

# DIGITAL TRANSACTIONS

Trends In the Electronic Exchange of Value

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It's been a long-lasting affair, and it's getting more intense.

Volume Seventeen, Number Nine • [DigitalTransactions.net](http://DigitalTransactions.net) • September 2020

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**HARBORTOUCH**  
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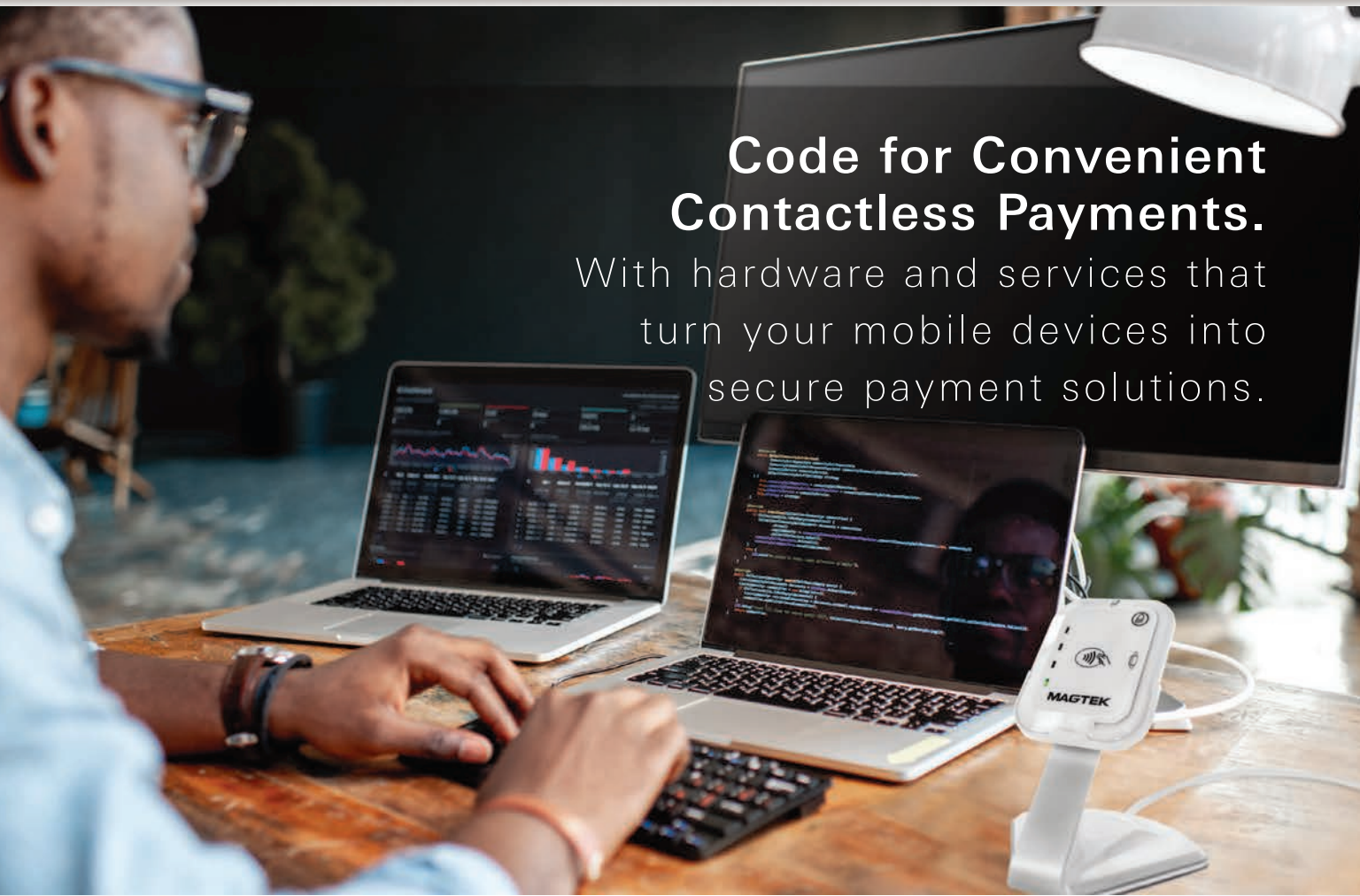
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Cover Illustration: Jason Smith, 123RF.com

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## WALL STREET AND THE PAYMENTS BIZ

**AS WE LOOK AT THE NUMBERS** at precisely 3:15 p.m. Eastern Time on Aug. 17, most of the payments and payments-related stocks we track are up for the day. Indeed, out of a basket of some 17 stocks, only four are down—and there's still part of the afternoon left. Some, like Adyen, Apple, eBay, Green Dot, Mastercard, PayPal, Shift4, and Square, are at, over, or very near, their highs for a year in which a pandemic has ravaged most businesses.

Jim Daly's cover story, starting on page 24, explains this shouldn't come as a surprise. "The publicly traded payments companies have done better than the broader market for years," he says. Indeed, as he points out, one hundred dollars invested early in 2011 in a basket of more than 25 payments stocks tracked by The Strawhecker Group would have been worth \$670 by the first quarter this year, a 22% compounded average annual return. The same investment in the S&P 500, by contrast, would have yielded \$234.

The love affair on Wall Street shows no signs of abating. In fact, the infatuation only grows more intense. Jim points to the example of one of the most recent IPOs, that of Shift4 Payments Inc. Priced by its underwriters in the low \$20s, the processor's stock debuted in early June as if shot out of a cannon and closed the first day at \$33.54. By mid-August, the shares were brushing against \$50. Two factors explain its success so far: investors appreciate its growing share of the vital restaurant business, and the big processor mergers last year made Shift4 and other players more visible to prospective clients by reducing the ranks of competitors.

Clearly, Covid-19 isn't damping demand for payments stocks. Another example is Green Dot, which got its start in prepaid products and now flexes a highly successful strategy centered on a bank it acquired in 2010. Dan Henry, who took over as CEO early this year, made it plain from day one that the bank is key to Green Dot's future. The market agrees. The stock opened the year at \$23.30 and by mid-August had climbed to the mid-\$50s.

We are not in the business of recommending stocks, nor do we intend to get into that game. The shares of any of the companies mentioned in this column could plunge tomorrow and stay in the basement for months. Our point is only to say that, to the extent the collective wisdom of stock markets matters, the payments business appears to be on a solid footing despite the buffeting of pandemics, economic shocks, and the inevitable regulatory interventions.

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Trends in the Electronic Exchange of Value

# trends & tactics

## PAYPAL PLOTS A NEW POS COURSE

PayPal Holdings Inc. has made big plays for the physical point of sale before, but late in July the San Jose, Calif.-based company unveiled what could be its biggest strategy yet to capture transactions at the cash register.

Top executives said an arrangement under way with CVS Pharmacy to run PayPal and Venmo transactions on Quick Response (QR) codes will roll out to all 8,000 CVS stores by the end of the year. Already, PayPal has deployed QR codes for payments in some 28 countries, chief executive Dan Schulman told equity analysts on a conference call.

The move comes as the month-old coronavirus pandemic has left hordes of consumers wary of touching payment cards or keypads. Such widespread caution has opened an opportunity for rapid development of a QR strategy as part of the PayPal wallet, Schulman said. “QR codes are a key strategic priority for us,” he told the analysts. “It’s critical for driving daily use. We will make the investments we have to.”

Besides CVS, PayPal is working with more than 100 “enterprise” merchants in the U.S. and European markets to introduce acceptance

of QR codes for payment, Schulman said. The effort includes talks with payment networks and terminal providers “to distribute our QR codes,” he added. “It’s not just about touchless payment, it’s rewards, offers, messaging. We think the economics over the medium term are quite positive for us.”

The thrust for QR code capability follows an initiative PayPal launched in May to bring the technology to small-scale sellers as part of its mobile app. The company at the time attributed the move to consumer and business fears of infection in the midst of the pandemic.

## SELLERS STOCK UP ON PAYPAL (Merchant volume in billions)



Source: PayPal



QR codes have proven quite popular in markets like China, where the big mobile-payments services Alipay and WeChat Pay depend on them. In these deployments, as well as in the PayPal program for small merchants, sellers display the code for buyers to scan with their smart phone. The scan triggers the transaction and movement of funds to the seller's account.

But the codes haven't gained a foothold in the U.S. beyond efforts to equip popular American chains to serve Chinese tourists. Other major companies, though, may be seeing potential. Apple Inc. reportedly was testing QR codes for Apple Pay earlier this month, for example.

PayPal has not discussed how it will price QR code transactions for big chains like CVS. It hasn't been so reticent when it comes to small sellers. In its May announcement, the company said these merchants would pay 1.9% plus a dime per transaction after the expiration at the end of July of an introductory free period.

For the first 14 years of its existence, PayPal stuck with its online-only payments service. But in 2012 the company began to enlist physical merchants as it hoped to tap into the much larger market for point-of-sale transactions.

At the time, PayPal was still part of eBay Inc. But eBay spun off PayPal to public ownership in 2015. That same year, PayPal said it planned a renewed POS thrust with near-field communication technology in its digital wallet. Unlike QR codes, NFC links to point-of-sale readers with very short-range radio waves.

Now, as it embarks on its latest POS gambit, PayPal is registering impressive results despite a

pandemic that is wrecking many world economies. Indeed, by the end of June it had enjoyed what it called the "strongest" quarter in its 22-year history.

Active accounts reached 346 million, up 21% year-over-year, including 26 million merchant accounts. This total also includes 21.3 million net new active accounts, up fully 137%. Payment volume totaled \$222 billion, exceeding the year-ago number by 30% on a foreign-exchange-neutral basis, and topping \$200 billion for the first time in the company's history. Revenue reached \$5.26 billion, a 25% year-over-year increase on an FX-neutral basis.

Venmo, PayPal's popular peer-to-peer payments service, ended the quarter with more than 60 million active accounts. Its volume totaled \$37 billion, up 52% as users turned to the product to move money to each other in the face of the pandemic.

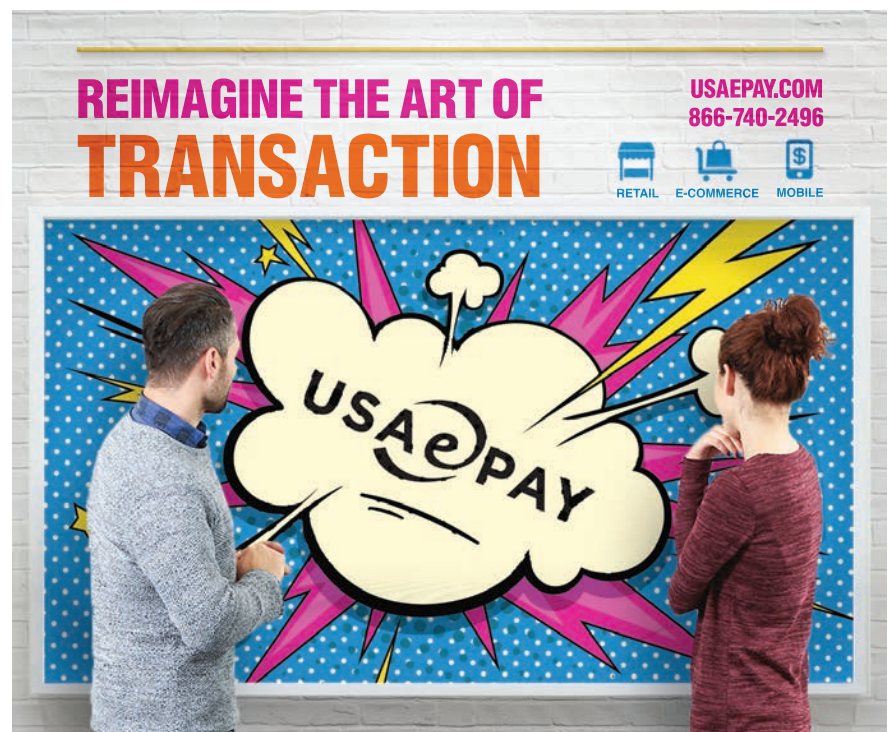
—John Stewart

## SENATOR DURBIN RIDES AGAIN

U.S. Sen. Richard Durbin and a Vermont Congressman said this summer they want the Federal Reserve to look into what they say are efforts by debit card issuers "aided by the dominant card networks" to prevent PIN-debit networks from getting a bigger share of booming card-not-present payment volumes.

"The Federal Reserve should consider appropriate enforcement action and policy responses to correct any such anticompetitive incentives and regulatory violations," says a July 24 letter to Federal Reserve Board Chairman Jerome Powell signed by Durbin, D-Ill., and U.S. Rep. Peter Welch, a Democrat who has monitored payment card acceptance issues for at least a dozen years.

Although he has been quiet in recent years, Durbin is well-remembered in the payments business as



the sponsor of the so-called Durbin Amendment to 2010's sweeping Dodd-Frank Act. The amendment famously regulated the interchange big debit card issuers could receive.

But it did more than that. To preserve network competition in a market dominated by Visa Inc. and Mastercard Inc., the measure also required issuers to make at least two unaffiliated debit networks available to merchants for transaction routing. The Fed's Regulation II, which took effect in 2011, implements the amendment's provisions.

Now comes Durbin's letter, which argues "intervention may become necessary again" because of "what appears to be the anticompetitive practice of major debit issuers refusing to enable PINless debit functionality on their cards."

PIN-debit networks, which typically have lower interchange rates than Visa and Mastercard, have in some cases developed PINless options in recent years to attract transaction volume, particularly in e-commerce payments when entering a PIN is an

extra chore for consumers and a technical hurdle for payments providers.

But issuers have an economic incentive to route transactions to networks with higher interchange rates, and Durbin's letter says if they don't provide bank identification numbers for PINless debit, the merchant may not have more than one routing option.

Citing estimates from research and consulting firm CMSPI, the letter says U.S. merchants could save at least \$2 billion a year in fees if PINless debit functionality "were made fully available" by having more transactions routed over the PIN-debit networks instead of the Visa and Mastercard networks.

"Because the volume of online 'card-not-present' transactions has increased dramatically during the Covid-19 pandemic, the need to address obstacles to PINless debit competition has grown more urgent," the letter says.

A Fed spokesperson declined to comment on the letter. A Mastercard spokesperson said the company is

reviewing the letter; a Visa spokesperson could not be reached.

The letter raises some of the same issues the Federal Trade Commission began investigating earlier this year. An FTC spokesperson declined to comment on the status of that probe, in which the agency has asked for documents from Visa and Mastercard.

"I believe there is merit to the letter," Anand Goel, chief executive of Optimized Payments, an Atlanta-based company that helps clients reduce their payment-processing costs, says in email.

But he adds: "I also believe the smaller PIN-debit networks have been slow to implement PINless capabilities. Visa and Mastercard are happy with the status quo, and neither has added [e-commerce] or PINless capabilities to their Interlink and Maestro [debit] networks, respectively, because they know those debit transactions will be routed through their 'credit' rails. So the inaction by Visa and Mastercard of not implementing PINless has allowed them to reap larger profits."

Goel says a good solution "would be for the Fed to force all issuers to support PINless capabilities. This would foster a competitive marketplace in all channels as the Durbin Amendment had intended."

In a statement, NACS, the Alexandria, Va.-based trade association of convenience stores, said "the law says that there should be a competitive market choice of payment network on every debit transaction. Unfortunately, Visa, Mastercard, and their largest banks have consistently tried to undercut competition. We appreciate Senator Durbin and Congressman Welch's tireless work."

—Jim Daly

## 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.



Source: The Strawhecker Group © Copyright 2020. The Strawhecker Group. All Rights Reserved. All information as available.

# NOT JUST VOLUME, BUT THE RIGHT KIND OF VOLUME

Shift4 Payments Inc. chose an interesting time to go public. Its initial public offering hit Wall Street in June in the teeth of a raging coronavirus pandemic. Last month, that move required the Allentown, Pa.-based processor to lay bare the plague's impact on its business as it conducted its first earnings call.

Stay-at-home orders and business shutdowns, with tentative reopenings, clipped the company's full-service, lucrative end-to-end payment volume in the June quarter 23% year-over-year to \$4.2 billion.

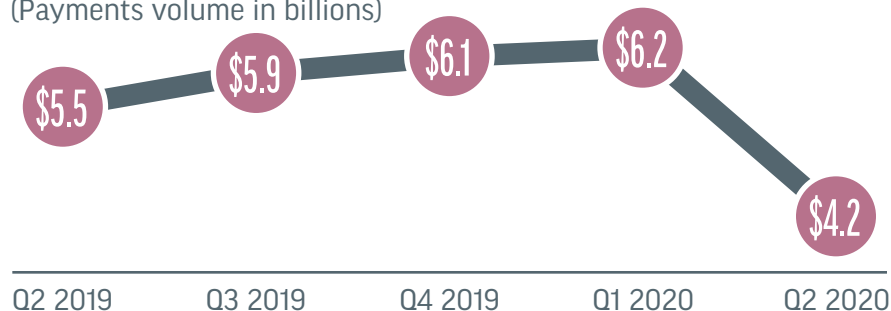
Things started looking up in June and July, however, with total payment volumes in July coming in as the second-highest number in the company's 21-year history, chief strategy officer Taylor Lauber told equity analysts on the call. And the pipeline is filling up.

"Our boarding of new merchants never really slowed during the quarter," Lauber said. Wall Street got the message. Shift4 began trading publicly June 5 and finished its first day at more than \$33 per share. By mid-August, that price was flirting with \$50.

The end-to-end processing portion of Shift4's business accounts for a relatively small part of total payments volume, with the gateway operation providing about 89%, executives said. But they made it clear they're set on a strategy to expand that number quickly. That's because the company can make as much as eight times more gross profit from the full-service end-to-end business than from merchants

## END-TO-END TAKES A HIT AT SHIFT4

(Payments volume in billions)



Source: Shift4

that simply use Shift4 as a gateway to other processors.

Typical gateway merchants fall into sectors Shift4 has historically served, including restaurant brands, hotels and resorts, casinos, and golf courses. These are merchants with complex payment needs. "We love food trucks, but serving food trucks is not what makes Shift4 special," said chief executive Jared Isaacman, who as a teenager founded the company in his parents' basement. He noted that conversions of gateway clients can be done in 24 hours or less. "All the connections are already there," he said. "It can be very, very simple."

With the emphasis on converting gateway to end-to-end business, the company projects its volume in that sector will not only recover but grow to between \$6.2 billion and \$6.5 billion in the third quarter, and to between \$6.5 billion and \$6.9 billion in the fourth.

In the face of the exigencies forced on payments markets by the pandemic, Shift4 found its card-not-present volume shifting from 15% of total volume in February to 40% in April as the company

moved clients to online ordering. That ratio has since declined to 80%/20%, Lauber said, though the company's introduction of QR codes for contactless payments is helping to buoy the card-not-present business.

"When it comes to payments, implementing a QR code solution is challenging," Lauber said. Merchants appreciated the fact "we were able to push it out," he added.

Another burgeoning market, executives added, is sports stadiums. The company got a big start in that category last month when the Las Vegas Raiders National Football League franchise named Shift4 its official credit card processing company. "Sports and entertainment is becoming an important market for us," Isaacman noted.

For the quarter, Shift4 logged gross revenue, less network fees, of \$67.4 million, down 10% year-over-year. Gross profit came to \$32.3 million, down 26%. The adjusted net loss totaled \$14.4 million, compared to \$4.4 million in the same quarter in 2019.

—John Stewart

# FEDNOW STICKS TO ITS PLAN

While the Covid-19 pandemic has raised the issue of speeding stimulus payments and other relief to consumers and businesses, the Federal Reserve system is staying with its planned 2023 or 2024 launch date for its FedNow real-time payment service, officials said last month in an update that came almost exactly one year after the central bank announced the service.

“We look to be on track for 2023 or 2024 but I expect over the coming year we will be able to get a little more precise about when we’ll be able to deliver the service,” said Kansas City Fed president Esther George, who spoke during a Web presentation that included Fed governor Lael Brainard and Kenneth Montgomery, the Boston Fed executive who has been heading up the FedNow effort for the past year.

FedNow, which represents the central bank’s entry into a business that has been served so far by private-sector players such as The Clearing House Payments Co., is “designing a pilot program as we speak,” Montgomery said. The goal is to recruit participants later this year for pilots that could launch early in 2021, he added.

But when what the Fed is now calling FedNow Instant Payments launches, it will not include cross-border payments or a so-called alias capability that would enable, for example, peer-to-peer payments to phone or bank-account numbers, George said. Aliases will come “at a later phase,” she noted, as the Fed concentrates on launching core



‘We are committed to interoperability to ensure nationwide reach. We can’t do it on our own.’

—LAEL BRAINARD, GOVERNOR, FEDERAL RESERVE

functionality. As for international payments, “we need to laser-focus on getting the service to function domestically,” she added.

At the same time, tokenization “likely won’t be available in the early implementation but we are looking at it for later,” Montgomery said. Tokenization replaces live account data with random strings of characters that can be decoded by participating institutions in an effort to thwart data theft.

Still, while the service may not come online soon enough to help distribute federal relief funds, Brainard stressed the importance of real-time delivery in such emergencies as an alternative to checks and debit cards through the mail.

“The pandemic is taking a tremendous toll on households across the country,” she said. “Instant payments would allow households to get instant access to funds rather than waiting for a check to clear.”

From the start, she said, the new service will support fraud tools with parameters set by banks; a liquidity management tool to enable banks to ensure they have sufficient funds to support instant settlement; and

interoperability, allowing links to other faster-payments services using the ISO 20022 electronic data interchange standard. “We are committed to interoperability to ensure nationwide reach,” Brainard said. “We can’t do it on our own.”

While the launch may be three or four years off, financial institutions should be drawing up plans now for how they can “serve their customers,” George said.

“Given how fundamentally different this product is going to be, it’s not too early to start thinking about it now,” she added. “What will it mean for accounting, operations, staffing? It will involve hard work to ensure this platform serves the country for many years to come.”

One factor in that planning process that may be hard to pin down for some time is cost. “We don’t have a number right now,” George said. “We’re still settling on the tech strategy, which will determine the cost.” Still, she added, pricing will be based on a “mature volume estimate” and the Fed’s mandate to recover its costs. DT

—John Stewart

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# A BASE FOR BOTTOM-UP CAPITALISM

### **MOST OF US WILL OPT TO PAY**

a higher price at Amazon, which already holds our financial and private data, rather than pay less and expose our data to a merchant with unknown security practices. The net result is that the megastores keep getting bigger, and newcomers are stifled, however innovative, superior, and better-serviced their products may be.

I hear from various craftsmen that the coronavirus kept them at home. They opened an online store, but have no way to impress on their prospective customers that it would be safe to surrender their personal financial information to such a hack-easy home-bound merchant.

This is a fundamental socioeconomic dilemma. Capitalism is powerful if it invigorates the bottom tier, not when it broadens the gap between rich and poor.

Technology can help in two conceptual modes: making hacking unprofitable and using digital cash.

A fence surrounding confidential data is only as good and as smart as its designers. Naturally, some hackers are smarter than the fence builders, and hacking continues. Now, suppose that the hacked data is short-lived. Its utility will diminish quickly to a degree that it won't be worth the effort to steal it.

A new technology does just that, and without burdening the customer and the merchant



BY **GIDEON SAMID**

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with frequent replacement of personal financial data. Conceptually, it amounts to “painting data with short-lived colors.” A computer technique attaches to account numbers, PINs, and passwords some extra data not visible to the user. This data is stealthily mounted, and stealthily refreshed, as often as desired. It is short-lived. Hence, a thief will be able to abuse his spoils only for a short time before the “colors” are refreshed (see U.S. Patent 10/395,053).

Think of it. Today a Social Security Number represents a lasting value for a fraudster. But with this coloring technology, the same data will be unusable a week later. The Social Security Number will not change. The invisible add-on data will simply expire.

This new “data-coloring” technology can also prevent phishing because your email client will be able to silently and cryptographically examine the identity of the sender, and alert you against phishing attempts (U.S. Patent 10/733,374).

Beyond security, privacy considerations motivate consumers to use cash, especially for transactions they would rather shield from

prying eyes, not because they are illegal, but because they expose the payer to ill-wishers.

Digital cash in its basic form is an extremely cost-effective solution for this, as BitMint has proven in its field-test cases. This is because when someone pays with digital cash, only the cash itself needs to be inspected, not the payer and not the payee. The authentication apparatus shrinks dramatically, and so does the service fee. Digital cash can be spent without an Internet connection, using hard wallets (U.S. Patent 10/754,326). The parties pay a fraction of a percentage point in operational fees. Now, once you tether money (see my book, “Tethered Money”), the cost rises, but so does the service.

Imagine the whole world as an accessible market. You could buy an independent movie directly from the overseas producer. You could buy a drawing or a statue you like directly from a poor artist far away. The buyer is not dependent on the security practices used by the unknown seller. In turn, you could get sensitive advice from an expert who gets paid without knowing who paid him.

No doubt, solid, non-speculative, quantum-safe, nationally recognized digital money is promising to catapult much-maligned capitalism to new heights. History tells us that bottom-up capitalism works. It is when monopolies emerge that the social benefit ebbs. **DT**

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# WILL COVID'S IMPACT LAST?

**COVID-19 HAS CHANGED** shopping and payments behavior, and a big question facing the industry is: How long will those changes last?

Most conversations about the pandemic start with, “When things get back to normal.” But all signs point to a new normal rather than a return to a pre-pandemic state. While that might be a disturbing thought, it could lead to improved relationships with customers and new payments products.

Big shifts in daily lives can provide an opportunity to make big changes. Kristen Berman, the cofounder of Irrational Labs, a behavioral economics nonprofit, explains that people change their habits when their environment changes. The pandemic has forced changes—working from home, for example—so the stage has been set for changed habits because peoples’ routines have been broken.

“When people are able to break out of their normal environments, then they can change their habits,” Berman says.

Evidence of such changes can be seen in research from the National Retail Federation that found that 58% of retailers said they can accept a contactless card payment in 2020, up from 40% last year. It also found that 69% of retailers said that contactless payments had increased since January.

Retailers expect that customers will continue using contactless payments, shopping online above



BY BEN JACKSON

[bjackson@ipa.org](mailto:bjackson@ipa.org)

pre-Covid levels, and using options like curbside pickup long after the pandemic ends, said Leon Buck, the NRF’s vice president of government relations, banking, and financial services.

“Retailers understand their customers—everybody wants faster, safer, and easier [shopping experiences], and they are going to accommodate it,” Buck said.

Berman, who is also a cofounder of the Common Cents Lab, a Duke University initiative focused on financial well-being for low-to-middle-income Americans, said now is a good time for payments companies to consider new ideas. People’s lives are disrupted, so they are in a mindset open to change.

One area in particular that may be ripe for change is financial health.

“While it seems like the worst time to be pitching people financial-health interventions—whether it be paying down your credit card or changing banks to avoid fees—this actually may be a very nice time to do it, because now more than ever people realize that their financial struggles could hit them,” Berman said.

This trend may already be showing up in the data. Credit card

balances fell by \$76 billion in the second quarter, according to the Federal Reserve Bank of New York.

As we all emerge from our Covid-19 shells and return to workplaces, that will be another inflection point for behaviors as environments change again, Berman says.

Of course, pandemic behaviors may have their own aftershocks. In May of 2020, the Federal Reserve surveyed 2,767 people who had completed its 2019 Diary of Consumer Payment Choice to ask how things had changed. Although 63% of consumers said they had not made an in-person payment since March, the average amount of cash that respondents were storing had nearly doubled from \$275 to \$534. It may be that we will see a spike in cash use when people begin making in-person payments again, as they will have a lot of cash to use.

Payments providers, retailers, and financial institutions have opportunities to help shape their customers’ behavior. As I have pointed out in earlier Payments 3.0 columns, many of the problems that have arisen from the pandemic are chronic issues that have been made acute.

The uncertainty has given us an opportunity to make course corrections that can lead to a profitable future for everyone. But we’ll need to rise to the challenge and begin thinking long term. DT



# acquiring

## IS THIS THE NEW ONLINE NORMAL?

As merchants, consumers, and payments providers wrestle with the Covid-19 pandemic, one thing is certain: Online fraudsters are as relentless—and opportunistic—as ever.

BY KEVIN WOODWARD

**IF LITTLE ELSE**, this year has proven that forecasts are grounded only in the moment they are made. No one could have foreseen in 2019 the impact of the Covid-19 virus on the U.S. economy and how it would alter e-commerce and online fraud.

Here's the impact so far. The most recent quarterly data from the U.S. Census Bureau for the second quarter finds that e-commerce sales accounted for 16.1% of all retail sales, or more than \$211.5 billion. That is much higher than the 10.8% share in 2019's second quarter, when online sales totaled \$146.4 billion.

The big questions about e-commerce in 2020 are how much

more will consumers shop online and how much more fraud will this shopping spree generate. It's already known that as e-commerce volume increases so does fraud. At least one fraud-prevention vendor noted major spikes in attacks in the first half of 2020.

Certainly, online-fraud issues have intensified in 2020, affected like so much else by the Covid-19 pandemic. As many states shuttered nonessential businesses and consumers shifted much of their spending to online stores, so, too, did criminals increase their misdeeds. Matters such as account takeovers and a better understanding of chargebacks surged to the forefront of merchant concerns, if they already weren't there.

Long a major issue for merchants and payments providers, account takeovers further cemented their position as the pandemic settled in place. "It's the number-one fraud trend we see," says Jeff Wixted, vice president of marketing and client solutions at Accertify Inc., an online-fraud specialist owned by American Express Co. "It's due to data breaches."

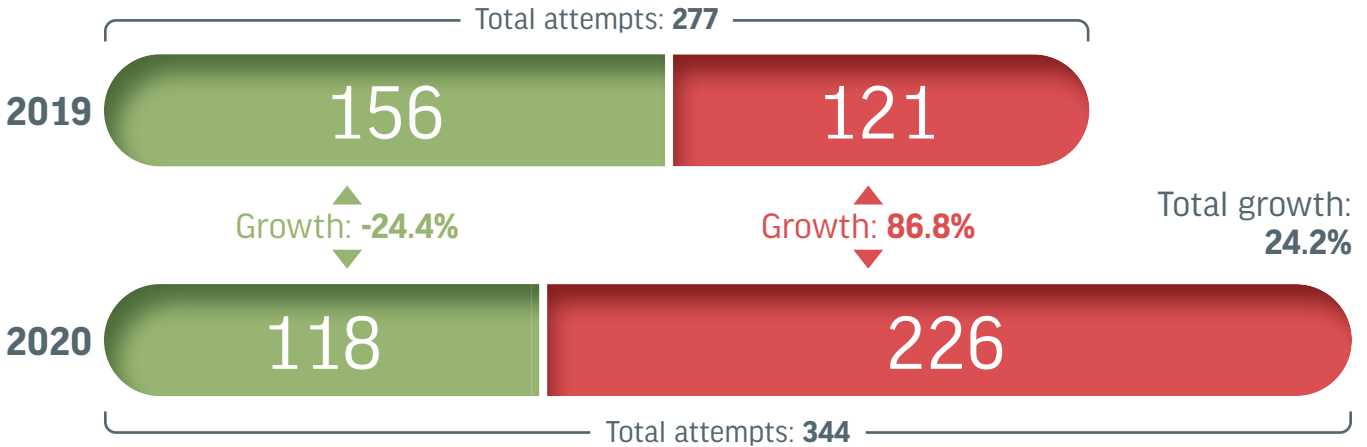
The problem worsened as habitual online shoppers increased their spending and consumers who formerly didn't shop online much increased their e-commerce activity. Wixted says some Accertify clients



# E-COMMERCE FRAUD ATTEMPTS

(Average monthly fraud attempts per U.S. e-commerce retailer, late February through late April)

■ Prevented ■ Successful



Source: LexisNexis Risk Solutions 2020 True Cost of Fraud Study/E-Commerce/Retail Report

are experiencing Black Friday or Cyber Monday sales volumes, referring to two peak holiday shopping days online.

## DIGITAL NEWBIES

Some suggest that account-takeover attacks will grow more numerous, especially as the fourth-quarter holiday season arrives. “We will see an intensification,” says Julie Conroy, research director for Boston-based Aite Group’s fraud and anti-money-laundering practice.

“We haven’t seen a big spike yet because the fraudsters have been focused on defrauding unemployment and the Payroll Protection

Program,” Conroy adds. The PPP program is a small-business funding program from the U.S. government.

A huge new segment of digital newbies who may be more susceptible to social-engineering scams could succumb to account-takeover attacks, Conroy says. At the same time, a lot of financial institutions have relaxed some of their velocity rules and dollar limitations on services like person-to-person payments and remote deposit capture because they want to ensure as few customers as possible are inconvenienced, she says.

Already, she says, “We have seen an uptick in phishing. All of the ingredients are there for the crime

rings to do well with account-takeover attempts.” Phishing scams gull online users into giving up key credentials like user names and passwords.

For some frontline personnel, rising fraud is already a problem. “Financial institutions definitely are contending with more account takeovers,” says Charlotte Ritonya, vice president of security and fraud, card services, at Brookfield, Wis.-based Fiserv Inc.

“As we shore up the point of sale with contactless [payments] and EMV, we start to shore up authentication,” Ritonya adds. “Account takeover is not a new event; we’re just seeing more and more of it.”

As other observers note, the cheap price of consumer data—information for the average stolen account sells for \$15.43, according to antifraud specialist Digital Shadows Ltd.—makes account takeover more widely available, says Christopher Mascaro, Fiserv vice president of fraud data and financial crime insights.



‘As we shore up the point of sale with contactless [payments] and EMV, we start to shore up authentication.’

—CHARLOTTE RITONYA, VICE PRESIDENT OF SECURITY AND FRAUD, CARD SERVICES, FISERV INC.

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## BIDDING THEIR TIME

Immediately after the Covid-19 lockdowns went into effect this spring, fraudsters sprang into action. According to data collected for its third-quarter Fraud & Abuse Report, San Francisco-based Arkose Labs said attack rates on logins increased 28% in the second quarter. Along with that was a 30% lower attack rate on account registrations and a whopping 47% decrease in the attack rate on payments.

Cloud configurations and the notion of software-as-a-service, which has contributed positively to ever-increasing decentralization of computing capabilities, also have been put to use by criminals.

“A couple of years ago, to do account takeovers, fraudsters would need teams of people to help,” Wixted says. But today, through cloud computing, someone could do it all themselves, he says. They can efficiently rent the software for a period of time and then shut it down, Wixted adds.

The account-takeover problem is compounded by constant data breaches leaching usernames and passwords, poor password practices, and technology advances, Wixted says, adding: “These make it even more impactful when it does happen.”

Because there are now more consumers going online to shop for the



## Account takeovers are ‘the number-one fraud trend we see.’

—JEFF WIXTED, VICE PRESIDENT OF MARKETING AND CLIENT SOLUTION, ACCERTIFY INC.

first time, those individuals can be at higher risk for account-takeover fraud, says Kimberly Sutherland, vice president for fraud and identity-management strategy at LexisNexis Risk Solutions, an Atlanta-based risk and data-services provider. “Less-experienced online users are always going to be at higher risk,” Sutherland cautions.

Some criminals, however, are bidding their time by creating sleeper accounts. In this scheme, Wixted says, the criminal creates an account and doesn’t necessarily do anything malicious with it initially. “They create them now and let them marinate for six to nine months,” he says.

These accounts can be spotted because, as is the case with accounts for loyalty or rewards programs, consumers generally don’t create an account and then let it sit unused, he says. There’s usually some driver to use the account, such as snagging points when booking a trip. Many technology providers can determine an approximate identity on online accounts, such as email addresses.

## ‘RIDICULOUS VOLUMES’

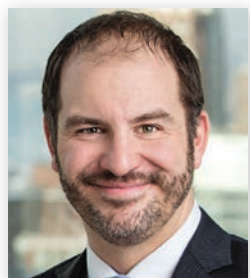
Chargebacks also have proven problematic during the pandemic. As online shopping volume has increased, so too have chargebacks.

“Most of the banks I interviewed have seen between a two- and three-fold increase in non-fraud disputes in the early months of the pandemic,” Aite’s Conroy says. This was compounded by the fact that many banks had offshore call centers that lacked the infrastructure to adapt to a work-from-home environment.

While some issuers have regained control of that, dispute volumes increased as summer travel plans were altered to reflect localized Covid-19 resurgence. “The other leg of the stool is that fraudsters recognize that call centers are seeing ridiculous volumes,” she says.

In the past 12 months, 17% of consumers initiated a payment dispute, says John Buzzard, lead analyst for fraud and security at Pleasanton, Calif.-based Javelin Strategy & Research. “It’s likely this number is going to increase as a result of Covid fallout,” Buzzard says.

“Anecdotally,” he adds, “we are hearing from some major processors that they are seeing an increase in friendly fraud chargebacks in the past two months as consumers have increasingly had buyer’s remorse and continuing financial



## Cheap prices for illicit data make fraud all the more prevalent.

—CHRISTOPHER MASCARO, VICE PRESIDENT OF FRAUD DATA AND FINANCIAL CRIME INSIGHTS, FISERV

uncertainty. This has been different than initial disputes centered around undelivered goods—think travel—that occurred when lockdowns first went into effect.”

The travel-and-hospitality industry saw a lot more disputes that Wixted says were not necessarily related to fraud, but could have emanated from a customer-service issue. A consumer calling to cancel a flight might have been frustrated by hold times, gave up, and chose to file a dispute, he says.

## MENACING ASPECT

The other menacing aspect of the pandemic is that online shopping already is at elevated levels as the fourth-quarter holiday shopping season looms.

One concern centers on whether online shopping will continue to outpace prior quarterly sales. In 2019, fourth quarter e-commerce sales accounted for 11.3% of all U.S. retail sales, according to the Census Bureau, up slightly from 11.2% in the third quarter.

“I don’t know if we’ll see high e-commerce volumes month-over-month,” says Sutherland. “Will it stay at a rate that is higher than 2019? One thing that definitely came out of the pandemic is a level of uncertainty as it related to the economy and as to whether a state remains open or closed. Because of the uncertainty, many consumers are hesitant to make big purchase decisions.”

Criminals, too, may be anticipating the fourth quarter. “Not just

from a fraud perspective, but from an economic standpoint, there may be more opportunistic fraud,” says Fiserv’s Ritonya. “There may be ways we start to see increases in disputes that are not valid.”

In addition to holiday shopping, the fourth quarter also signals a lot of personal-care purchases. “If the current trajectory for [card-not-present] payments continues, we will see a stronger usage develop around the holidays as health needs shift into consumer staples and personal-care items,” Buzzard says.

He adds: “Scarcity will drive demand and the demand, we anticipate, will mostly likely send more than a few consumers to fraudulent Web sites where they will be victimized in some way.” DT

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## OPEN BANKING AND ITS FRIENDS

Big moves by Visa and Mastercard have thrust data aggregators into the spotlight just as the focus of payments is expanding and the aggregation model is modernizing.

BY JOHN STEWART

**LIKE MOST BUSINESSES**, the payments world has been upended by the coronavirus pandemic and its impact on buyers and sellers alike. But just before the virus struck in the United States, Visa Inc. announced it had clinched a deal to shell out \$5.3 billion for Plaid Inc., an 8-year-old financial-data aggregator with links to 11,000 financial institutions.

Those connections are the vital links that let apps like Venmo (peer-to-peer payments), Chime (online banking), and Betterment (digital investing) reach financial institutions and serve users.

It's called open banking, and it's an increasingly essential business, not just for Plaid and not

just because businesses are—tentatively—reopening and consumers are shopping again.

The number of fintech startups that need these links to make their apps work smoothly is growing at a much faster rate. There were 8,775 of them in North America in February, up 52% from the same time in 2019, according to data-collection service Statista. By contrast, that number grew only 2% from 2018 to 2019.

“The number of financial apps consumers are using is growing pretty significantly. The number of payment apps is growing pretty quickly. And that's going to continue,” says Ben Isaacson, a former Mastercard Inc. executive who is now senior vice president for product strategy at The Clearing House Payments Co. in New York City.

The same faster expansion is happening overseas. The Statista numbers show a one-year doubling of fintech startups in the Europe, Middle East and Africa region and a 91% jump in the Asia-Pacific area.

Not only are there more apps, but the apps themselves are adding users hand over fist. PayPal Holdings Inc.'s Venmo service recently reported 52 million users, up fully 30% in one year (chart, page 21). Square Inc.'s Cash App, meanwhile, has hit 30 million users, which means it added 6 million just since the start of the year.



In concert with this app growth, aggregators like Plaid are booking more and more business. The company serviced more than 200 million linked accounts last year, up more than 55% from 2018 and 20 times greater than the number in 2015 (chart, page 22).

No wonder, then, that the card networks are paying attention—and opening their wallets. Mastercard agreed in June to lay out \$825 million in a deal for Fincity Corp., a 21-year-old company whose clients include Brex Inc., a fast-growing startup offering services such as business credit cards and cash management.

“They have very strong connectivity into the banking infrastructure, so we felt they were the right partner for us,” says Craig Vosburg, president for North America at Mastercard.

## A BIG DEAL

Payments providers and other financial services have long relied on data aggregators, but the business—and its technology—are undergoing fundamental changes.

Using prearranged links, aggregators access app users’ financial accounts on their behalf to perform services ranging from identity and balance verification to funds movement. The process makes for a faster, smoother transaction for consumer and fintech alike.

“Fintechs are an important sector in our economy,” says Stuart Rubinstein, chief executive of Akoya LLC, an aggregator spun off in February by Fidelity Investments and now owned equally by Fidelity, The Clearing House, and 11 TCH banks. Between the fintechs and

# TOP 10 FINTECHS

(Ranked by user count in millions)

	USERS	ANNUAL GROWTH RATE
Credit Karma	100	18%
Venmo	52	30%
Coinbase	30	36%
Cash App <sup>1</sup>	30	N.A.
Mint	20	26%
NuBank	15	150%
Toss	13	N/A
Clearscore	10	N/A
Etoro	10	N/A
Revolut	8	167%

N/A=not available 1. Formerly Square Cash Source: Visa presentation January 2020, citing the companies; Digital Transactions updates where available

banks that hold their mutual customers’ accounts, he adds, “We are the underlying connective tissue.”

These links to financial institutions can support a variety of purposes. “Account verification, for example, is one of a variety of opportunities, and something PayPal and Venmo have been applying for quite some time,” says Katja Lehr, director of global payment products at PayPal Holdings Inc. “Another example where PayPal and Venmo are leveraging open-banking data is in our risk decisioning, making sure our customers can use the payment method of their choice.”

But the nature of that “connective tissue” is changing. Aggregators historically relied on a technique called screen scraping, in which the aggregator deploys the app user’s valid credentials to access his accounts at financial institutions. These days, the business is moving toward application programming interfaces to achieve the same ends with safer connections.

APIs are “the new normal,” says Brian Costello, vice president of data strategy at one of the early players in aggregation, Envestnet Yodlee, Redwood City, Calif. “It’s a big deal.”

## 'A BLUNT INSTRUMENT'

The change includes an API standard for data sharing under development by the Financial Data Exchange, a Reston, Va.-based trade group embracing fintechs, aggregators, and financial institutions. The standard aims at what the group calls “data minimization.”

“Screen scraping is going to grab all the data and then sort through it. It’s a blunt instrument,” says Tom Carpenter, director of public affairs and marketing for the group, which operates under the auspices of the 21-year old Financial Services Information Sharing and Analysis Center (FS-ISAC).

By contrast, Carpenter says, the standard restricts data gathering to only the information required to satisfy a specific request.

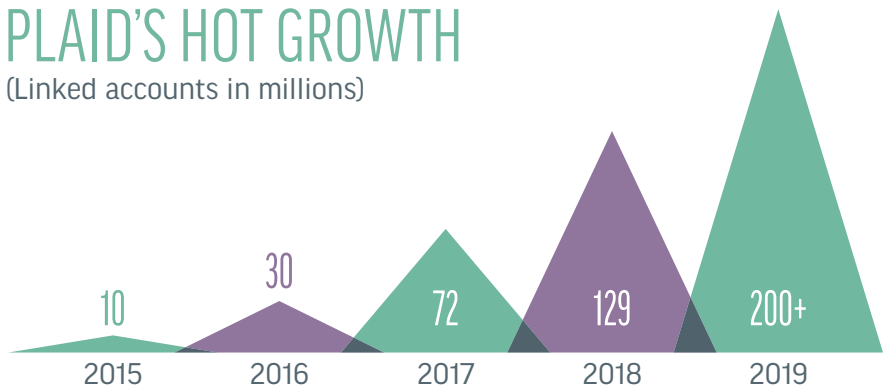
But more changes are in the offing, some experts say, now that Visa and Mastercard are laying out big sums to jump into open banking. The move toward developing a standard for data exchange played a role in stoking Mastercard’s interest. “We don’t see [screen scraping] as a great way for this business to be built,” says Vosburg. Visa did not respond to a request for comment for this story.



Vosburg: “Our strategy is very much founded on payments beyond credit and debit cards.”

## PLAID’S HOT GROWTH

(Linked accounts in millions)



Source: Plaid, as cited in January 2020 Visa presentation

That standardization undergirds what Mastercard sees as a way forward in payments not necessarily based on plastic. “Not every open-banking use case will involve a payment or movement of money, but there’s a reasonable subset that do,” says Vosburg. “Our strategy is very much founded on payments beyond credit and debit cards.”

He cites services like Mastercard Send, the network’s real-time transfer product, and the company’s efforts to develop a blockchain for payments, as examples of that strategy. “All these things can come to bear in an open-banking environment where there are needs to move funds,” he adds.

## 'VERY POWERFUL'

Some observers also see the card networks’ open-banking acquisitions as a way to build pipelines for additional transaction volume in businesses such as bill payment and peer-to-peer transfers.

“This is why Visa paid \$5.3 billion for Plaid,” says Patricia Hewitt, principal at PG Research & Advisory Services in Savannah, Ga. “It gives Visa ownership of all those connections.”

Others see value just in the data the aggregators can spin off, even if it’s anonymized. With these

acquisitions, the card networks have “access to some of the best data on what people do. That’s very powerful,” says Eric Grover, principal at Intrepid Ventures, a Minden, Nev.-based consultancy.

Perhaps the biggest factor, though, lies in efforts to move the United States to a nationwide real-time payments network connecting nearly all the country’s financial institutions. The Federal Reserve plans to have its real-time gross settlement system, FedNow, up and running by 2024 at the latest, for example.

That could put pressure on traditional card-payment networks, some observers say, if FedNow ultimately bumps up against such fast-payment services as Mastercard Send and Visa Direct. But a trend toward real-time payments could also put a premium on managing access by fintech apps to account data as those apps ramp up to compete for transactions that are irrevocable.

As unemployment lingers in the wake of Covid-19, a key to that action will lie in controlling risk, and that’s where the networks’ stake in open banking could hand them an advantage. “The real-time risk is that the money must be there and the user must be who he says he is,” says Hewitt. DT



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The background of the entire page is a vibrant, celebratory scene of Wall Street. It features tall, classical-style buildings with many windows, some of which have American flags hanging from them. The air is filled with a dense shower of multi-colored confetti (red, yellow, green, blue, pink) and streamers. Several large, bright red heart-shaped balloons are scattered throughout the scene. In the lower right foreground, a hand is visible holding a rectangular gift box wrapped in pink paper with a pattern of colorful polka dots. The overall atmosphere is one of excitement and success.

# WHY WALL STREET *loves* PAYMENTS

Shift4 Payments dazzled the payments industry and Wall Street with its June initial public offering. What do recent processor IPOs say about the prospects for payments companies?

BY JIM DALY



## No investment in the stock market is a sure winner, but payments investments often prove to be better than others.

On June 4, underwriters for merchant acquirer Shift4 Payments Inc. priced the company's initial public offering at \$23 per share, above their \$19-to-\$21 target just days before. The next day, Shift4's shares opened on the New York Stock Exchange at \$33.10—an instant 44% gain. Recently, Allentown, Pa.-based Shift4's shares have been trading in the \$50 range.

Not bad, considering that Shift4, which claims about 200,000 merchants generating more than \$200 billion in annualized payment volume, gets more than half its volume from the hospitality industry. After all, its IPO came during the midst of the Covid-19 pandemic, which forced the closure of many restaurants and sent hotel reservations plummeting.

Palo Alto, Calif.-based business-to-business payments provider Bill.com Holdings Inc. last year had expected to get \$16 to \$18 per share from its planned IPO, then upped the target to \$19 to \$21. But with underwriters sensing strong investor demand, the company priced its Dec. 13 IPO of 9.82 million shares at \$22 per share. The next morning, trading in Bill.com's new stock opened at \$37.25 on the New York Stock Exchange, 69% above the IPO price. It's been mostly upward since then. In mid-August, the stock was trading in the \$93 range.



“Wall Street loves payments,” says consultant Eric Grover, principal of Minden, Nev.-based Intrepid Ventures. “Payments remain, nationally and globally, healthy [for] secular growth long term.”



Shift4 and Bill.com have joined a club of about 40 publicly traded payments companies that, in addition to the four U.S.-based global card networks, includes merchant acquirers, online and specialty processors, PayPal, and all manner of tech suppliers.

IPOs let a company's funders cash out on their investments and potentially enable the firm to pay down debt, make acquisitions, and fund product development. But not every IPO is a home run. Striking out is a clear possibility, and sometimes the offering is simply the financial equivalent of a single or double.

The small acquirer Net Element Inc. had an IPO in 2012 but in May announced that it



‘A lot of the payments stocks, even some of the legacy companies ... their stocks have been holding up fairly well.’

—JARED DRIELING, SENIOR DIRECTOR OF CONSULTING AND MARKET INTELLIGENCE, TSG

would explore “strategic alternatives” because “the public markets do not appropriately recognize the value of our business.” The company recently struck a deal to merge with an electric-auto firm interested in its public listing, not its processing business, which Net Element is required to divest (box, page 30).

Merchant acquirer EVO Payments Inc. got off to a strong start with its May 2018 IPO, pricing it at \$16 per share and opening the next day at \$20.05. The stock, which lately has been trading in the \$27 range, largely outpaced the major market indexes in 2019. But it mostly trailed them in the recovery since the market tanked in February and March as governmental stay-at-home orders and related measures to control Covid-19 slammed the brakes on the economy. In late summer, however, EVO made strong gains, outpacing the S&P 500 and the Dow Jones Industrial Average.

As a group, the publicly traded payments companies have done better than the broader market for years, according to merchant-acquiring consultancy The Strawhecker Group.

Starting in the first quarter of 2011, a \$100 investment in a basket of more than 25 payments stocks TSG tracks would have been worth \$670 by 2020’s second quarter, representing a 22% compounded annual growth rate. That compares with \$234 for the equivalent of a \$100 investment in the S&P 500 over the same period, which had a compounded growth rate of 10% (chart, page 28).

“You look at a lot of the payments stocks, even some of the legacy companies ... their stocks have been holding up fairly well,” says Jared Drieling, senior director of consulting and market intelligence at Omaha, Neb.-based TSG.



American Express Co. joined the New York Stock Exchange in 1977, some 127 years after its founding and about 20 years after it got into the credit card business. A \$1,000 investment in AmEx’s IPO would have been worth more than \$446,000 near the end of 2019, according to the financial news and analysis service The Motley Fool. That return doesn’t even include the effects of reinvested dividends.

Spawned by banks, Mastercard Inc. joined AmEx as a global, publicly traded payment firm in 2006 with its seminal IPO—the first for a bank card network. The next year, Discover Financial Services, whose namesake card was founded in 1985 by Sears, Roebuck & Co., finally was spun off as an independent, public company by investment firm Morgan Stanley.

Visa Inc. followed Mastercard in 2008 with a record-breaking, \$17.9 billion IPO. As of late July, Visa’s market capitalization was about \$434 billion—by far the biggest in the payments industry, according to Yahoo! Finance. Mastercard was No. 2 at \$311 billion.

With the Federal Reserve and Congress trying to jump-start the economy, some observers believe now could be a good time for processors to tap the public markets, especially if they offer contactless and online payment options.

“The Fed is flooding the market with liquidity,” says Grover. “It’s been, maybe counter-intuitively, a healthy environment for payment IPOs.”

Adds San Francisco-based analyst Joseph Vafi, managing director for equity research at Canaccord Genuity: “The investor appetite is pretty darn good right now. I think the Covid pandemic has shifted the focus to electronic payments.”

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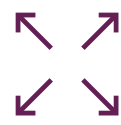
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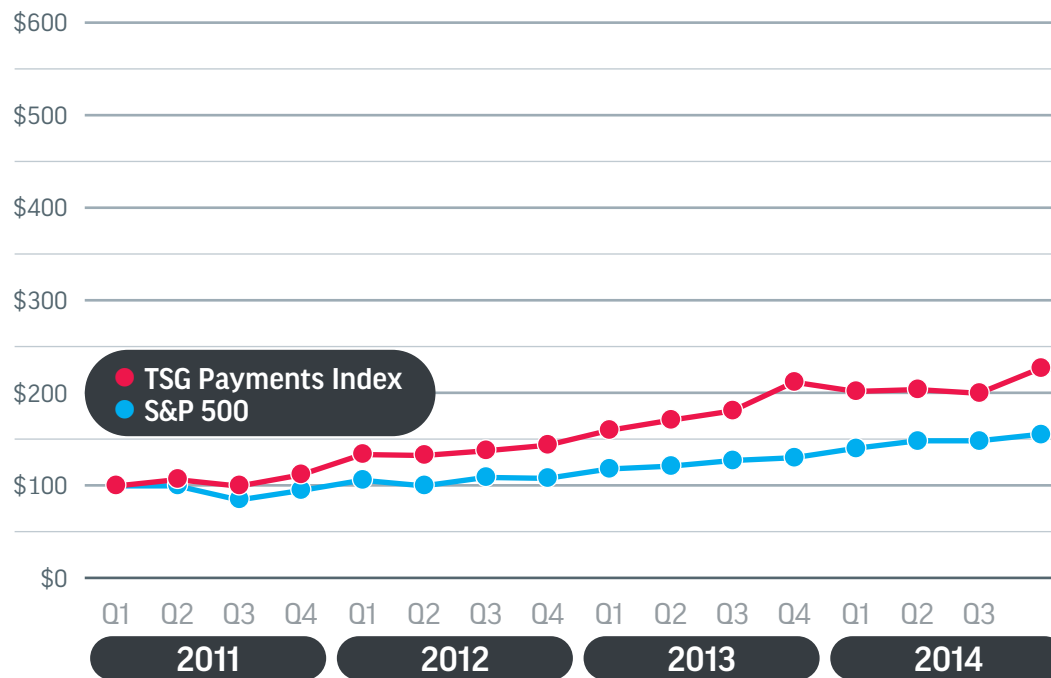


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# PAYMENTS COMPANIES VS. THE S&P 500

Value of \$100 invested in TSG Payments Index compared with the S&P, 2011-20



## 'A LOT OF CASH'

Analysts agree, however, that investors are looking more at the potential long-term returns from payments companies rather than whether they're capitalizing on short-term opportunities the pandemic creates.

Shift4 had been seriously prepping for an IPO since 2018, and actually had its eyes on eventually going public since it was founded in 1999 as the independent sales organization United Bank Card, according to founder and chief executive Jared Isaacman.

"The IPO is a journey, it takes a lot of time," he says.

Shift4 had hoped to ring the bell at the New York Stock Exchange on April 8, but the Covid-19 breakout delayed the "road show"—visits by underwriters and company executives to sell the prospective IPO to potential investors—by two months. "We were a week away from the



road show when the Covid-19 thing came along," says Isaacman, noting the tour was compressed into just a few days in the first week of June.

A Shift4 prospectus estimated the IPO, with 15 million shares to be sold and potentially another 2.25 million if demand warranted, would raise \$315 million to \$364 million in net proceeds. But the offering was oversubscribed and ultimately generated \$497 million in net proceeds.

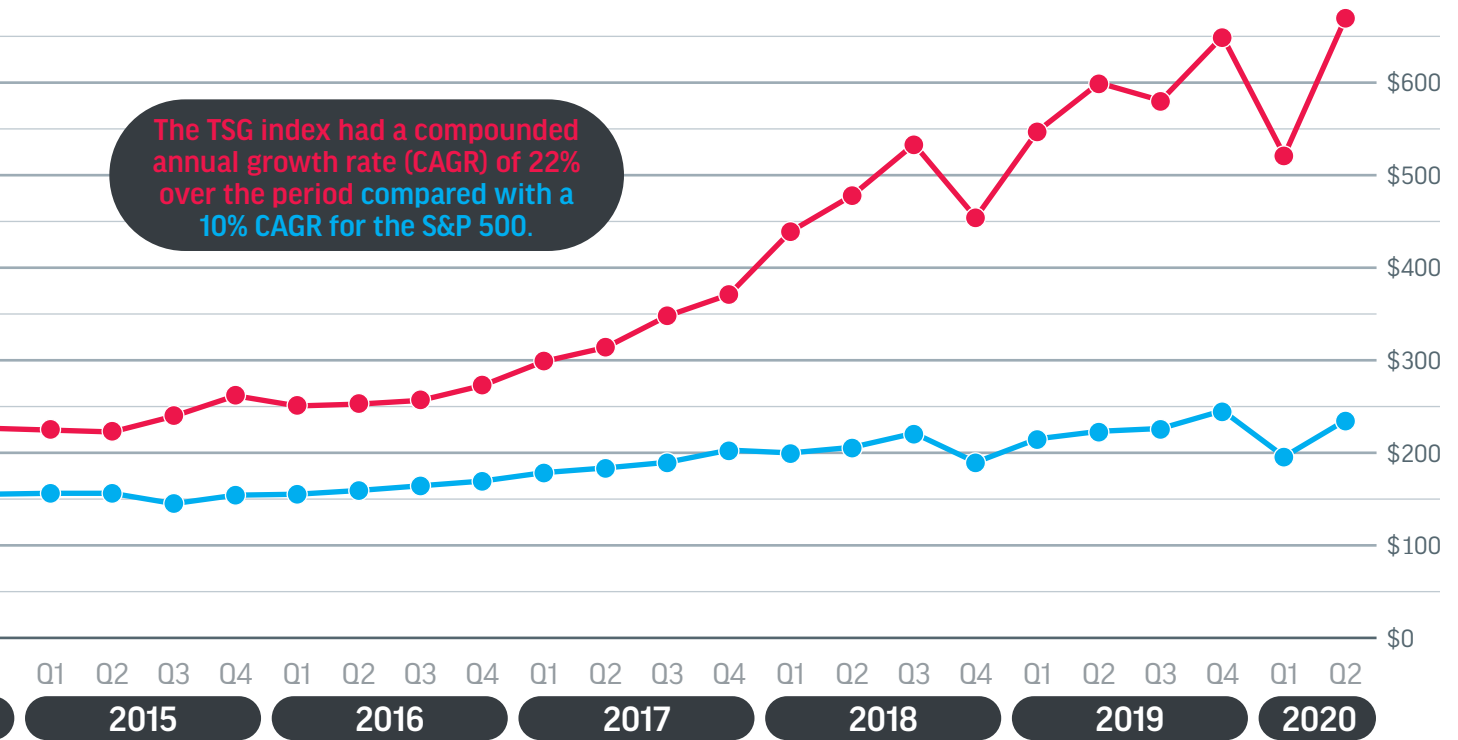
"There was just a lot of demand," says Isaacman.

Under Shift4's new holding-company structure, Isaacman retains the majority economic interest as well as the majority of the voting power. The private-equity firm Searchlight Capital holds a substantial interest, while the public shareholders have about a 22% economic interest but only a single-digit share of the voting stock.

The IPO enabled Shift4 to pay down more than \$285 million in debt "and put north of \$200 million on the balance sheet," says Isaacman.

"We achieved exactly what our objectives were, which were to substantially de-lever, and we put a lot of cash on the balance sheet for good times or bad," he says.

The TSG index had a compounded annual growth rate (CAGR) of 22% over the period compared with a 10% CAGR for the S&P 500.



Source: The Strawhecker Group

## FLASHY ADVERTISING

Isaacman won't say what Shift4 will do with the IPO funds, such as buy another company. Regarding potential acquisitions, however, "We try and keep a decent pipeline," he says.

Isaacman attributes the strong IPO in part to investors noticing Shift4 was gaining share in the restaurant industry, even though many establishments were getting hammered because so few people could eat inside in the spring and early summer ("Cooking Up a Comeback," May).

"We've always taken share from the competition," he says. "Our business can't just be measured in a static basis. We're growing because we're taking so much share." He adds that, "roughly a third of the restaurants and hotels in the country" use at least one Shift4 product, though not all take "our full stack" of software and payment services.



Another factor: Recent mergers have removed some of leading payment processors from the public markets ("Let's Make a Deal," May 2019). First Data Corp. is now part of Fiserv Inc.; Worldpay Inc., formerly Vantiv, is now part of FIS (Fidelity National Information Services Inc.); and TSYS (Total System Services Inc.) is now owned by Global Payments Inc.

"Right now, there is definitely a scarcity of payments assets," Isaacman says.

Analysts say investors gave points to Shift4's suite of software offerings and marketing. "Their technology platform allows disparate systems to connect in," says Gary Prestopino, managing director at Chicago-based Barrington Research Associates Inc. "That gets investors excited."

TSG's Drieling says Shift4's integrated offerings enable the company to capitalize quickly on new market trends. He points to the huge spike in restaurants' demands for online-ordering and related capabilities in response to the closure of inside dining.

"Integrated payments really give you that ability to pivot and focus on channels that are



# WHEN A PUBLIC LISTING IS YOUR MOST VALUABLE ASSET

Sometimes a company's core business proves to be less desirable than its listing on a stock exchange.

Merchant processor Net Element Inc. found that out in June when it signed a letter of intent to merge with Mullen Technologies Inc., a privately held startup that plans to sell Chinese electric sports cars in the U.S. The pending deal requires Net Element to divest its payment-processing business.

In early May, Net Element announced plans to "explore strategic alternatives ... to unlock shareholder value." The company claimed "it appears that the public markets do not appropriately recognize the value of our business."

Net Element did not state a value for the pending deal, but its stock rocketed June 15, the day of the announcement, to close at \$6.90 per share, up 50% from the previous \$4.60 close. For much of the previous year, the stock had been trading in the \$3 range or even less.

Share prices rose and then fell during the summer, closing in the \$9.50 range in mid-August. Yahoo! Finance pegged Net Element's market capitalization at \$35.7 million at that time compared with \$13.2 million as of Dec. 31.

The so-called "reverse triangular merger" is an all-stock deal that will enable Brea, Calif.-based Mullen to go public without having an initial public offering. Mullen will own 85% of the surviving company, install a management team led by founder and CEO David Michery, and get control of Net Element's listing on the Nasdaq Global Select Market. Net Element's shareholders will own 15%.

As of mid-August, no sale of the processing business had been announced. A Net Element spokesperson did not respond to *Digital Transactions*' inquiries.

Besides its North American merchant-processing business, North Miami Beach, Fla.-based Net Element has an international operation based in Russia. Russia generated \$3.2 million of the company's \$65 million in total revenues for 2019, says Lisa R. Thompson, a senior equity analyst who follows Net Element at Chicago-based Zacks Small-Cap Research.

The North American segment processed \$3.2 billion in volume last year, up 10.3% from 2018. The international segment posted \$425 million in volume, down 2.1%.

The post-merger company will be known as Mullen Technologies Inc., and it won't have anything to do with payments. Mullen, which owns eight car dealerships in California and one in Arizona, in addition to the CarHub online auto marketplace and other businesses, plans to import the Chinese-made, electric-powered Dragonfly K50 luxury sports car to the U.S. next year. Mullen also is developing electric car batteries, and even plans to assemble electric vehicles.

While IPOs get more headlines, reverse mergers are another way a company can tap the public equity markets. For Mullen, "it gets them out the door quicker, costs less, pays bankers less," says Thompson.

The letter of intent also requires Net Element to raise \$10 million in a private placement. Mullen shareholders could acquire another 5% of the post-merger company if it generates more than \$100 million in revenue over 24 months after closing.



# 'Right now, there is definitely a scarcity of payments assets.'

—JARED ISAACMAN, FOUNDER AND CHIEF EXECUTIVE, SHIFT4



[growing],” he says. “A lot of those merchants are looking to pivot, and quickly.”

The acquiring industry isn't noted for flashy advertising, but Drieling says Square Inc. and Shift4 have stood out. Shift4 has advertised on the reality TV show *Bar Rescue*, and in July it was designated the “Official Credit Card Processing Company of the Las Vegas Raiders” and the Raiders' Allegiant Stadium, where all payment transactions will be processed on Shift4 technology.

“They've done a tremendous job around marketing,” says Drieling.

Shift4 pioneered the tactic of giving away point-of-sale terminals as a way of booking new accounts, a controversial move copied by some of its competitors. Lately, it's updated that move by offering free QR-code payment technology or free online-ordering, takeout, and delivery systems for restaurants. Isaacman insists any short-term revenue hit through the giveaways is more than compensated for by the revenue the new merchants generate over time.

“We don't need to make money off of the individual service as long as we're winning the long-term relationship,” he says.

IPO and related activity continued throughout the summer. In early August, Atlanta-based payments provider Paya Inc., which is owned by private-equity firm GTCR LLC, announced a planned merger with a so-called blank-check company with a public listing. The combined entity will trade on the Nasdaq.

And while it's not a payments pure play, e-commerce services provider BigCommerce Holdings Inc. had an IPO in early August and saw its share price pop 201% on its first day of trading.



With Shift4 and Paya having partly filled the void of publicly traded payments companies created by last year's mergers, who might be next? Ant Group, the payments arm of China's Alibaba e-commerce behemoth, reportedly is looking at a public offering with listings on exchanges in both Shanghai and Hong Kong. The company's estimated valuation could be upwards of \$200 billion, Yahoo! Finance reported.

*The Wall Street Journal* reported in late July that point-of-sale credit provider Affirm Inc. was exploring an IPO, and Reuters said card-issuing platform Marqeta Inc. was looking to hire investment bankers ahead of a possible IPO.

Although it hasn't made noises about an IPO, talk never ceases about Stripe Inc., whose value analysts estimated at \$35 billion a year ago. Founded by brothers Patrick and John Collison, San Francisco-based Stripe started out in e-commerce services for merchants but also has moved into the physical payments world.

Consultant Grover says Stripe could go public “tomorrow morning.”

“At some point, the venture-capital firms that fund them, and the Collisons, will want to get liquid and will want to go public,” he says.

But today's strong IPO market has no guarantee of longevity.

“The private-finance markets are still pretty robust,” leaving alternatives to IPOs on the table, analyst Vafi says. And if Covid-19 keeps re-surfing, as it was doing in mid-summer, he says the result could be “headwinds in the economy. The public markets may not be as strong in a year.”

Thus, today's lesson may be to get in while the gettin's good. **DT**

## FAST THINKING FOR FASTER PAYMENTS

For financial institutions of all sizes, real-time transfers are likely to be a competitive necessity. But small banks must work out how to balance operational headaches with potential advantages.

BY **JACK BALDWIN**

Jack Baldwin is chairman of BHMI, Omaha, Neb.

**IT HAS BEEN GENERALLY ACKNOWLEDGED** that real-time payments can provide some significant benefits to financial institutions. But for smaller FIs, they come with some very real challenges.

Unlike the case with the current standard for automated clearing house daily payment fulfillment, supporting real-time or near real-time payments requires a true 24x7x365 environment. In addition, companies need to have the appropriate reserves on hand and the necessary staff to support real-time payments monitoring and administration.

It is important for smaller FIs to understand the true requirements, costs, and solutions associated

with real-time payments adoption. Additionally, they need to know what is available now for real-time payments, and what could be coming down the road.

### THE LANDSCAPE

Today, real-time payment networks are being deployed around the globe. These networks allow financial transfers to occur in near real time, permitting a recipient to have access to funds transferred by a remitter within seconds of transfer initiation.

An important aspect of this process is that the recipient will have unrestricted access to transferred funds. What this means is that after a remitter has initiated a funds transfer, possession of those funds is controlled completely by the recipient. In other words, the remitter cannot recall them. What's more, settlement of the whole transfer operation is immediate.

This capability contrasts sharply with traditional settlement methods, which delay settlement completion for hours or even days after a transfer.

This is a model typically followed by most funds-transfer operations. For instance, payments via checks or most wallet based payment



networks are settled via the ACH network. Historically, ACH settlement files are swapped among FIs on a nightly basis. Until this occurs and the involved banks or credit unions have adjusted their internal balances to account for ACH transactions, transferred funds cannot be used by recipients without restriction.

The main reason recipients can't fully take possession of the funds is that, until those nightly settlements have occurred, remitters can implicitly cancel the transfers. A remitter could, for example, write a check to a recipient and then simply withdraw all funds from the source account. Thus, the nightly settlement for the associated transfer will fail because there are no funds available to support it.

This basic remitter cancellation feature is part of many funds-transfer approaches that cause delays in settlement for a period of time. There have been some attempts to shorten the delays. For example, NACHA is offering same day settlement, permitting ACH settlement to occur on the same day as the transfer initiation. NACHA has also proposed an additional daily settlement window to allow multiple ACH settlement operations to occur each day.

However, despite these efforts, there is still a delay that could possibly result in interrupted funds transfers.

## THE RTP NETWORK

Until recently, the only "true" real-time funds-transfer network in the United States was the Real Time Payments (RTP) network. Created and operated by The Clearing House Payments Co., which is owned by most of the country's largest banks,

this solution provides customers of member institutions access to RTP services. These include support for real-time transfers and payments with immediate settlement of all transfer operations.

Rather than directly using ACH settlement, RTP member banks

instead settle among themselves using a common general ledger. This ledger is, in turn, supported by a common reserve account maintained by the Federal Reserve, to which all member banks contribute. Its members are required to maintain minimum reserve levels. If these reserve



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levels fall below a certain amount, additional funds must be deposited.

Since most RTP member banks tend to have large numbers of deposit holders, a sizable number of U.S. customer banking accounts can participate in the real-time payment capabilities it offers.

However, there is a significant number of accounts associated with smaller FIs across the nation that are not affiliated with RTP. For these customers, access to real-time payments may not come as easily. While RTP does offer real-time payment services to smaller FIs that partner with one of its larger member banks or authorized portal organizations, its outreach efforts have been marginally successful at best.

Unsurprisingly, many smaller FIs have reservations about joining a network operated by their larger banking competitors. Though RTP has offered assurances to smaller FIs to further entice them to join, many continue to be reluctant to do so.

## FEDNOW

Recognizing the need to extend real-time payment services to all of the nation's FIs regardless of size, the Federal Reserve last year announced the creation of its FedNow network. Initial estimates by the Federal Reserve suggest the network will be available by 2023 or 2024, though some industry experts have been skeptical of this timeframe.

The FedNow announcement was greeted enthusiastically by most smaller FIs, as the Federal Reserve is generally considered to be more of an "honest broker" or impartial operator of the payments network as compared to a private company or group.



Although FedNow seems promising for smaller FIs, those with fewer resources will be challenged to take advantage of the services.

This helped alleviate the concern that smaller FIs would be disadvantaged if they allied with RTP. However, though the news was positively received, some smaller FIs were disappointed with the four-to-five-year projected lead time before FedNow would be available. As a related correlation, RTP announced an upsurge in interest from smaller FIs following the Fed's announcement.

Although FedNow seems to provide a promising path forward for smaller FIs, banks and credit unions with fewer resources will be challenged to take advantage of the services provided by the solution.

One of the key problems is the issue of reserves. All FedNow settlement will be real-time gross settlement (RTGS), not net settlement. This means that every single transaction will be immediately and irrevocably settled by FedNow.

This is a stricter process than net settlement, which permits a financial institution to be deficient in required reserves for individual transactions as long as proper reserves are available at the end of a specified settlement window.

Thus, each FedNow participant must monitor its reserve level on a constant, round-the-clock basis to ensure reserves are adequately maintained at all times. If an FI does not have the reserves, the FedNow

platform will automatically fail the attempted transaction.

For those FIs not currently required to maintain reserve accounts with the Federal Reserve due to their size, there is also an additional consideration. For these smaller FIs, maintaining a reserve account to support RTGS would be a new operational obligation with additional costs to acquire and commit the necessary funds to cover the new reserve requirements.

Staffing may also be a major issue. Maintaining the staff to cover both normal banking hours as well as the additional 24x7x365 operations will present an increase in workforce and attendant training.

To fully accommodate the FedNow processing demands, these institutions must not only maintain 24x7x365 monitoring staff, they must also have the authority to refresh FedNow reserves if or when those amounts drop below certain levels.

Additionally, there are service expectations to consider with the extended hours. For example, does 24x7x365 operations mean that customer support will also be extended for related issues? FIs will need to decide how they will handle this from both a staffing and training angle.

Anticipating that this would likely be a burden for smaller banks and credit unions, the Federal Reserve is planning to allow participating



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FedNow institutions to designate service providers that can act on their behalf. These third parties will be allowed to submit or receive payment instructions as well as settle accounts of correspondent institutions.

FedNow regulators have not issued any rules or requirements governing the types of organizations that would qualify to be service providers and the type of oversight that they would be subject to by the Federal Reserve. However, these guidelines will presumably be updated as the availability date for FedNow approaches. Regardless of the regulations ultimately issued, smaller FIs that choose to outsource their FedNow operations will also incur the additional fees associated with it.

Another key concern with FedNow is its proposed interoperability with other systems, like the RTP network. While the Federal Reserve has confirmed this is a high priority for the network, it has also admitted to its complexity and that it may be difficult to have this functionality available during FedNow's initial release.

In addition, though the Fed has suggested it is open to exploring solutions for true interoperability between FedNow and other payment networks, The Clearing House has expressed its intention to continue expanding RTP to minimize the need for FIs to sign up for FedNow. Smaller FIs will need to keep this interoperability conflict in mind as they consider their long-term real-time payments strategies.

## DO THEY NEED FEDNOW?

Ultimately, each community bank or credit union will need to decide if FedNow makes sense for its institution.

The Federal Reserve has indicated that FedNow participants will each be assessed a portion of the network's overall operating costs so it can run as a financially self-sustaining platform. Therefore, regardless of the other FedNow issues that smaller FIs must address, there will be additional costs to offer FedNow.

For some FIs, these additional costs could potentially price them out of the network, especially if they have current services that may help provide a semblance of real-time payment capabilities. For example, some FIs currently offer same-day ACH services as their "real-time payments solution," with the expectation that account holders will be satisfied with unrestricted access to funds if they can be available on the same day as payment initiation.

What's more, this service could become an even more compelling option after NACHA adds the additional settlement window to its daily processing. Some smaller FIs may determine that "reasonably fast payments," while not truly real time, are good enough.

It is easy to see how smaller FIs that position themselves as service leaders or innovators may view FedNow services as a marketing advantage, one that distinguishes them in their local markets. However, it is also just as likely that the more conservative FIs may only embrace FedNow if their customers or members demand the service.

## THE FUTURE

Many of the challenges associated with FedNow are still conjectural. However, it does seem safe to assume that the Federal Reserve

is monitoring issues that could diminish its capabilities—or attractiveness—for those FIs that may wish to access FedNow services.

For example, the after-hours liquidity to support RTGS has been suggested as a possible stumbling block for smaller FIs. This could be addressed in a number of ways. One idea would be to use existing reserve accounts as sources to replenish FedNow reserve accounts.




The Federal Reserve has indicated that it may allow existing reserve accounts that currently must be maintained by FIs to be used as sources of funds to automatically maintain the FedNow minimum reserves. If approved, this arrangement could help smaller institutions cover the funds needed for after hours FedNow processing.

Additionally, relaxing the current RTGS requirements for those institutions deemed "well operated" could also provide relief for smaller FIs. As previously mentioned, the

Federal Reserve has confirmed that all FedNow settlement operations will be based on individual transaction settlement, which requires FIs to always have the reserves to support each individual transaction.

But the Federal Reserve already allows those FIs with good operating track records to incur “daylight overdrafts.” These overdrafts occur when a bank or credit union is allowed to withdraw more money



The United States is virtually alone in not having a national fast-payments network operated or directly supervised by its national banking authority. FedNow addresses this imbalance.

than it has in its Federal Reserve account to make a payment with the requirement that the overdraft be corrected by the end of a processing day.

With RTGS adopted as the standard for FedNow, offering a “night-time overdraft” would ease the reserve burden on smaller FIs by allowing their FedNow reserves to temporarily drop below the minimum required levels. For this to occur, however, minimum reserve levels would have to be reset within a specified period of time.

Due to the costs and complexity, many smaller banks and credit unions will be unable—or uninterested—in providing their own additional after hours staff for maintaining 24x7x365 operations. If the Federal Reserve still wants to attract these institutions, a key question becomes who will provide the needed support?

If the Federal Reserve ends up only allowing FedNow processing to be outsourced to correspondent FIs, then the situation becomes very similar to RTP affiliation. That is, smaller FIs will be forced to outsource at least partial operational responsibility to their larger competitors—something that FedNow has otherwise alleviated.

FIs of all sizes outsource various types of processing to outside companies that are non-banks. Fiserv, Vantiv, Jack Henry, and FIS, to name a few, perform several different types of payment processing services for FIs of all sizes. These organizations are not FIs and, consequently, are also not direct competitors.

In turn, it is not hard to surmise these, and similar organizations, will most likely offer after-hours FedNow processing services if the Federal Reserve allows it. This will certainly be a Federal Reserve consideration when drafting final FedNow rules and regulations.

## A QUESTION OF VALUE

As mentioned, there is some debate on whether smaller FIs actually need the real-time payments capability that will be offered by the FedNow network. The short answer is some will and some will not. Frankly, many community banks and credit unions are not seeing much demand

for real-time payments from their account holders. However, a truly national banking system should provide the same service opportunities to FIs of all sizes competing in comparable market segments.

While the RTP network can provide similar services to those proposed for FedNow, RTP is not generally perceived as a neutral network operator. Many smaller FIs have serious concerns about whether it will treat all its clients impartially.

Real-time payments networks are becoming increasingly available throughout the world. The United States is virtually alone in not having a national fast-payments network operated or directly supervised by its national banking authority. FedNow addresses this imbalance.

This is perhaps the greatest value of FedNow to smaller FIs; namely, it will be a neutral, trusted provider of real-time funds transfer services to all financial institutions, regardless of size. Because of this, many smaller FIs will see the network as an opportunity to better compete with their larger rivals in the world of faster-payment service offerings.

However, for smaller FIs, making the jump to implement these services may not be an easy process. Rather than adopting real-time payments processing for its own sake, community banks and credit unions must look to their own specific situations—their strategic business plans, pain points and accountholder needs before making a decision.

Only by understanding the true costs and impacts of issues like 24x7x365 operations and increased administrative complexity can they best choose the right path for their institutions. DT

Will the stupidity  
ever end?

# endpoint

## WHY SIGNATURES WON'T GO AWAY

The networks stopped requiring signatures two years ago. Something else is keeping them alive.

BY PATRICIA HEWITT

Patricia Hewitt is principal at PG Research & Advisory Services LLC, Savannah, Ga.



**“JUST SIGN THIS RECEIPT** and you’ll be all set.” Not being a violent person by nature, it did cross my mind to take the pen and jam it into the checkout counter, glaring defiantly at the clerk, and loudly stating, “NO!”

This is how angry I get at the stupidity of our market.

The payments experience in the United States is like wearing stripes on top and polka dots on the bottom. Both are a cover up, but they co-exist in opposition. That’s what I think about the continuation of a meaningless authentication practice that has been superseded by far better technology.

So, I decided to do a little digging into why this extremely irritating practice is so persistent two years after the card networks announced that signatures were dead and fintech is the Sun King. Here’s what I found.

First, the results from my poll on Twitter. I asked: “In 2018, the card networks eliminated signature requirements. In your opinion, why do merchants still keep asking us to sign a receipt

when we pay with our credit card?” I had 17 responses (not statistically significant, but read on):

**41.2%** - Unaware of Changes

**41.2%** - Needs updated POS

**17.6%** - Better Safe than Sorry

So that’s my Twitter-sphere of payments enthusiasts willing to take the poll. Skeptical that almost half the merchant population in the United States is unaware of these changes, I turned to my merchant expert colleagues for their opinion. Here’s what they told me:

“I think it’s less about software and more about consumers and merchants thinking they need it. Especially the older generations.”

“Merchants don’t know and or don’t trust that they don’t need signatures.”

“...some terminals that capture electronic signatures need to have their software updated, but neither acquirers or manufacturers seem to be interested in spending the money.”

### A POSITION OF POWER

Essentially then, one cohort believes that the acquiring industry doesn’t care what the networks say about



# STRAIGHT TALK FOR ISOs CONTINUES

A Q&A from First American's Angela Carranza and Ross Paup

**Many businesses adopted digital payment technology practically overnight in response to COVID; how have ISOs and merchants adapted to this change?**

**Angela:** When faced with the change to business that COVID caused, successful ISOs and merchants asked, "where do we go from here and how do we get there?" This mindset opened the door to new technology such as contactless payments and expanded service offerings that complemented mobile/on-the-go sales opportunities, both of which opened the door to a new and improved customer experience that will continue well beyond the pandemic.

**Ross:** Because First American offers a full suite of products and has been deploying NFC-enabled equipment and web-based solutions for quite some time, the majority of our merchants were in a position to adjust quickly.

We continue to work closely with our ISOs to ensure merchants are set up to capture payments in every possible manner—in-store, mobile/contactless and online—to mitigate any short-term impact from COVID and accelerate long-term growth.

If there is a silver lining to this pandemic, it's that both merchants and consumers are embracing new technologies and payment methods.

**What strategies can ISOs implement to help slow adopters get on the contactless band wagon?**

**Angela:** Speak to the safety aspects—both for employees and consumers—of touchless technology as well as the speed; contactless payments can save as much as five seconds per transaction. ISOs need payment solutions that enable their merchants to serve customers in both physical and digital environments, and contactless payments are the answer. First American, as part of its mission to provide maximum flexibility for businesses of every size and type, currently offers nine contactless device options.

**Ross:** Education is key. We are working with our ISOs to help merchants recognize the benefits of contactless payments and to explain how easily they can add/activate the capability on new or existing equipment. Consumer demand drives merchant behavior, and consumers want contactless solutions for both the health aspect and the convenience.

First American manages its equipment in-house—we don't utilize third-party fulfillment—and we are responding quickly and efficiently to ensure our merchants are set up to capture payments in every possible manner.

**Any pitfalls from this digital world that you are helping ISOs/merchants navigate/resolve?**

**Angela:** With new payment methods come new opportunities for fraud. First American is committed to protecting our partners and our merchants. Our solutions and gateways are fully compliant with PCI-DSS requirements, we monitor transactions to address or reject any that are risky, and we



Angela Carranza is Manager, Strategic Partnerships



Ross Paup is Senior Manager, Strategic Partnerships

provide data breach protection, offsetting fines incurred in the event of a supposed or actual security breach.

**Ross:** There is a lot of pressure on business owners right now to keep their doors open and pay their employees. First American has the technology our partners need to serve their customers in alternative ways; it is our job to educate them about this technology, and to dispel any misconceptions about high cost or complexity of integration that might keep them from adopting it. Change is never easy, but we have the tools our partners need to survive and prepare to once again thrive.

**The lines between ISOs and ISVs are blurring; how are ISOs capitalizing on payment integration opportunities?**

**Angela:** More and more merchants are looking for payment solutions that can also simplify business operations, and that's where software solutions come into play. The convergence of ISOs and ISVs are helping businesses of all types offer card present and card not present solutions to enhance payments with inventory, billing and reporting capabilities. Partners, like First American, who provide integrated solutions are helping ISOs build, monetize and protect their merchant portfolio.

**Ross:** First American has extensive experience working with both models and we are able to provide a variety of integration options to help any business enhance their payment capabilities. Many of our tools are geared toward integration opportunities, including 1stPay Blaze, a customizable online application tool that allows partners to board multiple merchants in one fell swoop, while controlling pricing strategy and terms for each.

**What do you see in your crystal ball for payment technology in 2021?**

**Angela:** I have no doubt that the rapid evolution of payment technology will continue, with contactless and digital payment options at the forefront, and that forward-thinking companies who can adapt quickly will leave others to catch up or fail.

**Ross:** The "new normal" will be fueled by contactless payments or mobile point of sale technology as merchants and consumers continue to embrace alternative channels like curbside and delivery.



signatures. If there's no perceived financial upside to the change and it's not mandated, then rule changes can be ignored. Let's just keep doing it because it's a sunk cost and changing it would require investments.

But wait. What about acquirers' ability to update software on the POS device? Isn't that a core fintech competency that allows acquirers to get new services quickly into market? Shouldn't this change be part of normal software-compliance updates?

No Virginia, that's not how compliance updates work. How it works is that someone or some group reviews all the compliance changes scheduled by the networks. Then, they check off all the ones that are required and cherry-pick the rest. If it's too much effort for too little benefit, and merchants aren't asking for it, the change gets shelved. Result: software updates relevant to signature capture gather dust.

Then why aren't merchants taking it upon themselves to eliminate the signature step in their checkout process? Wouldn't that improve efficiencies in throughput?

Yes, Virginia, it would. But since when has the U.S. payments market

become laser-focused on efficiency? We still process millions of checks each year.

This is not exactly a hip market. We do things the way we do things. Except when we don't, and then we change things, except when we don't because we don't want to. It's the idiotic logic of our free-market system in all its insane glory.

OK. Then why don't merchants just stop the practice? Because, Virginia, the truth is that receipts contain all sorts of information related to the transaction, like refund policies or delivery charges or the all-important survey.

Asking for a signature puts the merchant in a position of power. They can remind consumers who are asking for a refund that the policy is clearly stated on the receipt they signed. Because I always carefully read my entire receipt before I sign it, don't you?

## THE PAYMENTS MUSEUM

Let me be clear. Signature authentication belongs in the payments museum along with knuckle-busters and checkbooks. The card networks

could mandate the change, but that's not going to happen. So, let's consider why merchants still ask for signatures:

**Ignorance of Changes** It's likely they received some kind of update regarding this (I'm being kind), and simply didn't read it. However, acquirers could keep it on the list of update notices and periodically remind them.

**Software Update** POS software has to be updated periodically, and this update could be included as part of an overall modernization effort by the processor. One can wish.

**Signatures Serve Multiple Purposes** Merchants dealing in big-ticket items need to ensure their customers understand refund or delivery policies. But using the card receipt as a communication mechanism lacks technical creativity. I challenge the market to do better!

You may read this piece as a tongue-in-cheek treatment of one of our quaint payment practices here in the United States. I respect that, but don't turn away from the real issues.

First, the card networks have not been shy about mandating other big changes, so why not this? My guess is that the big processors wanted them to back off as they are still grappling with EMV-related terminal and software upgrades. Announcing this change produced a nice brand bump, though.

Second, merchants have hijacked receipts for purposes unrelated to card authentication. There's little will to find a better way.

Forget all the pronouncements about the importance of the consumer experience. The truth is, it's the merchant experience that really matters. DT

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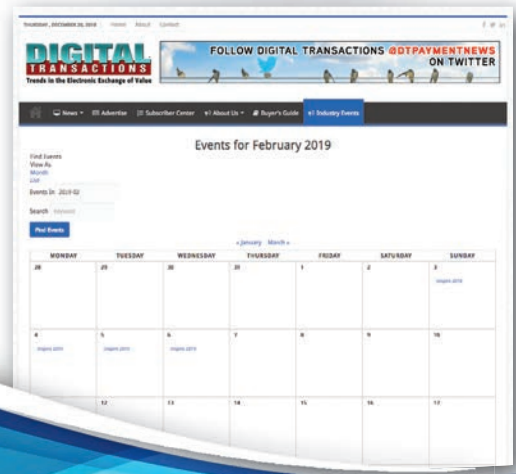
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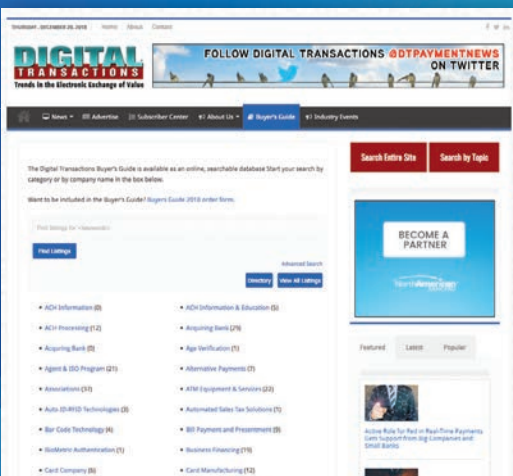


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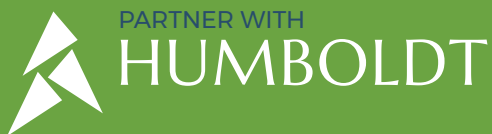


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