerce was exploding. Square and Stripe devised new products that enabled cost- and risk-effective ways to serve previously ignored startups and micro merchants.

M-Pesa and WeChat Pay leveraged mobile devices to create electronic payments systems in cash-based economies that lacked payments infrastructure.

None of these companies transformed an efficient, popular solution.

BIG COMPANIES SPECULATE

Adoption of a new solution by large companies is not an indicator of future success. A next-great-thing achieves mainstream adoption when both profits and growth are prevalent. Beyond that, large-company adoption lends credibility and staying power, but it does not constitute confirmation.

Apple's 2014 adoption of near-field communication for Apple Pay is a prime example. It helped solidify NFC as the technology of choice for in-store mobile payments, but it has not guaranteed success. NFC-based wallets have proven to be a low revenue, slow growth, highly speculative market.

Let's apply these rules to some of the products that have already been hyped as next-great-things and derive some conclusions:

CASE ONE

Blockchain and cryptocurrencies

TALK ISN'T JUST CHEAP, IT'S A RED FLAG

Extreme hype and speculation drove Bitcoin prices to a peak last December. Hype and prices have trended downward ever since. It's quite possible that the turn in December marked the point where blockchain moved from stage 2 of the hype cycle to stage 3.

SPECULATIVE BUSINESS MODELS FAIL FREQUENTLY

In 2014, a venture capitalist told me his blockchain investments would pay off when a country in crisis adopted Bitcoin as its national currency. I'll call that a speculative expectation, as is any of the following:

1. Payment-acceptance companies enabling cryptocurrency acceptance, even when there is virtually no consumer demand for cryptocurrency payment.

2. Companies using cryptocurrencies as funding vehicles, such as using initial coin offerings to raise capital to build their businesses, which will eventually enable transactions using their currencies.

3. Companies touting cryptocurrencies or blockchain as their product.

Look for real solutions to real problems, like managing payments that the banking system doesn't handle well. International transfers are expensive and tedious and domestic cannabis sales are cash-based due to federal regulations. They are underserved needs that can be served through blockchain and cryptocurrency solutions.

BIG COMPANIES SPECULATE

There are many large companies investing in blockchain. The list includes Apple, Google, IBM, Microsoft, Oracle, Bank of America, Chase, and Wells Fargo. Yet when you Google "blockchain success stories," you can't find anything less than six months old. The few stories to be found are loaded with words such as "trial" and "potential," "explore," "research," "pilot," and "venture." Billions have been invested in blockchain but it's tough to find a single success story.

CONCLUSION

Blockchain hysteria seems to be ending. There is a very small set of realistic use cases for which monetizable products can be built. Focus on those and ignore any company that promotes technology or currency first and value-delivery second.

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CASE TWO

Digital wallets and peer-to-peer (P2P) payments

TALK ISN'T JUST CHEAP, IT'S A RED FLAG

PayPal has included P2P payments in its digital wallet since the beginning. Braintree acquired Venmo's digital wallet and P2P payments service in 2012, which PayPal in turn acquired in 2013 when it bought Braintree. Square launched its P2P payments service (Square Cash) in 2013. Google has been iterating through digital wallet and P2P payments solutions since at least 2011. Visa has been enabling P2P solutions also since at least 2011. Apple launched its wallet in 2014 and its P2P service in 2017.

Digital wallets and P2P services have been around for a long time. Their hype cycles are over and the step-3 companies have been identified. Today's media coverage focuses on growth driven by Square Cash, Venmo, and Zelle. That's not hype.

SPECULATIVE BUSINESS MODELS FAIL FREQUENTLY

Digital wallets and P2P payments are not monetizable. Banks and payment networks are blocking wallet providers from earning revenue through merchant payments. Consumers aren't willing to pay fees to pay their friends.

To monetize wallet payments, wallet providers need their own acceptance networks. Only PayPal has that. There is no proven way to monetize P2P services. PayPal and others use P2P services to attract customers and funds that can be monetized through other products. As standalone products, digital wallets and P2P services are very speculative. They can, however, serve as efficient sales engines for companies with complementary, monetizable services.

TRANSFORMATION IS A RARE EVENT

Digital wallets and P2P services seek to transform multiple services. Transformation of efficient, popular solutions is rare, but profound success can come from filling previously underserved needs. Digital wallets and P2P services do some of each:

1. NFC-based digital wallets seek to transform in-store payments performed through card taps or dips with phone taps. This is an effort to transform a well-served, efficient, and popular product (payment cards).

2. P2P payments compete with checks and cash, both of which are outdated, inefficient payment media. Digital P2P payments is clearly an underserved need.

3. Online digital wallets improve Web-based and in-app checkouts by automating the payment process and providing security. PayPal has proven that this is monetizable. Evolving technologies provide new opportunities.

BIG COMPANIES SPECULATE

All of the relevant digital wallet and P2P providers are big companies. Zelle is co-owned by major banks. PayPal and Square are publicly traded with multibillion-dollar valuations. Apple, Facebook, Google, Samsung and others all participate in the digital-wallet and/or P2P payments markets. Their services are growing but none has demonstrated the ability to directly monetize wallets or P2P payments. They use these services to acquire or strengthen customer relationships to be monetized through other services.

CONCLUSION

In cash-based countries lacking electronic payments infrastructure, digital wallets and P2P services can be a real business. Elsewhere they are not. They are complementary services that can help great companies be a little bit greater.

Whether you're a multidecade payments veteran or a newbie, these four rules will help you understand payments-market dynamics. You'll understand why businesses that thrive in Kenya and China won't work in the United States, why Square Cash is valuable to Square even if it will never be a billion-dollar business, why NFC isn't and won't be the growth engine behind Apple Pay, and how best to invest your time when looking for the next great thing. DT

The payments market is large and fragmented.

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DIGITAL TRANSACTIONS
Trends in the Electronic Exchange of Value

SDA is value-priced. This positions ACH as the price-comparison point for all other domestic payment types being considered, particularly where instant transaction delivery is not the primary payment objective.

The Far-Reaching Impact of Same-Day ACH, One Year After Launch

Sarah Grotta is director for the debit and alternative products advisory service at Mercator Advisory Group, Maynard, Mass.

Competition from faster payments pushed the automated clearing house to introduce same-day processing, but now the ACH may well turn the tables, says Sarah Grotta.

It has been a year since same-day ACH (SDA) credits and debits have been available in the United States. Here's a quick refresher of SDA volumes reported thus far by NACHA, the governing body for the automated clearing house:

- 56.8 million credit transaction and $72.5 billion dollars processed in 2017;
- 18 million debit transactions and $14.5 billion dollars processed in 2017;
- 75.1 million total transactions and over $87 billion in dollar volume in 2017;
- 41 million transactions through the second quarter of 2018, representing over 200% growth compared to the prior-year period;
- Primary SDA use cases include consumer bill pay, payroll, and business-to-business payments.

That's not a bad start for a 1-year-old. In its favor, SDA has a built-in network, developed over decades through integration with over 12,000 U.S. financial institutions, that reaches nearly every U.S. transaction account. Hundreds of thousands of businesses can send SDA, and received SDA transactions can be fully processed, reconciled, and recognized by their account systems. This is the kind of ubiquity that newer faster and real-time payment options can only dream of.

The comparison of SDA to real-time payments is purposeful. Although SDA doesn't operate in real time and never will, it is being influenced by the development of new payment rails, and in turn is leaving its mark on the development of faster payments in the United States.

Consider that NACHA has just recently received approval from its membership that will extend the processing day by two hours, and to add another processing window for SDA, which will allow a faster option for more ACH transactions. Weekend and holiday processing is being considered too. Five years ago, processing on what was then considered non-business days was unthinkable, but the emergence of other faster-payments services is creating the need for ACH to increase its speed and availability.

'New Tricks'

Further progress has been underway for ACH modernization through the development of standardized application programming interfaces (APIs) for some ACH capabilities, as well as support for ISO 20022 messaging. These new tricks from an old payment type like ACH will preserve its viability as a payment option as new real-time, near-real-time, or just plain faster payments begin to emerge.

SDA is already seeing competition for payment transactions from Mastercard Send and Visa Direct credit-push payments, which are attracting volume for person-to-person (P2P) transactions and business-to-consumer (B2C) disbursements delivered within minutes and

DOES YOUR POS PARTNER HELP YOU CLOSE SALES?

As technology drives us into a new era of retailing, merchants are starting to view the omnichannel experience as necessity over novelty, and with that comes high expectations for the newest streamlined POS solutions. Fortunately for the MLS and ISO community, Electronic Payments is invested in something greater than just engineering. And while Silicon Valley and private equity businesses remain focused on product development, they're not invested in the overall merchant experience.

Don't get us wrong. The ability to scale in the fintech arena is imperative to remain relevant. We have to meet ALL merchant expectations in order to achieve wealth and success in this industry, and Electronic Payments can help you do so! If your POS software is not releasing new updates and features on a frequent basis, you'll need to answer some uncomfortable questions. You should see ongoing improvements and profitable features in your POS offering, such as support for Cash Discounting. A solution like Exatouch®, Electronic Payments' proprietary point of sale, publishes monthly software release notes to ensure our sales partners remain up to speed on product advancements. Today's merchants run from stagnation, and tools like these make it easier to sell, consult, and remain engaged with clients long-term.

If your POS partner does not provide access to their internal Sales Engineer Specialists for ongoing training and product demonstrations, then you're missing out on the most valuable sales resource for your business. Exatouch's dedicated Sales Engineers provide a direct line into the heart of the marketplace, keeping you on top of industry trends, features in high demand, and product updates. Furthermore, they address merchant network requirements, hardware upgrades and pricing, as well as close negotiations by navigating the entire sales cycle. They handle objections, properly set expectations, and make sure you're not missing out on opportunities due to a lack of product or industry intel. At the end of the day, your POS partner should enhance your consultative skills and empower you become a true business advisor in order to capture more business.

In today's POS environment, the merchant/agent relationship doesn't end after the sale. After all, the hard work begins after the merchant signs on the dotted line. Make sure that your POS partner oversees the entire setup—from menu/inventory builds and software imaging to deployment and 24/7 in-house technical support. By doing so, you can expedite all setups and handle escalated circumstances as they arise. Electronic Payments manages our own inventory, provisioning and shipping, allowing us to address warranty issues with the utmost speed and keep your merchants up and running. This level of involvement indicates a provider's dedication to your success, as opposed to those who simply sustain engineering and cultivate their own bottom line.

Adapting to merchant needs is the only way to survive these changing retail times, and it takes more than just innovation to harness true success.

sometimes seconds. Early Warning's Zelle platform will process well over $100 billion in P2P transactions this year, according to predictions by Mercator Advisory Group, and is moving aggressively into B2C disbursements.

What's more, after The Clearing House's launch last November of its real-time solution, followed by deafening silence, it was recently announced that integration with The Clearing House's largest owner banks has been in development and they will have the capability to reach 50% of all U.S. transaction accounts by year-end 2018.

Without the competitive pressure of the real-time payments initiatives, NACHA would not have moved forward with SDA or received membership approval for its enhancement. There certainly wouldn't have been a reason to embrace ISO 20022.

Competitive pressures go both ways, however. In addition to the near-ubiquitous reach that ACH enjoys and other networks will seek to copy, NACHA has also increased the allowable per-transaction amount from $25,000 to $100,000, which would make SDA more attractive for business-to-business payment activity. Other faster-payment types will have to quickly increase their limits, too, particularly if they want to participate in B2B channels, as soon as they feel comfortable that fraud can be controlled successfully.

Pricing Issues

Another way that SDA will have a defining impact on the development of faster payments lies in transaction pricing. SDA currently carries a fee of 5.2 cents more than the cost of a standard or legacy ACH transaction. Financial institutions can mark up this fee to their customers for the premium service provided. At a premium price of pennies per transaction for a payment that posts and settles in the same day for both credit and debit transactions (and might have weekend and holiday processing capabilities), SDA is value-priced. This positions ACH as the price-comparison point for all other domestic payment types being considered, particularly where instant transaction delivery is not the primary payment objective.

How important is speed? The answer appears to depend on the specific use case. According to a survey of businesses conducted by PNC Bank, greater value is seen in the 24x7x365 access that modern, faster payments offer than in the actual speed. Interestingly, at this early stage of development, over half of the respondents in that survey said they had no plans at present to adopt a real-time payments solution.

What we are witnessing now in the payments industry is the competitive one-upmanship of introducing new faster-payments networks, platforms, and products through a private-industry approach, with notable assistance from the Federal Reserve, but not a regulated mandate.

Venerable old ACH continues to learn new tricks, including the successful rollout of same-day transactions, to retain its relevance as more-modern payments emerge. The new payment types offering more efficient technology and greater flexibility are having to look over their shoulders at incumbent payments. In this way, ACH and SDA will drive the ways in which new faster and real-time payments evolve. DT

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