DIGITAL TRANSACTIONS

Trends in the Electronic Exchange of Value

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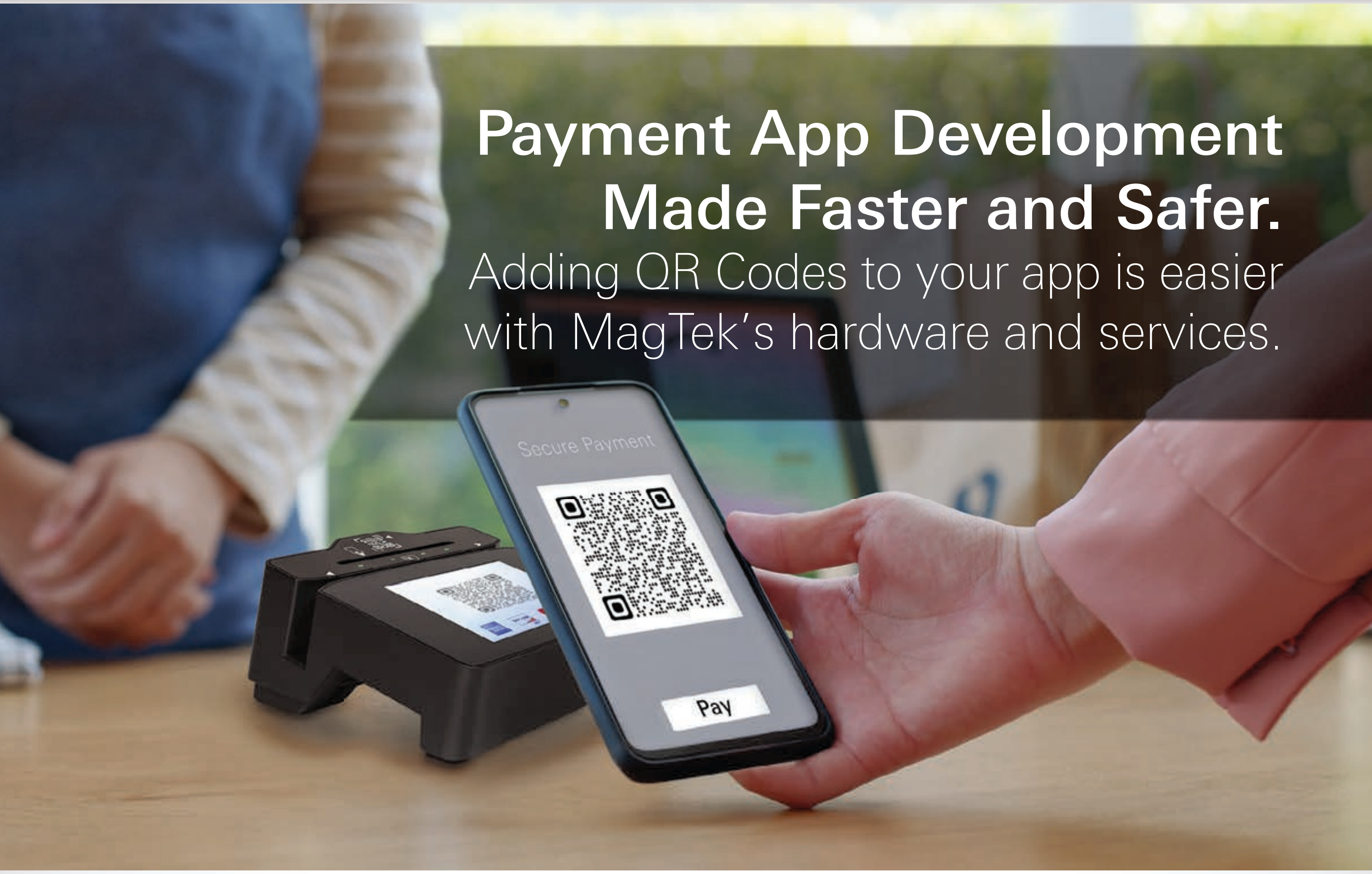

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the gimlet eye

A CROSS-BORDER COMEBACK

PUMMELED FOR NEARLY two years by the coronavirus pandemic, payments networks have lately found cause for optimism in a key market: cross-border travel. Hit hard by pandemic restrictions, that business is staging a comeback.

Mastercard Inc. reported in mid-April its cross-border volume in March climbed above numbers last seen in 2019. Earlier, Visa Inc. said its March-quarter growth in cross-border volume "remained robust," with a 38% increase in transactions over the same period last year. Excluding transactions within Europe, the volume increase was even more robust, at 47%.

An easing of travel restrictions has had much to do with the improvement, said Sachin Mehra, Mastercard's chief financial officer, during an earnings call this spring to discuss the company's first-quarter results. The improvement, he added, has occurred "faster than we expected. We are off to a strong start to 2022 with the recovery of cross-border travel."

For Visa, too, the recovery "was stronger than we expected," said Vasant Prabhu, Mehra's counterpart at Visa, during that company's earnings call. The comeback in the business is particularly notable, he added, because cross-border transactions tend to be highly profitable for the network. Disruptions caused by Russia's invasion of Ukraine have not impacted cross-border traffic "so far," Prabhu added. But for Visa, at least, the level of transactions is "still below" that seen pre-pandemic.

Cross-border transactions—those in which the issuing country is not the same as the merchant country—matter to the card networks as a barometer of the health of their international, markets and of the networks' ability to serve those markets. The onset of Covid-19 two years ago threatened that ability, though it also had the effect of boosting e-commerce traffic globally.

With respect to the Ukraine war, much the same can be said of Mastercard, which reported its cross-border volume was up 53% compared to the first quarter of 2021. But excluding Russia, where both Visa and Mastercard have shut down processing following the imposition of sanctions on that country, the increase was still 52%. For April through the 24th, Mastercard said its volume increased 60% compared to that period last year, while the increase excluding Russia was 65%.

In sum, "cross-border [activity] is still fundamentally sound," pronounced Mehra. In fact, he pointed out, improved consumer spending overall is helping to drive the cross-border trend line back to pre-pandemic normality. Unsurprisingly, much of the improvement in cross-border business can be attributed to a lessening of restrictions put in place early on to combat the spread of Covid, both card networks said.

Maybe, just maybe, the industry can now begin to put the bad news of the last two years behind it.

John Stewart, Editor | john@digitaltransactions.net

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PUBLISHER Robert A. Jenisch

EDITOR-IN-CHIEF John Stewart

SENIOR EDITOR, DIGITAL
Kevin Woodward

CORRESPONDENTS
Jim Daly, Peter Lucas

ART DIRECTOR/PRODUCTION EDITOR
Elizabeth Novak

DIRECTOR OF ADVERTISING
Robert A. Jenisch, 877-658-0418
bob@digitaltransactions.net

ADVERTISING SALES REPRESENTATIVES
Robert Mitchell, 877-658-0418, x7
bmitchell@digitaltransactions.net
Rob Akert, 877-658-0418, x6
rakert@digitaltransactions.net

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

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trends & tactics

THE NEW FACE OF BNPL

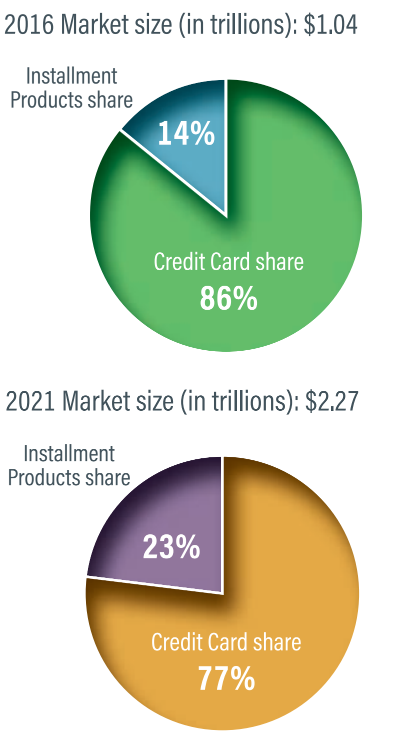
At least some payments players appear to be preparing for an important new phase in the buy now, pay later business, with an opening salvo to include significantly larger loans and revised credit terms that make the advances appear more like traditional installment programs.

The move comes as the short-term point-of-sale lending gambit's skyrocketing popularity has attracted scrutiny from federal watchdogs, including the Consumer Financial Protection Bureau, which contend some consumers are being induced to take on more debt than they can handle.

"The regulators are going to catch up with all of this," warned Brian Shniderman, U.S. chief executive for OPY USA Inc., a unit of Australia-based BNPL player OpenPay Pty. Ltd. Shniderman spoke last month at a national payments conference in Nashville, Tenn., convened by Nacha, the rules-setting body for the automated clearing house network.

THE LATEST INSTALLMENT

(Growth of BNPL and POS financing)



Source: Nacha Consulting

In sharp contrast with the low-value POS loans that have characterized the BNPL craze of recent years, companies like OPY offer instant financing for big-ticket costs such as medical bills, automotive repair, home-improvement projects, and college tuition. Now, the company is making a big move in the U.S. market, Shniderman told the Nacha audience. "It's not buying tennis shoes. It's for more important needs," he said. "And it's very inexpensive for consumers as long as they pay on time."

Shniderman predicted the BNPL business will consolidate as new federal rules take hold, driving up lending costs. "It's going to get regulated, and [some] can't meet the cost of compliance," he said. Current providers will also struggle with their inability to finance bigger tickets, he said, along with the need to invest in technology needed for data collection.

In a demand letter sent in December to five major players, the CFPB requested information related to three main areas of concern, including the potential for overspending by consumers who rely too heavily on the readily accessible point-of-sale credit.

What Shniderman called BNPL 2.0 will shift much of the cost of POS lending activity to the merchant, he said, with big-ticket sellers expected to be able to shoulder the expense. “We can do better if we have a large pool of participants so they don’t get hit with all of the cost,” he noted.

The market OPY is targeting is big and growing rapidly. Installment lending at the point of sale has grown from 14% of a $1.04 trillion unsecured U.S. lending market in 2016 to 23% of a $1.27 trillion market last year, according to figures Shniderman presented. Credit cards account for the balance in both years.

Along with this growth, he argued, will come an evolution toward consumers sharing the cost of lending with merchants. Terms, now typically four equal payments over a six-week period, will lengthen as the service is aimed at larger-ticket goods.

Instead of the younger audience now said to be using BNPL, the user base will shift toward older consumers using the funds to pay for non-discretionary goods and services. Users will be savvier credit users and be subjected to credit checks, but the service will sustain higher loss rates and be subjected to regulation, Shniderman predicted.

OPY has already reached an agreement to install its service in terminals from Worldpay, the big acquiring operation that is part of FIS Inc., Shniderman said. More such agreements are likely, owing in part to deals with independent software vendors, the developers that weave payments capability into business technology. “Our favorite way is [for it to be] embedded by ISVs,” he noted.

—John Stewart

SQUARE AIMS AT CHECKOUT WITHOUT FRICTION

Aiming to help developers address friction at checkout, Block Inc.'s Square unit late Thursday announced several new tools for its Square payments platform. The announcement was made at Square Unboxed, Block's annual developer and partner conference.

The centerpiece of the new tools is Cash App Pay for Developers, which enables developers to add the Cash App Pay payment method to their Square-powered online checkout flow with a few lines of code using Square's Web Payment SDK (software developer kit). The smoother integration capabilities can help developers reduce friction at checkout for the 70 million active Cash App users in the United States, Block says. Cash App Pay for Developers is available in the U.S.

Cash App Pay, which launched in 2021, can be used at Square merchants and allows consumers to initiate a payment from their Cash App wallet by scanning a Quick Response code or touching a button on their mobile device. Cash App, which launched in 2013, includes features that allow users to pay each other, invest in stocks, and buy and redeem Bitcoin.

One merchant segment expected to benefit from the new tools for Cash App Pay is health care. "Enabling patients to pay with Cash App for their health-care services and prescriptions allows health-care organizations to further increase financial accessibility and inclusivity, especially for the growing population of patients that primarily utilize non-traditional banking," John Bona, co-founder of Reference Health, a payment platform for health-care organizations, says in a prepared statement.

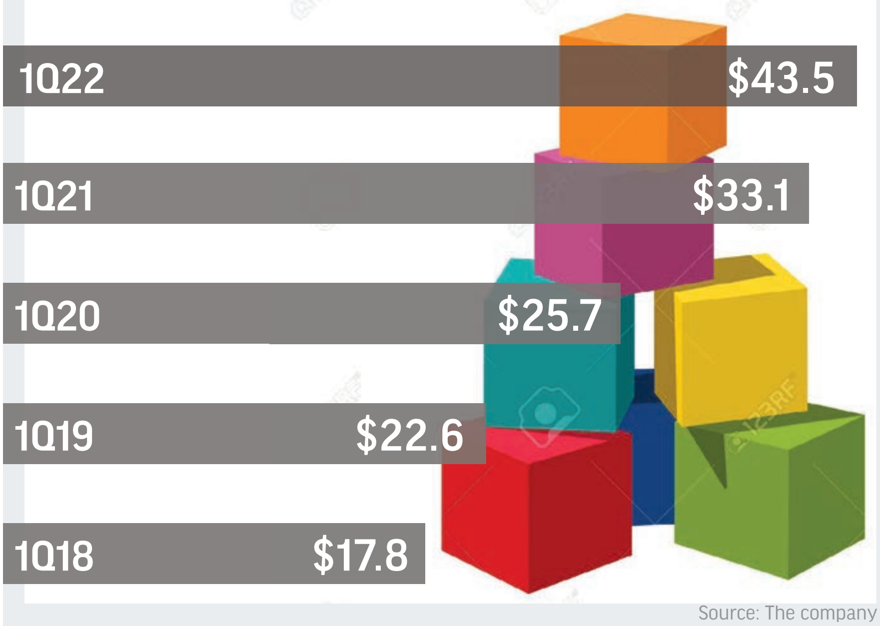
"Health-care organizations need to accept any and every form of payment the patient is willing to use—including supporting accepting payments from the growing category of mobile payment apps," Bona adds.

In addition to the tools for Cash App Pay, Block also introduced two new application programming interfaces—Bookings API and Checkout API—to help developers and partners build and enhance commerce solutions for Square merchants. The Bookings API enables developers to leverage Square Appointments within their apps. As a result, developers can create and manage bookings, search availability of staff members, and send automated text and email reminders, among other features.

The new API will give sellers the opportunity to list their services on their platforms, while being able to see that appointments booked from these platforms are automatically entered in their Square Appointments POS. "This launch includes robust APIs for our larger demand-gen partners, as well as APIs for businesses to customize and integrate their booking experience across their buyer surfaces," a Square spokesperson says. Bookings API is available in the U.S., Canada, the United Kingdom, Spain, Australia, and Japan.

BLOCK BULKS UP

(Gross processing volume, in billions)



Source: The company

Checkout API is a way for developers to integrate into their workflow a hosted checkout page that works via text, Web site, internal dashboard, and in store, with minimal code. The new version of the API offers flexible configuration and supports Afterpay, a buy now, pay later provider acquired in January, Cash App Pay, and Square Pay. Checkout API is available everywhere Square operates globally.

"It is a much simpler way to implement online checkout than fully piecing together all of Square's APIs in a custom checkout," says the spokesperson. "Our latest API version is even simpler to integrate and introduces much more configurability. Plus, the API comes pre-built with flexible payment methods like Afterpay and Cash App Pay."

Finally, Block is testing new features for Terminal API, which launched in 2020. The features unlock new omnichannel use cases and include order itemization on the Terminal device, delayed capture to authorize a payment upfront and collect funds later, card-on-file for recurring purchases, and app fees so developers can monetize services for payments processed via Terminal API. The new beta features are available in the U.S.

In an address at the Square Unboxed conference, Vijay Vachani, Square's head of partnerships and developer platform, said more than 900,000 active sellers are using partner integrations on Square's platform, a 10% increase year-over-year. He added partners are seeing more profitability by leveraging Square's platform, with a 150% growth of payouts year over year.

—Peter Lucas

FOR GROWTH, PAYPAL COUNTS ON ITS SUPER APP AND SLICKER CHECKOUT

PayPal Holdings Inc.'s top management made it plain at their last earnings call they're not backing down from a strategy they outlined earlier this year that made it seem the payments giant was abandoning an emphasis on sheer growth in favor of increased user engagement. That impression disappointed analysts who follow the company and shaved nearly 20% off its stock price the following day.

But this spring chief executive Dan Schulman has added some context to that strategy, emphasizing PayPal is seeking growth through existing and new products, including its newly revamped digital wallet and an improved checkout for online merchants. That strategy, he made plain, leaves little room for overnight expansion via acquisitions.

"Transformative acquisitions are not on our agenda at this time," he told equity analysts during a call to discuss PayPal's first-quarter results. "Make no mistake. We have strong convictions on the growth prospects for our business, however, we believe the secular tailwinds from digitization and e-commerce are transformative. We believe we will continue to grow revenue faster than e-commerce growth."

At the same time, Schulman acknowledged PayPal's plunging stock price—a trend that began well before that somber Feb. 1 earnings call—has hurt investors. PayPal closed at just shy of $80 per share in mid-May, down from well over $200 six months ago. "Our investors expect more from us than we have delivered. We need to do better," he said.

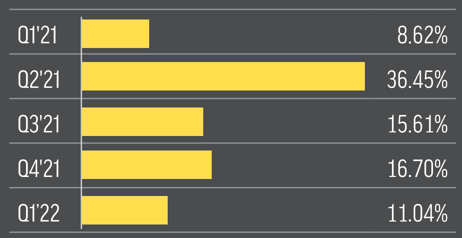
As he has in prior earnings calls, Schulman underlined engagement, the number of transactions performed per account, as a clear priority. This number stood at 47 in the first quarter

MONTHLY MERCHANT METRIC

Total Same Store Sales YOY Growth %

This is sourced from The Strawhecker Group's merchant datawarehouse of over 3M merchants in the U.S. market. The ability to understand this data is important as SMB merchants and the payments providers that serve them are key drivers of the economy.

All data is for SMB merchants defined as merchants with *less than $5M in annual card volume* as well as *Standalone Merchants Only*.



Metric Definitions: (Only use definitions related to an individual month's release)

Same Store Sales YOY Growth % - Annual volume change/growth of retained (non-attrited merchants with positive revenue and volume) accounts for given period divided by total portfolio volume from same period of the prior year

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

Payments Experts. Powerful Data. THE STRAWHECKER GROUP on 429 million active accounts, up from 42.2 on 392 million accounts in the first period of 2021. Here, he said, the new wallet, which PayPal dubbed a "super app" upon its debut last year, will play a key role. "We clearly think the world is continuing to digitize, and the wallet is going to be one of the key elements of how we continue to drive engagement," he said.

PAYPAL'S GROWTH IN THE SCHULMAN ERA

	2015	2019	2021
Active Accounts (mil)	1,800	49%	$420
Transactions (bil)	1,200	58%	$307
Payment Volume (bil)	743	72%	$187

The new wallet offers a panoply of features, including an array of payments, shopping, and financial capabilities, and represents the company's first complete redesign of its app in seven years. It also enables cryptocurrency transactions. Now, Schulman said, it can help PayPal unlock more volume, referring to the fact that 30% of PayPal's users account for 80% of current payment volume. "There's a ton of growth we can have," he said.

Meanwhile, increasing checkouts is now a priority, as Schulman cited a statistic indicating fewer than five out of 100 consumers who visit a merchant's site proceed to check out, "We are thinking about the next generation of checkout," he said. "There's a lot of interest from merchants, and no one can do that as well as we can." He acknowledged, however, that "checkout is a hard business."

The tactical emphasis on checkout and the new digital wallet comes as PayPal bids farewell to its longtime chief financial officer, John Rainey, who left to join Walmart Inc. His role is being filled by Gabrielle Rabinovitch, who is serving as interim CFO.

For the quarter, PayPal processed $323 billion in total payment volume, up 13% year-over-year. Revenue totaled $6.48 billion, a 7% increase.

—John Stewart

PAYSAFE EXTENDS ITS NORTH AMERICAN IGAMING REACH

Online gaming in the United States is attracting a number of payment processors, but few so much as Paysafe Ltd. In its latest deal, the U.K.-based company is working with Strive Gaming, a player-account management (PAM) platform designed to meet multi-state iGaming requirements in North America.

With an integration of Paysafe's payments technology into Strive Gaming's PAM platform, Strive's clients will enable gamers to deposit funds into their accounts using a credit or debit card, and have access to Paysafe's Skrill USA digital wallet, which was upgraded during the fourth quarter of 2021 to include Paysafecash and paysafecard eCash solutions for gamers who prefer to wager online with cash.

Paysafe, which last month announced a partnership with Playtech plc, a provider of gambling software to the United Kingdom and Europe, will also provide real-time reporting and analytics for the monitoring of transactions to optimize online payment acceptance and enhance security to protect player and operator data.

This latest partnership expands Paysafe's existing relationship with Golden Nugget Online Gaming by extending Paysafe's technology to Golden Nugget clients in Arizona and Ontario, Canada. Paysafe already services Golden Nugget in several states, including Michigan, through a separate agreement.

"Integrations and partnerships at the deepest levels, and quickly achieved, are a hallmark of our tech stack with no technical debt," Strive Gaming chief executive Max Meltzer says in prepared statement. "Strive Gaming has become a leading platform in the United States and Canada quickly because of our scalable technology, enabling speed to market and efficiencies for leading operators. Integrating and collaborating with Paysafe makes so much sense for our customers, and we are pleased to be working with Paysafe now and over the long-term."

In an earnings call with analysts last month, Paysafe announced total payment volume, excluding embedded finance volume, came $31.2 billion for the latest quarter, a 13% increase from the same period a year earlier. Volume from embedded finance totaled $4.4 billion, the company said. In addition, Paysafe's acquiring volume in the U.S. increased 21% year-over-year.

The company also reported continuing progress in its wallet business, which consists chiefly of the Skrill and Neteller products. Its digital-commerce business overall grew 2% to $11.3 billion in volume, but revenue fell 11% to $198.5 million.

—Peter Lucas

CRYPTO AND MODERN-DAY ALCHEMY

BY GIDEON SAMID
gideon@bitmint.com

ISAAC NEWTON AND Robert Boyle were two geniuses who labored with passion on their vision to replace gold digging with science: alchemy. It was an overshot. But their labor lay the groundwork for modern chemistry. Hundreds of years later, brilliant mathematicians try to replace gold digging with cryptographic tools. History repeats itself.

Elements coming forth in Bitcoin are used today to endow society with cyber money: account public visibility, zero knowledge proof. Alas, as with the alchemists of yore, the core vision was not sustainable. It was exciting, nonetheless, offering *unguided community consensus; disallowing any minority of elites to dictate to the majority*.

Bitcoin enthusiasts view central banks as oppressors. They claim that mathematics will come to the rescue. But without authorities to sort out the nodes of the network, one scheming individual could establish a myriad of nodes, and lay claim to undue power. Satoshi Nakamoto fixed this flaw. Instead of node count, use labor count to allocate power (mining), Nakamoto said.

This helped somewhat, but not enough. The few, the rich, invest in mining equipment and disrupt the fair and balanced allocation of power. It turns out that whatever the mathematics, a smart and resourceful minority can bend it to their advantage. This minority is well hidden, so there is no clear address to hold accountable, to rectify the distortion. The advantage of a central bank is that it does have an address and there are means to fix things.

Once alchemy climbed down from its unattainable vision to cook gold in the old lab, the door was opened to the marvels of chemistry. Once crypto drops the dream of payment without an accountable social entity, the beauty and benefit of digital money will come into full bloom.

Bitcoin's combined message of public-account visibility and zero proof of knowledge is, no doubt, brilliant. It replaces secret bank accounts with publicly visible records where the account owners can prove ownership without revealing what they wish to keep private. This allows for the transactional history of each digital coin to be made public while offering privacy to the traders.

Now that is a negotiable mathematical challenge. Today, most crypto coins rely on a single algorithm (Elliptic curve). This algorithm's days are numbered, assailed as it is by the looming quantum computers. Yet, the zero-knowledge concept can be rescued by countermeasures. BitMint, for instance, applies algorithmic mutation. Much as Covid-19 survives through mutation, so digital coins can mutate their base algorithm and stay ahead of their predators, manifesting mathematical decentrality.

Bitcoin money is self-referential. It does not exist outside the Bitcoin protocol. This *nothing-to-something* process faces the reverse prospect of *something-to-nothing*. By making cyber money *other-referential*, it becomes a digital claim check to an asset that draws its societal value from deeper roots, and hence increases stability and reliability.

This notion opens the door to manifestation of decentrality. Every asset of transactional value—be it a fiat currency, real estate, any license, specified rights—can be traded through digital claim checks. And every entity commanding some measure of public trust (not necessarily banks) may offer such digital strings to represent those assets. Lively competition will blossom along with a large variety of coins, which will combine and attain ever-growing stability and utility.

Many closed doors stand in our way. Let's open them one by one and find out what's behind them. Hundreds of years after the failure of alchemy, modern chemistry discovered that gold can indeed be created from other elements. Who knows what insight awaits digital money as it is used to lift society to new heights? DT

THE NEW PAYMENTS FRONTIER

BY BEN JACKSON
bjackson@ipa.org

AS ELECTRIC CARS become more numerous, America needs a new kind of "gas station" that allows drivers to recharge their batteries. The question is, how will they pay?

The federal and state governments want to encourage the adoption of electric vehicles by helping to solve the refueling problem that has concerned buyers from the beginning.

The U.S. Departments of Transportation and Energy announced in February that the Biden Administration's infrastructure law would make nearly $5 billion available to build out a national electric-vehicle charging network. The Department of Energy's Alternative Fuels Data Center reports that, between 2015 and 2020, the number of charging stations in the United States more than doubled, and in 2021 grew by more than 55%, from 31,738 to 50,054.

By comparison, the Bureau of Labor Statistics said the United States had 108,461 gas stations as of the third quarter of 2021. Payments are standardized for gas sales, making them accessible to all drivers. The electric-vehicle recharging industry needs to catch up, and regulators want to ensure open access.

Tesla Inc. built its own charging stations, which are for the exclusive use of its customers. Tesla owners have a payment account on file with the company, and the charger communicates directly with the car for payment.

If charger providers follow Tesla's lead and create their own payment systems, that could be a barrier for drivers. To prevent this, California, which wants 100% of new-vehicle sales to be electric by 2035, prohibits mandatory memberships to use publicly available changing stations and requires that stations accept EMV cards.

Station operators can offer subscriptions and memberships along with open payments. Vehicle manufacturers are still allowed to have their own proprietary charging stations.

Last year, the Federal Highway Administration published a request for information to ask what conditions should be put on grants to increase the availability of chargers. In its comment letter, ChargePoint, a third-party charging-station company, advocated for "technology agnostic" open payments. A letter signed by 14 charging companies said the rapid pace of development of payments technologies means no specific payment technology should be mandated.

In its letter, Ford Motor Co. said that it was developing charging stations and a payment app that includes "FordPass" for payments. The letter also said Ford is working on recommendations on when and where to charge during a trip and navigation to nearby charging stations. It is worth noting that Tesla offers similar services.

This could open the door to road trip apps that would help people find and pay for charging, for places to eat, and for places to stay. These apps could incorporate services such as roadside assistance, attraction information, and even regularly scheduled maintenance. The best of them will also likely allow drivers to toggle between different payment types and maybe even provide tools like savings purses for people to prepare for their vacation in advance.

One concern is the ever-present digital divide. In February, the California Air Resources Board noted that "contactless payments alone are not sufficient for lower-income drivers who may not have a tap-enabled smartphone." Developing products for low-income people to pay for charging will be another innovation opportunity for payments providers.

Charging-station operators will need to balance access and innovation. Electric-vehicle drivers will welcome discounts and loyalty rewards on battery charging, as they do for filling gas tanks. Operators will want to make sure that the charging stations in front of their convenience stores, restaurants, and service bays are welcoming to as many drivers as possible, regardless of their payment method. DT

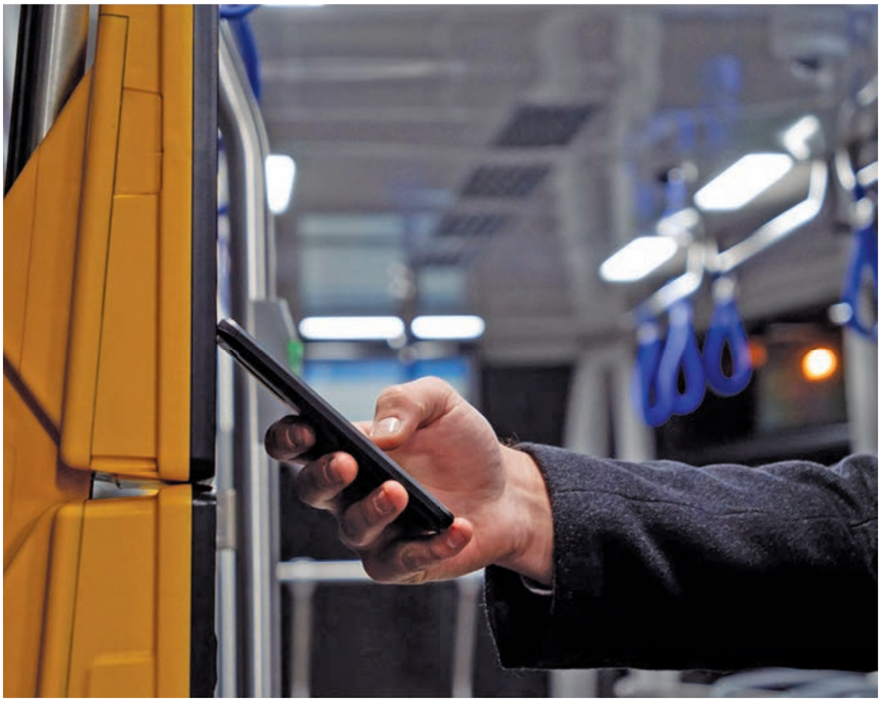
MASS TRANSIT'S NEXT BIG MOVE

First came contactless. Now, transit payments are gaining the account-to-account advantage, and with it more flexibility for riders and insight for operators.

BY KEVIN WOODWARD

LONG HERALDED AS a key factor in spurring contactless payment adoption, transit-payment programs are fully embracing the technology. Yes, the Covid-19 pandemic was a key instigator in this change, but advancing payment technologies also are making it easier, and desirable, for transit operators to adopt contactless payments. This is especially true for open-loop schemes that let riders use the payment device of their choice.

Transit systems, in many instances, have had to contend not only with decreased ridership in the past couple years, but also with the trepidation of passengers who feared touching turnstiles and payment kiosks. That's where contactless payments was the apparent answer.



In 2021, 88% of riders expected a contactless payment option from their local transit operators, found the Visa Inc. "Future of Urban Mobility Survey." And 74% of consumers, in general point-of-sale transactions, intend to keep using their tap-and-pay cards this year, according to a report from the Electronic Transactions Association, a Washington, D.C.-based trade group, and The Strawhecker Group, an Omaha, Neb.-based payments advisory firm.

Outside of contactless payments, the boom in account-to-account payments also is altering transit-payment programs. Operators adopting this technology are able to provide customized payment schedules without having to manage thousands of stored-value accounts.

"The pandemic helped spur that growth to allay fears of handling cash and [minimizing] contact," Brian Stein, co-vice chair of the Secure Technology Alliance Transportation Council. The Alliance is an Englewood, Colo.-based organization. "I don't see that momentum changing direction any time soon."

Others agree. "Transit ridership was dealt a significant blow throughout the pandemic as riders looked for other ways to commute to avoid contracting the virus," says Andy Taylor,

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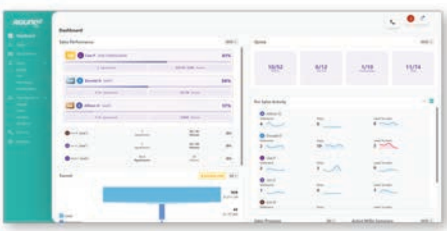

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senior director of global strategy at Cubic Transportation System. "This emphasized the need for modern technologies that support contactless fare collection to curb the spread of the virus and give customers great peace of mind."

"The result," Taylor continues, "has been promising with a number of transit agencies around the country adopting systems that enable multiple methods of fare payments, including digital wallets and contactless cards."

'MORE EFFICIENT'

Among these is the OMNY project for New York City's Metropolitan Transportation Authority, which enables riders to pay with major-brand contactless credit and debit cards as well as Apple Pay, Google Pay, Samsung Pay, and FitBit Pay.

In April, the OMNY contactless system counted more than 1 million taps on a Friday alone, reported SILive.com. The MTA also said in December the OMNY scheme had been installed throughout the city's transit network, the site said.

And, in New Jersey, the Port Authority of New York and New Jersey announced in November it would adopt a tap-and-go contactless payment service to begin in 2023. The current system uses a physical fare card. The new one will let riders use their own cards and mobile devices. The authority expects the cost for the new system to be $99.4 million.

In Boston, the Massachusetts Bay Transportation Authority will convert its currently insertable CharlieTickets to tappable ones this month. This also will enable riders to use a contactless credit or debit card, Apple Pay, and Google Pay on select subway lines and bus routes. Eventually, the fare-payment service will be available on all MBTA transit modes.

The common critical element in all of these projects is the ability for the fare service to access the user's funding account in near real time without requiring an intermediary stored-value wallet.

"Cloud-based computing has really helped spur this moment," Stein says. "Now the cost and management in the back end is much more efficient and economically viable for transit agencies."

'ONE TO MANY'

It also brings flexibility for riders.

As an example, commuters buying a monthly pass have had to pay the full fare amount—which could be a few hundred dollars—up front. In an account-based fare scheme, the rider might be able to just pay for the next ride or keep a certain amount to cover the next ride, she says. This can help riders avoid having to lay out the entire monthly rider fees all at once, Stein says. Account-based services also may enable fare capping, where, after a certain number of paid rides, the following rides are at no charge.

"When transit agencies combine open-loop payments with fare capping, riders avoid tying up funds on a transit card in anticipation of their commutes (when they might not even be sure how often they'll be riding on a given day or week)," says Julie Scharff, head of card present and strategic initiatives at Visa in an email message.

"They can pay for rides directly and be confident they are getting the best price, while keeping funds available for other daily essentials in addition to transit," Scharff continues.

Visa reported earlier this year it processed more than 500 million tap-to-ride transactions globally in the first half of its fiscal 2022. It processed 700 million for all of the previous fiscal year, which begins each Oct. 1.

This flexibility is essential, says Taylor. "Commuters want to have greater control and flexibility over their days, and that extends to transportation. Offering various ways to pay contactless fares and making fares more cost-effective for riders by introducing fare capping or rethinking the multi-day fare pass can enable transit agencies to support the future of work in new and exciting ways," he says.

For transit operators, an additional benefit is further insight into

Hicks: "There is a "move from a one-to-one relationship between the vendor and consumer to a one-to-many."

Scharff: "When transit agencies combine open-loop payments with fare capping, riders avoid tying up funds on a transit card."

ridership patterns. "What excites me the most is the move from a one-to-one relationship between the vendor and consumer to a one-to-many," says Chris Hicks, chief revenue officer at Till Payments, an Australia-based payments-technology provider that recently marked its North America entry, in an email.

"The shift benefits everyone in the ecosystem," Hicks says. "The operators enjoy the previously unimagined insight into their consumers' transit habits, importantly, who their consumers are (age, economic and geographic demographics all form a part of this transformational change), while consumers enjoy the ease and the convenience of innovative payments solutions."

EXPANDED OPTIONS

Integrated access to other transit providers, other partnerships, and other loyalty programs also could develop. "In addition to contactless and tap-and-go capabilities, the continued development of partnerships and loyalty programs will be integrated into the payment process," says Mike Crumpler, managing principal at Capco, a Belgium-based consultancy with multiple U.S. offices.

"This will help sustain continued patronage and potential growth in existing and new markets," he continues. "We should expect to see an expansion of these payment options being tested and expanded [further] in large mass-transit markets around the country."

Adopting open-loop fare-payment services may also serve riders and agencies well as employers and employees adjust to hybrid work models. "Until recently, every leg of a journey required a new payment, the result being a burden on both the consumer (having to deal with the inconvenience of multiple check-ins), and the operator (with increased operational costs associated with the processing of numerous transactions for a single journey)," Hicks says.

Transit payments that enable riders to complete multiple legs in a day and have the costs consolidated into a single end-of-day payment enables consumers to access and use the transit network so it accommodates their needs to work from home, the office, or another location without having a raft of transaction lines on their statements, he says.

New fare systems also can better address access to public transportation. "As cities continue to get moving again, there will need to be a greater focus on fare-payments systems that are equitable for everyone," Scharff says.

"For instance," he adds, "fare-capping with open-loop payments will play an important role in balancing a much more dispersed workforce without disadvantaging those whose work routines remained constant throughout the pandemic. Fare capping offers every customer the most flexibility and value."

Open-loop and contactless payments also can lower cash use, and its costs, for transit operators. With funding mechanisms using automated clearing house access or a payment card, customers can add money to a transit account as needed, which may help reduce cash use on buses, Stein says. A majority of transit operators are bus-based, he adds. "That's the one element where connectivity to the fareboxes to the backend is quickly improving," he says. There will still be a need to accept cash on buses because 100% cash removal is very unlikely, Stein says.

Transit operators have been reaching for account-based fare systems for a long time, he adds, but as with anything, timing is everything. Contactless payments at the point of sale and in transit saw greater adoption because of the pandemic. And, as is likely at the point of sale, contactless payments for transit are not likely to retreat.

"Everything was point of presentation when [the transaction] happened," Stein says. "Now, this is shifting to the account in the backend." This affords transit operators and their vendors some creativity in designing fare-payment schemes. "Now, with accounts moved to the back end, this opens the door to new programs. Contactless cards helped spur open programs." DT

HOW FAST DO PAYMENTS HAVE TO BE?

When it comes to real time or same day, there are advocates in each camp. But which option is better? The answer is far more nuanced than the question.

BY JOHN STEWART

FOR A NUMBER of years now, the payments industry has talked about so-called faster payments. But what does this term really mean? Five years ago, The Clearing House Payments Co. LLC, a company owned by many of the nation's biggest banks, launched its Real Time Payments service, which moves money, as the name implies, virtually instantly.

A year before that, the national automated clearing house system introduced a service that moved credits so they could settle the same day if they met a certain daily deadline. In 2017, Nacha, the system's governing body, added same-day debits. Last year, the number of credits and debits combined more than doubled the 2019 total and was up 74% over 2020 (chart, page 22).

"We had phenomenal growth last year. We haven't seen that real-time has caused a shift in traffic," says Jason Carone, a senior vice president with responsibility for the Electronic Payments Network, TCH's ACH business. Adds Bob Steen, chairman of Mt. Vernon, Iowa-based Bridge Community Bank: "Same-day has outperformed in volume beyond anyone's expectations."

At the same time, popular consumer payments services, such as the Zelle and Venmo peer-to-peer networks, are thriving on their ability to tap real-time capability.

So just how fast is fast, and do payments have to be made in real time? With some six years of experience with both faster ACH and The Clearing House's RTP network (not to mention foreign real-time services), the payments industry is still sorting this out.

The answer, though, takes on increasing urgency as the Federal Reserve prepares to launch its FedNow real-time payment system next year, a move that will kick up competition in faster payments to an even higher level.

'IMMEDIATE IMPACT'

Nacha has worked over the past few years to enhance the same-day service in ways that accommodate a greater range of payments and keep settlement windows open later, making the service available for transfers that take place late in the banking day.

The dollar limit, which started out at $25,000, went to $100,000 later, and in March was raised to $1 million. That has opened the service to a much wider array of transactions, including business-to-business payments and credit card settlements for large merchants, Nacha says. "It had a pretty immediate impact," says Michael Herd, senior vice president for ACH network administration.

Now, payments executives can see the same-day service "is worth my while—there is not a lot of my transactions that aren't eligible," Herd adds. An example: insurance payouts. "The prior limit left [insurers] with too much of their client base not eligible," he says, "but a significant enough part of the client base is now covered."

That pleases community bankers. "There's no question real time is going to be beneficial," says Michael Bilski, chief executive at North American Banking Co., which has five offices in Minnesota. "But for the majority of payments, if settlement happens within 24 hours, that's good for most people."

But at the margins of the payments business, same-day settlement may not be good enough for some people and some businesses in circumstances where funds are needed within seconds. "There's still a need for finality of payment," says TCH's Carone. "I really need to know that money's in my account. I can't wait til the end of the day. A wire or real time will do that."

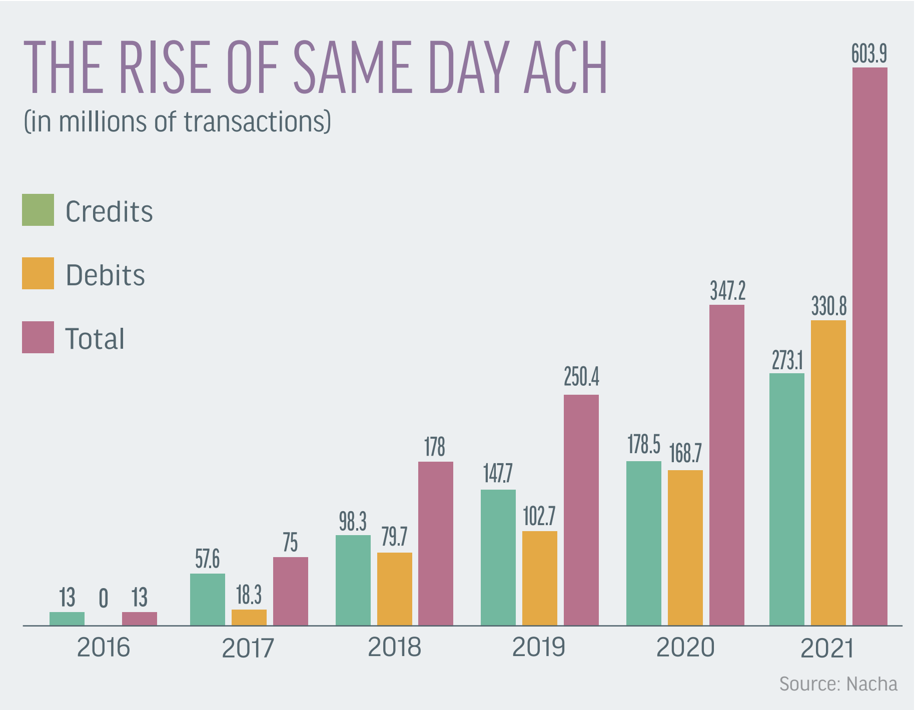
He cites an example of a warehouse where a truck is ready to pull away from the dock and the delivery must be paid for immediately. Another scenario he mentions is the ride-share driver, who can be compensated "multiple times per day" through a real-time network. "That driver needs to put gas in his tank," Carone adds.

'CONSIDERABLE VALUE'

But speed isn't the only critical factor. Real-time payments offer another advantage in the volume of information they can carry about the transaction, experts say.

"The business has the ability to recognize the transaction more quickly, with a lot less manual effort. That creates considerable value the business would be willing to pay a little more for," notes Sarah Grotta, director of the debit and alternative products advisory service at Mercator Advisory Group, a Marlborough, Mass.-based consultancy.

Wholesale pricing for same-day ACH and real time is roughly similar at around a nickel per transaction, Grotta says, though much depends on financial institutions' markups. "That can vary quite a lot," she says. "It all depends on how banks decide to price. In general, [they] are pricing ACH lower."



In the end, it may not be a question of how much real-time transfers eat into the market share claimed by same-day ACH. Rather, the actual outcome may turn out to be both faster-payment rails taking a bite out of a much older cousin. Grotta cites an example. "Payroll is a big use case for real-time payments as well as for same-day ACH," she notes. "They're both encroaching on wire transfer." DT

WILL FRAUD FEARS HINDER FASTER PAYMENTS?

With some fast and near-instant payments services and apps already available, and more coming, what's the biggest hurdle to consumer adoption? It turns out it's fear of fraud, according to recent research.

Approximately 40% of U.S. consumers are wary of using faster-payments options overall, according to survey results issued last month by the Federal Reserve Banks. The results come as the Fed is preparing to launch FedNow, a real-time payments network, next year. Competing services are already available from The Clearing House Payments Co. LLC and from Early Warning Services LLC's Zelle peer-to-peer payments app, along with a number of private-sector apps.

Meanwhile, the automated clearing house network has offered same-day clearing since 2016. With an increase in March in the transaction dollar limit to $1 million, the service has already seen fast growth. Dollar volume on the ACH for transactions settled on the same day grew 53% in March compared to February.

Some 2,015 U.S. adults were questioned for the Fed survey, which was conducted during the second half of last year.

The consumers who indicated what the Fed calls "limited or no interest" in faster-payments services cited a number of reasons, but fraud concerns loomed largest, with 49% of this group citing this as in inhibitor. The concern is shared across age groups, with those 55 and over citing it but at least 44% of younger cohorts doing likewise.

Fraud fears, however, also imply a marketing opportunity. "Faster payment services that ensure users will not be responsible for fraudulent transactions may be able to attract some of these consumers," the study, which allowed multiple responses, says.

Tying in to the fraud concern, some 38% said they don't want to "share account info," while one-third simply indicated they didn't "know enough" about faster payments.

The second-highest cause of reluctance? A proliferation of apps. Some 46% said they're wary of having to manage or learn yet another service. "Everyone uses something different, so I'm constantly signing up for new things and getting new apps and new e-mails. It drives me crazy," said one respondent, as quoted by the study.

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OPEN BANKING'S UNSTOPPABLE MOMENTUM

Consumers may not know what open banking is, but they sure like what it does. And the technology hasn't even hit its stride yet.

BY PETER LUCAS

From real-time account verification and money movement to apps that provide lenders and landlords an up-to-the-minute overview of an applicant's credit history, open-banking technology is the engine that drives the modern payments ecosystem.

The power of open banking lies in the fact that it allows consumers to grant third parties access to their accounts and financial data through payment and financial-management apps—access these third parties can't get through a bank. That capability has propelled several payments apps to the top of the charts. The list includes Chime Financial Inc., Square Inc., Stripe Inc., Venmo, and Zelle.

One reason such products have grown in popularity is they offer consumers what they want; whether it be choice, lower costs, or other benefits they can't get from a bank. Another reason payments are a key part of the open-banking landscape is that open banking makes its easier, and faster, to pay for goods and services, and send money to friends and family, according to Plaid Inc.

Plaid is an open-banking services company that has built a data-transfer network that powers fintech and digital-finance products, and counts Chime and Venmo among its clients.

"Ultimately it is consumer expectations for more mobile-friendly and connected services that is driving the acceleration of digital finance overall," says a Plaid spokesperson.

Yet, for as much as open banking is shaping the modern payments landscape, it remains a behind-the-scenes technology for most consumers. A 2021 survey by Axway Software, a provider of open-banking solutions, reveals that 50% of respondents have never heard of the term "open banking."

Still, consumers do know that they like what it does—which is make available affordable, alternative payment and financial-management applications that give them control over their financial data, and deliver a better user experience.

The same survey by Axway reveals that 84% of respondents agree with the concept of having more control over their financial data. This desire for control goes to the heart of the open-banking movement, which is rooted in the idea of breaking down data silos within financial institutions to make consumer account and financial data more accessible, in a safe and controlled way, to the fintechs and other third-party partners that need it.

"Increasingly, consumers are turning to fintechs to round out their financial services and get access to those services on their terms," says Sunil Sachev, head of fintech and growth for Fiserv Inc., which has partnered with several open-banking players, including MX Technologies Inc. "As a result, fintechs are working with financial institutions to build frictionless experiences for different slices of consumers."

'EARLY INNINGS'

There are three primary forces driving adoption of open banking: the regulatory environment, increasing competition, and consumer acceptance of open-banking applications.

On the regulatory front, legislative bodies around the world are pushing for increased leeway for consumer and small and medium enterprises to control their data when it comes to third-party access, permissioning, and privacy, says Jess Turner, executive vice president, global open banking and API at Mastercard Inc.

While U.S. open-banking regulation lags that of other countries, federal policymakers such as the Consumer Financial Protection Bureau are developing standards to ensure data continuity and protection.

In Europe, a recently revised version of the PSD2 regulation includes security requirements for the initiation and processing of electronic payments and the protection of consumers' financial data. The regulation is intended to make the banking industry more accessible to new players that are expected to develop and promote innovative products and services, while ensuring the protection of consumer data.

"Open banking is a technological shift that is still very much in its early innings. As it emerges and matures, federal policymakers play a meaningful role in the direction and pace of this transformation," Turner says. "Providing clarity on data protection expectations, data-privacy requirements, and consumer-data rights will help shape a more secure, diverse, and inclusive financial market."

Turner argues that the payments industry and regulatory bodies must ensure that consumers have data continuity, which enables the data from a consumer's bank statements, paper checks, and online-banking apps to follow her into the realm of open banking and open finance.

"Sending information digitally is dramatically more secure than sharing papers, emailing information, or handing over a check at a cash register," Turner adds. "For consumers and SMEs, continued access to their own data and the right to share it with other financial institutions or fintech companies will be transformational."

Another driver of open banking has been the Covid-19 pandemic. "When stores and banks closed, people had to find new ways to do just about everything, and digital finance was there," says the Plaid spokesperson.

"We've now reached a tipping point in consumer adoption, where more people now use fintech than social-media or streaming-video services like Netflix," says the spokesperson. "In fact, between 2020 and 2021, the proportion of U.S. consumers using fintech grew from 58% to 88%."

'COMPELLING OFFERS'

One way fintechs can use account data obtained through open banking is to create private-label debit cards that route transactions through the automated clearing house, as several companies such a Cumberland Farms have done for years. "Good account data is needed to facilitate payment of those transactions," says Sarah Grotta, director of the debit and alternative products practice at Mercator Advisory Group.

Providers of buy now, pay later loans can leverage open banking to determine a consumer's ability to repay the loan and determine how large a loan the consumer can qualify for to minimize its risk.

Number of Open Banking Users (in millions)

	2021	2022	2023*	2024*
Europe	18.8	28.4	42.6	63.8
Far East & China	10.3	13.9	20	28.1
North America	2.7	3.9	4.5	5.7
Latin America	1.2	1.9	2.9	4.5
Rest of World	7.4	11.9	18.9	30

*Projected | Source: Statista

Another example of how open banking is powering innovation is TomoCredit, a San Francisco-based startup that helps immigrants and expatriates lacking a credit history demonstrate their creditworthiness by giving permissioned access to their financial accounts.

TomoCredit uses real-time data to improve risk assessment and decision-making with a more comprehensive picture of an applicant's financial health. That helps give them access to a credit card, according to Mastercard.

"The more data available on a consumer's financial life, the greater the benefits, because those leveraging open banking can identify who is likely to be interested in new products," Grotta says.

"They can also see what consumers pay for certain products, which opens the door to offering a more competitively priced alternative," she continues. "By understanding the customer data they can access, open-banking providers can craft more compelling offers."

'A DISRUPTIVE FORCE'

With open banking making it possible for fintechs to offer products and services that compete with those offered by traditional banks—as well as innovations that traditional banks can't offer—it is on the verge of becoming a disruptive force for banks and the card networks to contend with, payments experts say.

"There are two kinds of banks in the United States, legacy banks that can't adapt to open banking because of technological limits, and neobanks that are API-driven," says Abhijit Chaudhary, chief product officer for Green Dot, a fintech payments provider and bank-holding company. "Our focus is on empowering our customers to use services they need; open banking goes a long way toward addressing those needs."

That fintechs and neobanks not only see the value in open banking, but have the technology to support it, means it is not surprising they are initiating partnerships with banks rather than banks taking the intiative. "We are seeing a lot of fintechs, especially larger ones that have shared customers with banks, reaching out to financial institutions, but not the other way around," Grotta says. "There are a lot of banks that share customers with fintechs."

From a socio-demographic perspective, open banking provides financial institutions an opportunity to stay relevant to customers who also use fintech products, payment experts say.

"Financial institutions have the data that open banking needs, but they are not leveraging it, whereas fintechs use that data to understand the consumer at a micro-level," says David Whitcomb, vice president of product for MX Technologies.

"With the data financial institutions have, they can see what products and services their customers are using outside their walls and leverage it to create competitive alternatives that solve problems for consumers," Whitcomb adds. "When a problem can be solved, it creates opportunities for new revenue streams."

Ways financial institutions can leverage open banking to serve their customers include offering loans, overdraft protection, and other services that don't have high fees. They can even enable gig workers to set up auto-deposits from multiple employers with minimal friction, payments experts say.

COMPETITIVE HEAT

But financial institutions are not the only legacy providers in the payment industry feeling the competitive heat from open banking. The card networks are, too. The threat here comes from the technology's ability to verify account ownership and balances for account-to-account payments.

Real-time verification of account-to-account transfers can, in theory, render moot the use of credit and debit cards at the point of sale. With open banking, a consumer could pay a merchant directly from a designated account, and the merchant could instantly validate the account, the consumer, and that the consumer has the money to make the purchase.

But Visa and Mastercard are no strangers to open banking. Both have made acquisitions to ensure a beachhead in this technology. In June last year, Visa paid $2.15 billion for Tink AB, a Stockholm-based company with links to 3,400 financial institutions throughout Europe.

Top Reasons U.S. Consumers Turn to Technology to Manage Their Finances

Save Time/Less Work	57%
Save Money	42%
Improve Financial Health	37%
Automate Financial Processes	28%
App Is Better Than What Exists	27%
Try Something New Financially	24%
Consolidate Financial Information	20%
Social Pressure	17%

*Percentage of Respondents. Respondents could provide more than one reason.
Source: Mastercard: The Rise of Open Banking

The deal was viewed as a consolation prize after the U.S. Department of Justice in 2020 objected to an attempt by Visa to buy Plaid. The DoJ argued the deal would hand Visa too much power over the debit business.

Mastercard, meanwhile, has been staking its own claim. In 2020, it acquired Finicity Corp., for $825 million. Later, it landed Aiia, a Copenhagen-based provider with connections to 2,700 banks and an account-to-account payment volume of more than 1 million transactions monthly. The price for Aiia was not disclosed.

Mastercard has wasted no time leveraging those acquisitions, announcing in March plans to launch two new payments tools that rely on the open banking and account-to-account transactions. One of the new tools, Payment Success Indicator, will enable the payment originator to check on the consumer's account balance, as well as his or her historical payments behavior.

"We have always powered experiences that enable consumer choice, and in recent years, we have further differentiated Mastercard in the market by diversifying beyond the card," says Mastercard's Turner, who adds that open banking is a natural progression for Mastercard. "Open banking is yet another proof point of how we're truly empowering consumers with flexibility and control."

Visa did not respond to interview requests.

'A RISING TIDE'

Despite all of open banking's promise, the trend is raising concerns about data protection. The Data Collaboration Alliance, a Toronto-based non-profit that helps consumers and organizations control their information, argues that, as open banking proliferates, fintechs and financial institutions need to build apps without copying data silos or screen scraping, a process that allows the gathering of customers' financial transaction data from multiple sources.

"In today's world, data has no boundaries, so we need to get away from such data-management practices as screen scraping and copying data silos, which do not always respect or preserve access and governance controls set by the rightful data owner," says Chris McLellan, director of operations for the Alliance.

"One of the most important ways we can accelerate major breakthroughs in open banking is to embrace new data-management technologies, standards, and protocols that place data ownership at the forefront of digital design," McLellan adds. "This way, data is managed as something with real value that shouldn't be subject to unrestricted replication."

The push for data protection aside, open banking is just hitting its stride, and that leaves lots of room for future innovation. "The appetite for these services is ever-growing around the world, and mainstream adoption of open banking is happening, with more than 80% of consumers in the U.S.—and 90% of younger consumers—already connecting their bank accounts to technology apps," says Mastercard's Turner.

"Now is the time to embrace the opportunity of open banking," she adds. "It is truly a rising tide that will lift all boats." DT

CHARGEBACK MITIGATION: HOW TO SCALE UP WITHOUT SLIPPING UP

As transaction volumes grow ever larger, applying technology the right way becomes critical.

BY **ROENEN BEN-AMI**

Roenen Ben-Ami is co-founder and chief risk officer at Justt.

CHARGEBACKS ARE THE black sheep of the payments industry. While new technologies have changed the payments space dramatically in recent years, chargebacks have barely evolved. For both merchants and card issuers, they are still almost always handled manually, with individual disputes sometimes taking 120 days or longer to resolve.

As volumes climb, this presents a big problem: How can merchants and issuers leverage the incredible innovations that are transforming the payments space while still ensuring they're giving both their customers and individual transaction disputes the close attention they need?

To find out, I headed to the Merchant Risk Council, and brought together two experts: Matana Soreff, vice president of risk and compliance at Melio, a business-to-business payments platform for small businesses; and David Garcia, senior director of payments and risk at FastSpring, a full-stack commerce platform for growth-stage software-as-a-service and software companies. Here are four big takeaways from our conversation:

1. YOU CAN'T PREVENT CHARGEBACKS

It's tempting to try to clamp down on chargebacks using the same preventive strategies employed to minimize conventional credit card fraud: identify likely fraudsters, then shut them out. That doesn't work with friendly fraud, though, because "liar buyers" are hard to spot. They look just like your regular customers. Screen them out, Soreff explained, and you'll wind up punishing countless honest customers, while losing significant revenues along the way.

Instead, have high-risk customers go through a slightly more

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As volume grows, so does the problem of disputed transactions.

involved sales pipeline that lets you gather the information and evidence needed to challenge a subsequent dispute. "If it does end up happening, you'll have more documentation," Soreff explains.

2. TRIAGING CHARGEBACKS CAN BACKFIRE

Another common strategy as chargeback volumes soar is to prioritize the things your in-house team does well, while ignoring harder-to-win chargeback cases. That sounds like a reasonable strategy, Garcia says, but it can lead to companies giving up on large numbers of chargeback cases that were actually winnable. "We've found that you can win over half your liar-buyer disputes just by responding," Garcia says.

Forgoing those chargebacks costs you money, but it also hurts your reputation. Let too many chargebacks slide, and you could get into hot water with your acquirer, and even lose your merchant account—or wind up on issuers' "naughty list," leading them to side with cardholders.

That can snowball, Garcia warns, with issuers coming to view your company as prone to chargebacks, and favoring customers even in friendly fraud cases you'd ordinarily have expected to win. Even as chargeback volumes climb, he says, it's important to fight as many cases as possible in order to protect your business.

3. AUTOMATION ONLY GETS YOU SO FAR

The obvious way to handle chargebacks at scale is to automate your mitigation processes. But while automated software can allow you to contest huge volumes of disputes, it's important to be realistic about the results you'll get.

The reality is that fully automated systems generally have a low success rate because they apply crude rule-based strategies to gather evidence and fill out forms, rather than optimize for your industry, your business, and the particulars of the dispute in question.

The key, Garcia argues, is to use automation in ways that support, rather than supplant, human mitigation experts. It's possible to streamline and automate the process of formatting chargeback paperwork in the way a given issuer requires, for instance, while still using expert insights and human judgment to ensure that the right evidence is being collected and deployed.

By building on human insights, rather than simply trusting machines to get the job done, you can achieve better results at scale. "That's the power of machine learning," Garcia explains.

4. KEEP YOUR ISSUERS HAPPY

It's also important to realize that the chargeback process is powered by people at every step of the way—including an issuer's chargeback-resolution process. If you can make your issuer's job easier by providing the right evidence in a timely way, you'll build a reputation for diligence that will help you win more cases over time, and that can bring other important benefits to your company along the way.

By contrast, Soreff warns, if you make the issuer's job difficult—say, by churning out low-quality forms based on crude automation—or if you fail to respond to chargebacks at all, you can damage your relationship with an issuer in ways that cause lasting harm.

It's important to look beyond the cost of a single chargeback, and take a broader view of how chargebacks impact your business. "You're leaving a lot on the table, but you're also hurting your reputation," Soreff says. "As a payment company, our reputation with the networks is almost more important than recovering the funds."

THE WAY FORWARD

So what does it look like when you put these insights together? The key is to build a scalable solution that treats technology as an invaluable tool, but not as a silver bullet. It's by applying tech in the places where it does the most good, and using it to support and augment the power of human experts, that you can create a truly scalable solution for chargeback mitigation.

That means, for instance, that applying a one-size-fits-all tech solution won't help you to achieve scale in useful ways. Instead of cookie-cutter tech tools, it's important to seek out tailor-made tech solutions that build on

"It's tempting to try to clamp down on chargebacks using the same preventive strategies employed to minimize conventional credit card fraud: identify likely fraudsters, then shut them out. That doesn't work."

team members' knowledge and experience, and that are designed and implemented with the specific needs of your industry and your company in mind.

Machine learning can be an incredibly powerful tool as you scale your mitigation capabilities, but it needs to be trained and structured based on the insights of real people who understand your industry and your business and also understand the requirements and preferences of the issuer's team.

Add it all up, and it's apparent that bringing fintech innovations into the chargeback space is the only way to scale and meet the needs of today's merchants. But we need to do so by remembering that there's no substitute for expertise and experience when it comes to building out your chargeback-mitigation capabilities. DT

WHAT U.S. BANKS NEED TO KNOW ABOUT FEDNOW

Questions abound about factors like adoption and technical requirements. But staying on the sidelines is not a wise option.

BY **DAVE SCOLA**

Dave Scola is U.S. chief executive at Form3.

BRINGING THE U.S. payments industry into line with that of other advanced economies such as the United Kingdom and Europe has been a priority for the Federal Reserve, and next year we are going to see some real movement on this front when FedNow goes live.

Currently, real-time payment and settlement capabilities are not ubiquitous. When it launches, FedNow will open up a nationwide real-time payment network available to all the banks that are currently members of the Fed.

It will likely be the biggest change to the payments environment in this country since the introduction of the automated clearing house (ACH) network, the electronic funds-transfer system we have been using since 1974.

Regional and community banks are set to gain the most from FedNow. The majority of these institutions aren't members of The Clearing House, the New York City-based company owned by America's biggest banks and operator of the 5-year-old Real Time Payments (RTP) network. So they don't have access to a real-time network.

However, their customers want the ability to move money in real time across the United States for a variety of purposes, from interpersonal payments to paying bills and making payroll payments. They will also want to be able to receive Federal payments, including benefits, instantly once the government is ready to enable the capability.

To that end, FedNow will bring core clearing and settlement capabilities to a number of different transaction types. It will also support ISO 20022, which has become the de facto global standard for payments messaging.

FedNow will have a number of features that will ensure data security and combat fraud, while offering consumers a better experience, as they'll be able to transact in real time 24 hours a day, seven days a week.

"There may be a temptation to play the waiting game [with FedNow]. But the cost of doing nothing will be considerable."

ADOPTION QUESTIONS

FedNow is due to go live at some stage in 2023. The launch will happen in several phases, with additional features being introduced continuously. At the moment, the plan is that there will be some testing in a sandboxed environment some time around September, when stakeholders will be able to check that their systems are ready for the implementation.

However, there are still some questions regarding how quickly FedNow is likely to be adopted.

The Clearing House's RTP service launched in 2017 and saw support grow slowly but steadily, so it may be some time before we see FedNow being widely adopted in the U.S. Ultimately, though, consumer demand will be the major driving factor. The Covid-19 pandemic has accelerated the decline in the usage of cash, with more people wanting to avoid handling physical money. So the desire to use real-time payment processing has increased.

The Federal Reserve is not requiring its members to commit to FedNow just yet. Many banks are likely to make their strategic decisions based on what they perceive to be likely consumer demand. But at a time when many banks are looking to modernize and bring their legacy systems into line with cutting-edge competitors such as neobanks, there's a massive opportunity to use FedNow as a catalyst for digitalization.

Consumers have become used to having everything they want, right now. Goods can be delivered to their door in minutes. Digital services and information can be accessed instantly. It's only natural that consumers should want to have the payment services they use brought into line with these principles.

They shouldn't have to wait for payments to clear when the goods and services purchased are available instantaneously. That's a dislocated experience. So the demand for real-time settlement is certainly there, and banks that adopt FedNow will dramatically improve the payment experience for their customers.

GETTING READY

Preparing to join FedNow will undoubtedly be a complex task. And, while the bulk of the work will need to be done ahead of the go-live date, there is also the maintenance of the system to consider, in terms of ensuring ongoing compliance and technical adherence.

Banks that are planning to join FedNow will be at varying stages of readiness. One of the key areas of concern will be the integration of real-time capabilities into existing infrastructure. Many banks will need to modernize and digitalize their approach to connect to FedNow.

They'll need to look at using API-based platforms for ensuring the real-time exchange of information. This will enable them to embed the payment experience into other channels so it flows along with what the customer is doing. Infrastructure must be reliable and secure, with high levels of resilience and zero downtime to ensure a true 24/7 service.

While the Federal Reserve is doing what it can to ease the path for banks—for example, by offering the chance to enroll as a "receive only" participant—many institutions will need to look outside of their organizations for help. Forming strong technical partnerships will be the key to success. Banks that act fast and outsource the integration and management of the process to a trusted partner can be ready to go live at launch.

In summary, wait-and-see is the wrong approach to FedNow.

Banks should be aware that the approach they take to implementing FedNow needs to be streamlined and cost-effective. In a challenging economy, internal resources are likely to be stretched, and there may be a temptation to play the waiting game. But the cost of doing nothing will be considerable.

There is a lot to be gained from embracing FedNow. The demand for real-time payment and settlement is clear, and customers who don't have access to this service through their bank could very well take their business elsewhere. Now is the time to be bold. Don't wait to see what everyone else does. DT

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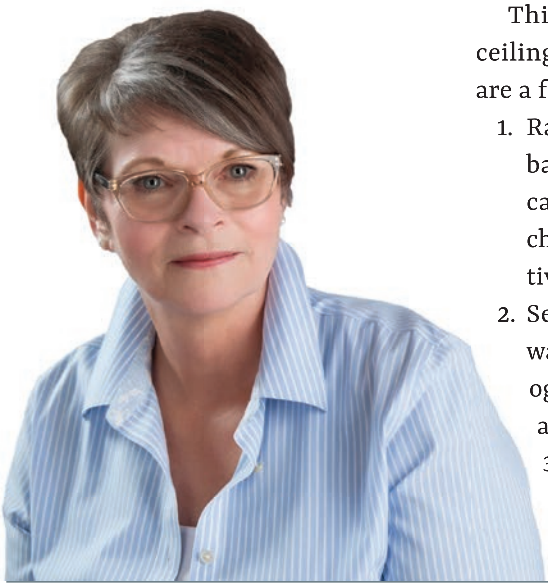
PAYPAL IS A LEGACY SOLUTION. THAT'S A PROBLEM

For all its resources, the payments company faces a growth problem it may not be able to solve on its own.

BY **PATRICIA HEWITT**

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



THIS IS A STORY about PayPal, one of the most trusted brands in e-commerce. It's been one of the most trusted brands in e-commerce for decades. Today, it's fastest-growing demographic is the 50-and-up cohort. And that's pretty much the problem. Consider this the executive summary of its story.

Think of PayPal as the Facebook for payments. And, as my 12-year-old grandson told me recently, "Grandma, nobody is on Facebook any more." This meant nobody in his age group, just to be clear. Oh, there's still lots of people on Facebook and lots of PayPal accounts that have one transaction of any kind per year (their definition of an active account).

This is called hitting a growth ceiling. When that happens, there are a few options:

1. Rationalize as coming from a bad economy, inflation, cyclical changes, Covid, or climate change, and project future positive change;
2. Sell to a larger company that wants more accounts, technology, resources, geographies, or all of the above;
3. Raise more money on new growth projections;
4. Move into a new market;
5. Shop your feature-functionality closet and stuff all the good parts into a new super app.

The first four options are hundreds of years old. So that leaves number five. As some of you who read Endpoint regularly know, I'm not a believer in the super app. I believe that apps instead have super powers. So what is PayPal's? I think it's being the leader in e-commerce payments, which is pretty much what its super power has always been.

In other words, what PayPal has come up against is the age-old problem of having a legacy solution that is still ahead of its competitors, but starting to show its age, so it's now forced to go outside its core competency and compete for customer's core banking services.

Further, competitors like Block (Square) and SoFi now have U.S. banking licenses, so they can directly acquire deposits, lend money, and issue cards. Stripe and Adyen are compiling meaningful services for the small-business market. Other issuer/acquirer mashups have taken place, like Fiserv/First Data and Global Payments/TSYS, and are ready to exploit the synergies of a two-sided marketplace.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This is not to mention Chase, Goldman Sachs's Marcus, and digital wannabe banks like PNC. Actual digital banks like Chime. Retailers like WalMart and Walgreens. And finally, mobile wallets like ApplePay and GooglePay.

THE STUFFED APP

Ultimately, let's be honest here, many of these solutions are boring old banking services, which means you've got to compete on the experience and relevancy to the user, and, at the same time, control for the capital-intensive effort of new account acquisition.

PayPal's experience trying to incent new consumers onto its platform pretty much backfired when it offered a high-value rewards bonus for signing up. Ultimately, it had to purge millions of accounts that had taken the bonus and run. A back-of-the-envelope estimate to acquire a new retail bank account starts at $250 and can reach $500. New credit card? $150 to $250 per account. Another sobering statistic is that 30% of all bank-account customers switch accounts in the first three-six months.

Finally, it's no secret that younger consumers like to pick and choose their financial services based on personal preferences. That's a dynamic that makes a super app sound kind of intuitive, doesn't it? Until you factor in what the user experience is like for an app stuffed with lots of feature functionality. Just check out the reviews on Google Play for PayPal's super app. You'll read a lot about friction.

That's because what PayPal is chasing is a WeChat Pay-like experience. But the problem is that WeChat's super app operates as a hub for externally delivered services that live in the app increasingly through mini-programs that decrease friction. To visualize this, think of the main WeChat app as a Web browser that enables access to lots of other apps through simple links that take us where we need to go.

By contrast, PayPal is primarily integrating into its app its own services, like Honey Rewards, Venmo, and PayPal Credit, alongside its own wallet and third-party prepaid debit card, credit card, bill-pay service, and savings account, none of which was built to interoperate. Comparing this experience to WeChat is a lot like comparing Facebook to TikTok. Similar on the surface, but a different experience altogether.

A REACH

This is not to say that PayPal doesn't have quite a bit going for it, including, let me say again, being a market leader and trusted brand in e-commerce as well as in P2P payments via Venmo, along with its rich network. But even with all that, the problem it's now running into is simply the sheer breadth of available financial services.

Net new markets in payments are pretty small and getting more finitely targeted all the time. For example, the unbanked part of the U.S. population is about 5%, which likely represents households that don't want a bank account for one reason or another. In developing markets, like India for example, not only does PayPal face fierce local competitors but also a government that ensures its homegrown payment schemes come first.

If you consider all of the solutions PayPal has to offer— e-commerce, money transfer, BNPL, debit and credit cards, deposit accounts, savings, cryptocurrency—the idea that it's going to continue to grow these year after year in double digits through digital and physical payments via a super app seems like a reach.

Instead, I'd place my bet on a near-term merger. Just makes sense when you're a legacy solution. DT

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