DIGITAL TRANSACTIONS

Trends in the Electronic Exchange of Value

16TH ANNUAL

THE 10 MOST PRESSING ISSUES IN E-PAYMENTS

Durbin-Marshall Legislation
BNPL Default Rates
The Regulatory Threat
P2P Fraud
Shopping Cart Abandonment
Protecting Open Banking
How Not to Prevent Gun Violence
The Unattainable Goal of Zero Fraud
The Chip Shortage's Ongoing Impact
Can Stablecoins Find Stable Ground?

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contents

NOVEMBER 2022 • VOLUME 19, NUMBER 11

ISSUES IN E-PAYMENTS

Durbin-Marshall Legislation
BNPL Default Rates
The Regulatory Threat
P2P Fraud
Stopping Cart Abandonment
Protecting Open Banking
How Not to Prevent Gun Violence

The 10 Most Pressing Issues in E-Payments 18

The payments business has moved on from the pandemic, but it faces a host of other issues. Here's our annual catalog of the ones causing the most headaches.

THE GIMLET EYE The Great Experiment **4**

TRENDS & TACTICS **6**

The Fed Says Online Debit Counts, Too

More than a decade since the Durbin Amendment, the Fed says issuers must abide by the law for online transactions.

Apple Pay Later Than Expected

The operating system that supports Apple's snazzy new BNPL app is in place. Where's the app?

For the First Time, Debit Cards' Popularity Tops That of Credit Cards

A variety of advantages—including no interest charges—has catapulted debit card usage over the past year.

Plus, Security Notes laments that even sophisticated security firms are downplaying quantum computing's threat; and Payments 3.0 explores how payments players should approach their regulators in what has become a dicey new environment.

ACQUIRING **12**

The Processor Reaction

Acquirers are trying to disentangle the many implications of the proposed Credit Card Competition Act. Some doubt the bill's impact would be good.

E-COMMERCE **15**

Why Earned Wage Access Is Taking off

Enabling workers to tap their wages ahead of payday is gaining popularity among employees and employers alike.

NETWORKS **28**

Why the Metaverse Is the Next Big Opportunity

With digital commerce showing huge potential, it's time for payments players to take this virtual world seriously.

STRATEGIES **25**

Apple Pay Later Reconsidered

Apple's venture into BNPL may prove more difficult for the computing giant than it thinks.

ENDPOINT **31**

The Transformation of Business Payments

The pandemic sped adoption of digital payments, but it also revolutionized supply chains.

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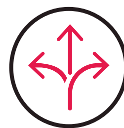

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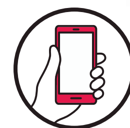

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the gimlet eye

THE LAW IS THE LAW

THE BUSINESS OF routing payment card transactions has been much in the news lately, first with a bill that would legislate network choice for credit card transactions and then with action by the Federal Reserve to reinforce a requirement that was supposed to guarantee merchants a choice of networks for debit card transactions.

The two actions have precisely one man in common—Sen. Richard Durbin of Illinois, whose interest in the arcana of payment card competition seems never to wane. He proposed earlier this year to bring downward pressure on merchants' credit card acceptance costs by requiring that merchants have a choice of at least two unrelated networks for processing. If one network is Visa, the other can't be Mastercard.

That may sound familiar. A dozen years ago, Durbin shepherded legislation into law that required that merchants have a choice of unrelated networks for debit card transactions. The legislation—which ultimately became an amendment to the massive Dodd-Frank Act—also included a provision that capped debit card transaction fees for large issuers. No such cap is part of Durbin's credit card proposal.

Time will tell how the credit card version will turn out. As it happens, however, the payments industry after all these years is still adjusting to the debit card provisions—which, agree with them or not, are the law of the land. So wayward has the industry been in this respect that the Federal Reserve finally had to issue a requirement last month clarifying that yes, issuing banks really do need to enable two unrelated networks for their debit cards.

Now, this column has never been particularly sympathetic to non-market solutions to competitive issues. But neither has it been keen on willful subversion of the law. Many banks have offered the excuse over the years that networks not called Visa or Mastercard simply can't handle aspects of modern debit card technology, such as PINless debit. Lately, too, some have argued that only Visa or Mastercard can decipher their own tokens—the technology that masks actual card account numbers. Merchants have howled over the years that workable solutions exist for both issues.

We don't pretend to any deeper understanding of this argument than the reasonably informed observer. But we have the conviction that none of these arguments by the banks actually holds water. Here's why. You may feel—as we do—that the law rests on faulty premises, but the law is the law. If banks are required to enable routing via a choice of networks, with the inclusion of capable systems like NYCE or Shazam, then that's what they must do. A dozen years of unlawful practice is enough.

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Trends in the Electronic Exchange of Value

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THE FED SAYS ONLINE DEBIT COUNTS, TOO

The Federal Reserve last month completed work on a clarification that reinforces a more than decade-old requirement that issuers enable a choice of at least two completing networks for online debit card transactions. The release follows months of research and investigation by the Fed and will go into effect July 1 next year.

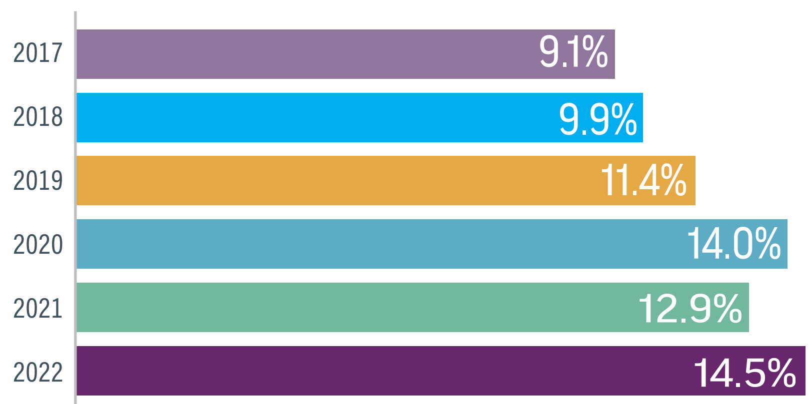
The announcement, which the regulator characterized as an "update" to its regulations enforcing the 2011 Durbin Amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act, answers years of complaints by merchants that issuers and processors were effectively shuttling all of their online traffic to a single network, typically Visa or Mastercard.

This practice, merchants have said, raised their transaction costs and violated the language of the law. Issuers and processors have maintained the practice is necessary in many cases where competing networks are unable to handle so-called PINless debit, or online transactions without the PIN codes cardholders enter to authenticate themselves in physical stores.

By contrast, merchants have complained for more than a decade that debit card issuers have largely evaded Durbin, which requires a

THE RISE OF E-COMMERCE

(U.S. sales as a fraction of total commerce, fourth quarter of each year)



Note: Figures are for the fourth quarter each year, except in 2022, where the figure is for the second quarter. Source: U.S. Department of Commerce

choice of at least two networks for both offline and online transactions.

"The industry has been waiting for this announcement for a long time," says Sarah Grotta, an independent payments-industry analyst. Even the Fed had been deliberate in arriving at Monday's clarification, she said, adding, "It's been a year since the Fed said this is the direction they were going in."

Merchant trade groups, which have long protested what they see as an effective absence of network choice in e-commerce, celebrated the Fed's announcement.

"This ruling is particularly important given the dramatic shift to e-commerce during the pandemic and the increased use of mobile apps and digital wallets for in-store purchases," said Doug Kantor, general counsel for the National Association of Convenience Stores, in a statement.

"These transactions account for a rapidly increasing share of our nation's economy and the Fed has closed a major loophole that allowed them to escape the competition intended by Congress," Kantor continued. "Card networks should have to compete the same as any other business."

E-commerce sales account for 14.5% of all U.S. retail sales, up from 9% five years ago, according to the Census Bureau (chart). But Fed research found that so-called single-message networks—systems that combine authorization and settlement in a single electronic message—processed 6% of all online, or card-not-present, transactions in 2019. By contrast, these networks handled some 40% of all in-store transactions that year. Single-message networks are seen as competitive alternatives to dual-messages networks such as Visa and Mastercard. National single-message networks include major systems such as NYCE and Shazam.

Now, with the Fed's October announcement, "all issuers need to ensure they have a PINless debit option. Many do, but many do not," says Grotta.

Issuers that lag may have only themselves to blame, say some observers. "The Fed's original implementation of the Durbin Amendment was crystal clear," notes Eric Grover, a payments analyst and consultant who opposed the Durbin Amendment. "The fact that some debit issuers chose not to comply with the law to enable at least two debit networks for all transactions offline and online is appalling, notwithstanding that it's bad law."

—John Stewart

APPLE PAY LATER THAN EXPECTED

Apple Inc.'s latest financial product, a buy now, pay later service called Apple Pay Later, has yet to arrive, though the iPhone operating system it was expected to require launched Sept. 12.

Why is that? One Bloomberg columnist suggests Apple Pay Later, which was announced in June, may not arrive until 2023. His argument rests on Apple's statement that other delayed features of the new iPhone operating system, iOS16, will be coming later this year, though the statement left out a timeframe for Apple Pay Later.

"This leads me to believe that the company isn't completely certain when Apple Pay Later will be ready for launch," Bloomberg's Mark Gurman, says in a post. "It's possible the feature won't arrive until iOS 16.4 in the spring. I'm hearing there have been fairly significant technical and engineering challenges in rolling out the service, leading to the delays."

What's really going on is anyone's guess. Apple did not respond to a *Digital Transactions* inquiry.

Apple Pay Later will work as do many other BNPL services, with purchases divided into four equal payments over six weeks, though Apple intends to self-finance its service. Apple Pay Later will use Mastercard Inc.'s installment infrastructure, enabling merchant acceptance with no integration requirements.

Apple faces a number of challenges with its entry into what has turned into a hotly competitive BNPL field, some observers point out, not least the delicate matter of gauging consumer credit risk (page 25).

Still, other experts say a delay in launching Apple Pay Later may not be as detrimental as it sounds. "There's still an opportunity to make a splash even if it's delayed," says Sheridan Trent, director of marketing intelligence at The Strawhecker Group, an Omaha, Neb.-based consultancy. "This is Apple. They have very loyal customers. They've obviously got

significant market share when it comes to people's phones and how they use it."

A technical issue could be why Apple Pay Later is yet to come, she says. Or perhaps the prospect of impending regulation may be the holdup. Earlier this month, the Consumer Financial Protection Bureau released a report on buy now, pay later services that offered a regulatory outline, but no sweeping overhaul. "We're kind of in a regulatory confusion here," Trent says. "But it looks like there will be some kind of regulation coming. It's hard to say."

If Apple is waiting that out, the delay could be a while, given the typical pace of regulatory implementations. "If it's driven by regulation, it might be more than a year," she says. "It may not."

While consumers have plenty of BNPL options, Trent doesn't think a delayed entry for Apple Pay Later will harm it, though it means the service could miss out on the upcoming holiday-shopping season. "We've seen from past behavior that people really like BNPL," she says. She acknowledges that Apple wants to offer a quality product, but the holiday-shopping season is prime for BNPL use.

"I don't think there's a significant disadvantage to that," says David Morris, principal analyst at Insider Intelligence, a New York City-based research firm. Yes, competitors can use the time to advance their positions, and there could be a downside in that regard, he says. "But that does not discount the competitive advantages that Apple will still have," Morris says, such as Apple Pay, the Apple Pay user ecosystem, and other strengths.

And perhaps Apple held up on releasing Apple Pay Later to let the regulatory landscape clear up a bit. "There are some unresolved regulatory issues that Apple Pay Later may actually benefit from stepping in a few months later, given the quick pace the CFPB has taken in assessing the issues of concern," Morris says. "It may be a in a position to step into BNPL lending with a clearer regulatory framework."

—Kevin Woodward

FOR THE FIRST TIME, DEBIT CARDS' POPULARITY TOPS THAT OF CREDIT CARDS

Consumers' usage of debit cards has finally surpassed that of credit cards. Through the second quarter of 2022, 56.2% of consumers preferred debit as their primary payment card, compared to 39.5% for credit, according to a report from S&P Global Market Intelligence.

Those numbers represent a dramatic change in the payments landscape, as just 40.2% of consumers cited debit as their primary payment card as recently as last year, compared to 54.6% for credit.

The reasons for the overwhelming shift are varied. On a broad scale, they include lower or no fees for debit card use, faster settlement, the additional security feature of a PIN for card-present transactions, and no interest charges. Another factor is that consumers view debit as a way to prevent overspending and to better manage their finances.

"Predictability, low/no fees, and greater ease of managing money are the primary benefits of using debit cards," says Jordan McKee, director, fintech research and advisory for 451 Research, a technology-research group within S&P Global Market Intelligence, by email.

When drilling down into the reasons, however, two stand out: the growing issuance of contactless cards and the popularity of buy now pay later loans, McKee says.

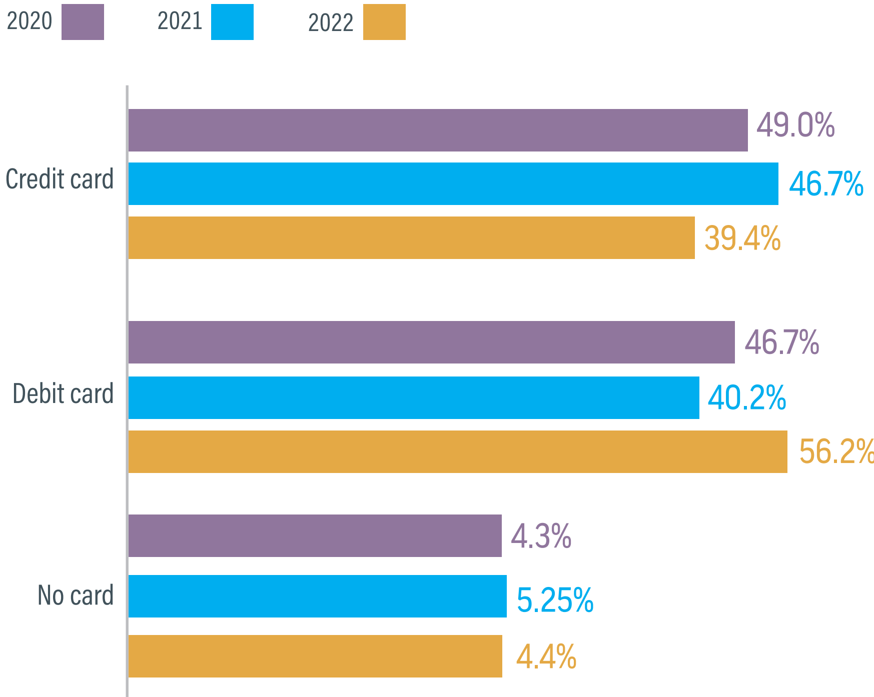
In the United States, 59% of consumers have a contactless card, and 34% of those consumers say they are using their card more often due to the card's tap-to-pay functionality. Those factors are opening the door for debit cards to be used for more everyday and smaller-ticket purchases, according to the report.

"As we have seen in markets like Australia and the United Kingdom, contactless debit cards tend to displace cash for smaller-ticket purchases, leading to an increase in card utilization," the report says.

Dovetailing into that trend, the report points out that consumers have begun to favor debit cards more for everyday purchases during the Covid

DEBIT WINS A PRIMARY

(Percentage of consumers viewing credit and debit cards as their primary cards)



19 pandemic, a category where debit usage has been particularly strong. As a result, consumers have started using credit cards more for discretionary spending, according to the report.

BNPL's influence is being driven by Gen Zers, millennials, and Gen Xers, all of whom, the report says, are heavy users of BNPL. Consumers who view BNPL loans as a replacement for credit card debt say they can pay them off using their debit card.

"Our research shows that Gen Z and Millennials are often credit-averse, and prefer the predictability of debit," McKee says. "The rise of BNPL options has helped younger consumers continue to rely on debit while still gaining access to greater purchase flexibility."

Debit card usage among Gen Zers, Millennials, and Gen Xers has grown substantially the past year. Debit usage among Gen Zers has risen 26.8 percentage points since 2021, while Millennials and Gen Xers increased their debit card usage by 18.4 and 18.6 percentage points, respectively during the same period.

Lastly, security is likely playing a role. Indeed, 71% of payment card users indicated that privacy and security are major factors influencing their payment card choice, according to the report. "While debit and credit are both subject to security/fraud protections, consumers might view debit as a more secure payment method since it offers an additional layer of authentication via a PIN," the report says.

Despite younger consumers' growing preference for debit cards, the jury is out on whether the trend will continue as those generations age.

"As younger consumers—those with the strongest preference for debit—mature, the question remains if they will 'graduate' into credit card users," says McKee. "BNPL will likely play a role here and could result in these consumers continuingto rely heavily on debit while leveraging BNPL tactically for larger purchases."

—Peter Lucas

MONTHLY MERCHANT METRIC

Total Gross Processing Revenue %

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

Total Gross Processing Revenue % - 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 datawarehouse of over 4M merchants in the U.S. market. The ability to understand this data is important as SMB merchants and the payments providers that serve them are key drivers of the economy.

All data is for SMB merchants defined as merchants with less than $5 million in annual card volume.

Period	Total Gross Processing Revenue %
Q1'21	2.399%
Q2'21	2.433%
Q3'21	2.450%
Q4'21	2.450%
Q1'22	2.471%
Aug'22 (T3M)	2.523%

Source: The Strawhecker Group © Copyright 2022. The Strawhecker Group. All Rights Reserved. All information as available.

LIFEBOATS ON THE TITANIC

BY
GIDEON
SAMID
gideon@bitmint.com

Call me a sore loser, if you will, having just lost the prestigious G20 BIS 2022 CBDC contest to a payment company from the Philippines, Dragonpay. I arm myself with excuses. Perhaps. Dragon is a fine, accomplished outfit. The thoughtful judges saw more merit there than they identified in BitMint.

But the reason I bring this story to the readers of my column is that BitMint's slogan was "Quantum Safe Technology," which was a cry in the wilderness. Only one other competitor, Idemia, addressed the quantum threat. None of the other shortlisted finalists in this competition (Mastercard included) claimed priority on account of their resilience to the pending quantum attack.

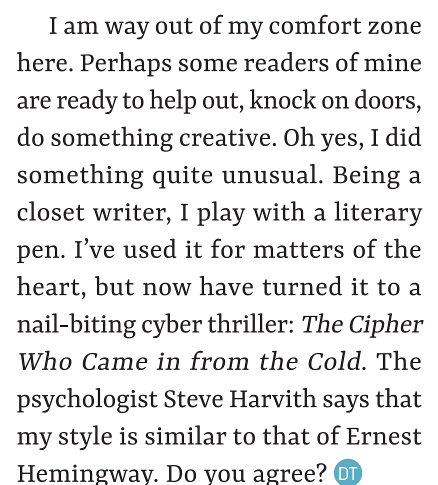
Moreover, when I asked the judges about the weight of quantum resilience in their considerations, the answer was unanimous: not a priority, nothing imminent, and anyway, the U.S. National Institute of Science and Technology (NIST) has already published several quantum-resistant algorithms, so all is well.

The prize-awarding international event brought together global financial executives of the highest order. They talked about what they know: cross-border, settlements, privacy, money laundering, escrow—policy, policy, policy. The fact that cyber finance (legacy and digital) relies on an obscure mathematical construct called an elliptic curve was not brought up. The fact that financial cybersecurity is hinged on the assumption that its attacker is armed with no more than Turing machines was not mentioned. The reality that every serious crypto shop in the world is busy advancing quantum computing—and most of them are doing so in stealth—was not an issue.

As to NIST, they are worried indeed. They launched a global campaign to develop quantum-resistant algorithms to meet the threat that bankers stubbornly ignore, and they are in a hurry. Unlike climate change, where we have credible models for when the coming threat will arrive and how damaging it will be, with quantum we have no credible estimate as to when the blow will fall and how powerful it will be. What is easy to conclude is that, if quantum hits before we are ready, global cyber payments will collapse. Only coins and banknotes will do.

Cryptographically speaking, we have a brute-force quantum defense, ready to fend off any attack, quantum included. I have personal knowledge that high-value cyber targets integrate this "pattern-devoid cryptography" in their cyber-defense posture. But talking about it is not good for business. It highlights the vulnerability of the ciphers the industry is promoting as flawless.

The Titanic was billed as the ship that could not sink, packed with the latest in high tech. It was a lonely voice that argued in favor of lifeboats, "just in case." That is how I see us, the few and far between who ask, while NIST is developing quantum-resistant high tech—none of which has been field-tested—why not deploy what we do have, which does not need testing because it comes with a "good-to-go" stamp from the most reliable source humanity has: mathematics. We have the lifeboats just in case. We hope we will never have to use them.



I am way out of my comfort zone here. Perhaps some readers of mine are ready to help out, knock on doors, do something creative. Oh yes, I did something quite unusual. Being a closet writer, I play with a literary pen. I've used it for matters of the heart, but now have turned it to a nail-biting cyber thriller: *The Cipher Who Came in from the Cold*. The psychologist Steve Harvith says that my style is similar to that of Ernest Hemingway. Do you agree? DT

REGULATORS: SQUARE OFF OR PARTNER UP?

BY BEN JACKSON
bjackson@ipa.org

SHOULD AN INDUSTRY square off against its regulators or partner up with them?

The answer shapes consumers' access to financial products, and thus their financial lives. An acrimonious relationship stifles innovation, leaving consumers with fewer options to meet their financial needs.

Unfortunately, many signs point to a lot of future grappling between payments providers and regulators.

An early sign of this growing acrimony was PayPal's lawsuit in December 2019 against the Consumer Financial Protection Bureau. PayPal opted to sue the Bureau rather than work through the regulatory process to try to make changes to the prepaid rule. While it is impossible to read the minds of PayPal's executives, it is clear they did not see any other path forward.

More recently, the American Bankers Association and six other trade groups in September sued the Bureau and director Rohit Chopra over a March update to the Unfair, Deceptive, and Abusive Acts and Practices (UDAAP) exam manual. The update expanded the statutory definition of "unfairness" to include discrimination. The plaintiffs said the Bureau had overstepped its statutory authority. (The Innovative Payments Association was not a party to this suit.)

At the same time, the Bureau's approach to the industry has become increasingly unfriendly over the past two years. I detailed some of the changes in my July column. The upshot is that the Bureau is telling fintechs it will be watching them closely—but not working with them—to ensure consumer protections.

While regulatory agencies should not be captive to the industries they regulate, they need to understand those industries. They cannot get a full picture of an industry without a willingness to learn how it operates. Consumer advocates can provide important feedback, but they rarely, if ever, provide information about how consumers benefit from products or services.

In recent months, we've seen approaches to consumer protection that do not require brawls.

For example, the Biden Administration is taking great pains to understand cryptocurrencies while simultaneously looking to protect consumers and promote innovation. In March, an executive order launched a "whole-of-government approach to addressing the risks and harnessing the potential benefits of digital assets and their underlying technology."

Crypto is not the only place where there are benefits and risks to new technology. Perhaps other regulators could follow the White House's lead and consider new payments technology holistically before looking to regulate them or promulgate guidance that changes the interpretation of existing laws and regulations.

Another example of a public-private partnership is the Federal Trade Commission's Scams Against Older Adults Advisory Group, of which the IPA is a member. The group was created as part of the Stop Senior Scams Act, passed in March. It has four priorities: "1) expanding consumer education efforts; 2) improving industry training on scam prevention; 3) identifying innovative or high-tech methods to detect and stop scams; and 4) developing research on consumer or employee engagement to reduce fraud."

These goals require the participation of all stakeholder groups. Stopping financial crime requires a team effort, and the FTC recognizes the important role that industry plays on that team.

The Advisory Group can serve as a model for the ways in which the industry can engage with government agencies and consumer advocates to bring real solutions to problems. Other agencies might consider how they could form similar groups.

Payments providers meet people where they live as their customers face everything from economic hardship to fraud to new technology. Providers can share a lot of knowledge based on those daily interactions that can contribute to protecting consumers and the financial system. They should not be shut out. DT

THE PROCESSOR REACTION

Acquirers are trying to disentangle the many implications of the proposed Credit Card Competition Act. Some doubt the bill's impact would be good.

BY KEVIN WOODWARD

THIS ROAD HAS been traveled before. This time, U.S. Sen. Richard Durbin (D-Ill.) wants to place restrictions on credit card practices, specifically transaction-routing practices.

As *Digital Transactions* reported in September, the bill (introduced in July), would require that all banks with $100 billion or more in assets offer acquirers a choice of two unrelated networks for routing. If one network is Visa, the other can't be Mastercard.

The hope is other networks, including debit card systems like Pulse, Shazam, or Star, will compete for the business, driving down transaction costs for merchants.

But while this credit card bill resembles a similar requirement for debit cards enshrined in the Dodd-Frank Act as the Durbin Amendment, it differs from that 2011 law in an important respect. The Durbin Amendment imposed caps on debit card fees applied to card issuers with more than $10 billion in assets as well as ordaining routing choice. This latest credit card measure only tackles routing choice.

Still, these laws have a way of taking on nuances over time. The Federal Reserve just in October said that Durbin's requirement that issuers enable a choice of at least two competing networks for debit transactions also applies to card-not-present debit transactions.

Last month, Sen. Durbin tried to attach the credit card legislation, known as the Durbin-Marshall bill, to the National Defense Authorization Act, which sets the annual Department of Defense budget and must be passed by the U.S. Senate and House before President Biden can sign it into law. That effort fell short mid-month when the defense bill went forward without the credit card legislation attached.

Another Durbin and Marshall amendment, more focused on fees commissary users pay, would have required the Defense and Treasury departments to issue a report on surcharges some veteran

Hoch: Merchants "would push to the point of card issuers paying them."

classifications pay to use credit and debit cards in commissaries.

THE MAIN ACT

But the Credit Card Competition Act of 2022, as the credit card routing bill is styled, is the main act. Retailer groups, such as the National Retail Federation, have warmly welcomed the proposed law.

"Opening the business of routing credit card payments to new players will mean merchants and banks can now accept credit card networks that charge lower costs," says Brian David Crane, founder of Spread Great Ideas, a digital marketing fund. The impact of the bill could mean businesses "will have far more options for choosing the kind of payment networks they have to deal with."

While the card-competition amendment has generated scads of attention, its direct impact on acquirers might be restrained. Meanwhile, it could have broader implications for the overall payment card business.

Some processors claim the bill, should it become law, will have little or no effect on them. "From our point of view, it doesn't really affect us much," says Louis Hoch, cofounder and chairman of Usio Inc. "It won't affect how we sell." San Antonio-based Usio offers payment acceptance, funds disbursement, and related services to merchants.

But pull back a bit from the acquirer focus and the impact could be larger, he suggests. "It will only benefit the big retailers," Hoch says, those that pay according to a cost-plus model of pricing. That credit card acceptance model assesses the interchange rate plus a fee for each transaction. Many

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Crane: Alternative networks can please consumers with "similar rewards programs."

smaller merchants pay a bundled rate and may lack the volume to negotiate a different rate scheme.

Hoch says the impact will hurt the infrastructure of the whole payment system. "Hopefully, it doesn't pass," he says. He ventures that should it be approved, the bill would just force income streams to shift. "The banks will find a different way to recapture that income," he says. "What might get lost is the consumers may have the most harm because they could potentially lose benefits they've been relying on, like cash-back options."

And while Durbin's strategy of attaching the proposed legislation to a must-pass bill like the National Defense Authorization Act fell flat, the effort may also have exposed the legislation's inherent weakness, some industry players say.

It is perhaps the realization the Durbin-Marshall bill wouldn't be able to advance on its own that it was attached to the NDAA, suggests Jeff Tassey, chairman of the Electronic Payments Coalition, a card-industry lobbying group. "Just like the original bill, with Dodd-Frank, he has to find some other way to get this into must-pass legislation," Tassey says.

He adds the bill could end up attached to an omnibus spending bill much later this year, he says. "They have another bite of the apple in the omnibus in the lame-duck session," he says. The omnibus bill is intended to keep everything funded, he says.

'DOWNSTREAM IMPACT'

Attaching the Durbin-Marshall bill to crucial legislation like the defense-spending measure was a nice try, says Patricia Hewitt, proprietor of PG Research & Advisory, a Savannah, Ga.-based payments consultancy. Now, she says, rival global networks and large retailers are likely to be the beneficiaries if the bill passes into law on its own merits.

"The big winners are potentially AmEx and Discover, who stand to gain issuers as the only other two global card networks in the mix," she says.

Hewitt says the impact could be limited since not all issuers would be affected by the law, "but the results may be similar."

Her take is that the largest merchants will gain much from this legislation "since they will bring the card networks to the table and force pricing concessions including favored interchange fee rates." And, like Hoch, she suggests a shift in costs may follow.

"Due to the technical impact these changes will force on the market, overall costs for all participants will rise," Hewitt says. "However, I'm of the opinion that, especially with chips on all cards, it's less onerous than it might have been if the industry was still dependent on magstripe, but there's still a lot of downstream impact."

That's exactly where Hoch suggests the impact will be, should the bill become law. "If this goes through, it will only benefit large merchants that have the cost-plus model," he says. "We won't change our pricing."

History could be instructive here. When the Durbin Amendment went into effect, many acquirers retained their pricing and bundled debit card transactions into one rate or a small number of rate pools.

'IT WILL NEVER STOP'

And what about the impact on cardholders? Hoch does not see how the Durbin proposal will yield any savings for consumers. Instead, it will damage the cardholder's experience with her credit card, he argues. "The issuer will recoup that income in a different way," he says.

Spread Great Ideas' Crane disagrees. The bill, if it passes into law would likely please most merchants, but it could also lead to systems that will work to the advantage of consumers, he suggests.

"This will surely appease merchants who have advocated for lower card-acceptance costs," he says. "Yet, suppose the new card-processing alternatives, e.g., current debit-only networks, can provide similar rewards programs as consumers have always enjoyed with Visa and Mastercard with more secure and cheaper options. In that case, I believe consumers will be more than happy to adapt."

But even if the bill passes, Hoch doubts the big merchant groups will cease their push for lower interchange and card-acceptance fees. "They would push to the point of card issuers paying them," he says. "It will never stop. They will never be happy." DT

WHY EARNED WAGE ACCESS IS TAKING OFF

Enabling workers to access their wages ahead of payday is gaining popularity among employees and employers alike.

BY **PETER LUCAS**

HOURLY-WAGE EMPLOYEES and gig workers incur unexpected expenses between paychecks, such as a home or auto repairs or medical bills, for which they don't have the cash. Their choices are taking out a payday loan or paying the bill with a credit card. Both options increase their debt load. Or they can wait until their next pay day and pay the bill late, for which they incur a late fee.

It's no wonder, then, that payroll advances have grown in popularity in recent years. The advances, distributed through a digital option called earned wage access, allow hourly and gig workers to tap a portion their wages outside a normal pay period at a nominal fee or at no cost.

That's a big plus for hourly workers who need cash to cover unexpected expenses. Some 80% of these workers have less than $500 in savings, according to Branch, a provider of financial services including earned-wage access, or EWA.

EWA has become such a popular perk that many hourly wage and gig workers have come to view the offering as a benefit that can sway their decision on whether to accept a job offer, especially if they had EWA through other employers, experts say.

"Employees that have had EWA tend to look for employers that offer it when searching for a new job," says Francisco Alvarez, an advisor for Aite-Novarica Group, a Boston-based consultancy. "These workers look at EWA like a traditional employee benefit, such as paid time off or health insurance."

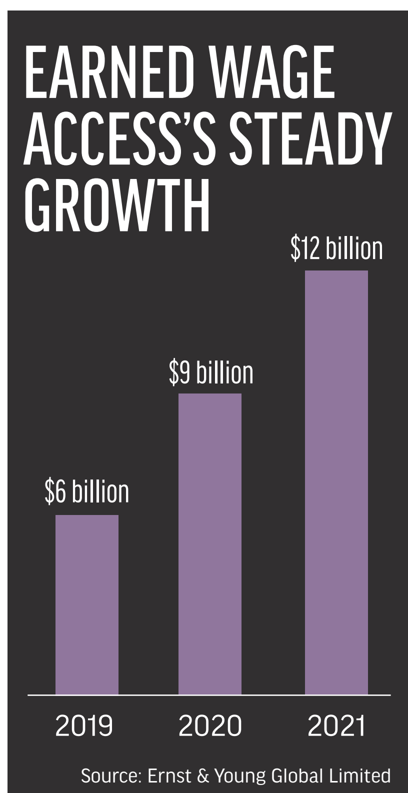
'AN INCREDIBLE BENEFIT'

One of EWA's most prominent benefits is that it can spare employees from paying late and overdraft fees when they get caught in a cash crunch,

says Michelle Young, vice president of operations for Automated Data Processing Inc.'s Employee Financial Solutions Group.

On average, hourly wage workers incur more than $1,000 in fees annually from a temporary inability to pay their bills, Young says. Offering EWA helps these employees improve their financial wellness, she adds. ADP offers EWA through its Wisely digital-payroll solution.

Pegged as a $12-billion market in 2021, up dramatically from $6 billion only in 2019, EWA is poised to grow 30% annually, according to Advasa, a Japanese provider of EWA services. While the market is still relatively small in terms of annual dollar volume at the moment, it has the potential to become a $12-trillion market annually, according to Ernst & Young Global Limited. Currently, there are about 20 EWA providers in the United States and 10 in Japan, according to Advasa.



Source: Ernst & Young Global Limited

Approximately 12% of the workforce in the United States has access to EWA, according to EWA provider Immediate Financial Services. "The size of the EWA market is changing rapidly as employers realize the benefits of offering it," ADP's Young says. "Nine of 10 employers are aware of EWA, and of those employers, the majority want to offer it."

For employers, the benefits of offering EWA can be substantial, as it can help attract new employees at a time when many businesses have been struggling to fill vacant positions. It can also help retain employees.

The latter benefit is a very attractive proposition for employers during what's become known as the great resignation, an ongoing trend in which employees have voluntarily resigned from their jobs en masse. The trend began in early 2021 during the Covid-19 pandemic.

Birmingham, Ala.-based Immediate says 80% of employees would prioritize an employer that offers EWA over one that does not.

"In the current era of the great resignation, giving employees flexibility [around] their paychecks is an easy way to create a positive impression, enhancing brand images while reducing turnover," says Itaru Inaho, Adavasa's vice president of corporate planning. "With EWA, for example, employees are less likely to take out credit card debt or source a payday loan when faced with financial troubles, [which is] an incredible benefit."

With EWA, employees can request an advance of up to 50% of their earned wages during their current payroll period. To reconcile the advance, employers typically have the advanced sum deducted from the employee's next paycheck. In some cases, employees are charged a fee between $1 and $5. In others, the employer absorbs the cost of the advance.

For gig workers, one benefit is that they can receive advances after completing a shift. Some EWA providers are also making its possible for hourly wage workers who also earn gratuities to receive at the end of a shift the tips that customers paid as part of a credit or debit card payment. Branch, for example, has offered this option since 2020.

The option was developed in response to consumers' growing use of cards during the Covid-19 pandemic.

"As more tips were being placed on cards during the pandemic, that money could not be paid out right away since the tips were not paid in cash," says Branch chief executive Atif Siddiqi. "Restaurants and hair salons are businesses that receive a lot of tips on cards, and enabling workers to have access to those funds outside of payroll is a big plus."

To make it easier for Uber drivers to receive their earnings, Branch recently partnered with card-issuing platform Marqeta Inc. to issue the Uber Pro Card, a Mastercard-branded business debit card to which earnings can be automatically deposited after every trip at no cost.

Drivers and couriers can also access up to $150 of their earned fares through the card, as well up to 10% cashback on gas and up to 12% on electric-vehicle charging, Branch says. In addition, drivers and couriers will have access to health-care benefits through Stride, a benefits platform provider for independent workers.

"These kinds of features help hourly wage and gig workers with

budgeting and long-term planning of their finances," says Siddiqi, who adds that more than 300 businesses use Branch's EWA solution.

'DIRE CONSEQUENCES'

For employers, EWA can increase productivity and reduce absenteeism. A recent survey by EWA provider Immediate Financial Services of its customers revealed that 82% of workers say they feel more engaged on the job since having access to their earned, but unpaid, wages.

Immediate's EWA offering integrates with an employer's time-tracking software to receive real-time updates of employee hours worked and wages earned. Earnings can be transferred to a bank account or reloadable debit card.

One reason employee productivity improves when EWA is available is that workers tend to bring their financial worries to work, which can impact their productivity, according to ADP. "More than 70% of [hourly wage] employees worry about finances at work and more than one in three workers worry about personal finances more than once a week, and that impacts productivity," says ADPs Young.

At the same time, some 31% of employers offering EWA say they have seen a reduction in employee absenteeism, according to ADP. It is not uncommon for gig and hourly wage workers to call in sick so they can pick up second jobs when in need of extra cash outside their normal payroll period, experts say.

"Alleviating financial stress leads to a more productive workforce," says Immediate chief executive and founder Matt Pierce. "Dealing with unexpected financial needs is one of the biggest stressors facing workers today. These challenges have dire consequences for employees, which in turn can spell big trouble for employers…by driving down employee engagement and satisfaction."

Increased employee retention is another benefit to employers offering EWA. Immediate, for example, has found that, among its users, employee turnover can be reduced by as much 40%. That's a big savings for employers as it costs a business six to nine months of a lost employee's salary to find and train a replacement, according to Advasa.

'REGULATORY CLARITY'

EWA's growth has not escaped the attention of federal and state regulators, however. For the most part, providers see increased regulation as a good thing, as it can lead to industry standards. The key to preventing regulation that could stifle competition is to help regulators understand how EWA can improve employee's financial wellness, experts say.

"We want regulators, especially at the state level, to understand the importance of earned wage access to employees," says Young. "Even though the Consumer Financial Protection Bureau has weighed in on earned wage access, we expect regulations to come at the state level. So far, no state has issued a definitive judgment on EWA."

While the Consumer Financial Protection Bureau indicated earlier this year it is likely to take a harder second look at EWA, the agency issued an advisory statement in November 2020 that EWA does not constitute a loan or credit provided the employee makes no payment to access wages earned through EWA.

One area where regulators are likely to scrutinize EWA is how providers make use of the data linked to the transactions, says Aite-Novarica's Alvarez. Nevertheless, Alvarez doubts that increased regulatory scrutiny will slow the growth of EWA.

"Some aspects of earned wage access can be confusing, so there is a need for regulatory clarity, but I don't see that slowing growth. It's more likely that increased regulation will result in a single fee structure," Alvarez says.

If anything, the growth of EWA will help employers and payroll providers to rethink how the traditional pay period works. "Traditional payroll was developed with payroll practitioners so employers had the capital to pay their employees," says Young. "Today, flexible pay is not only becoming table stakes, it's making payroll employee-centric." DT

EWA BY THE NUMBERS

80% The percentage of Fortune 200 companies that have adopted EWA

55.8 MILLION The number of workers who used an EWA Solution in 2020

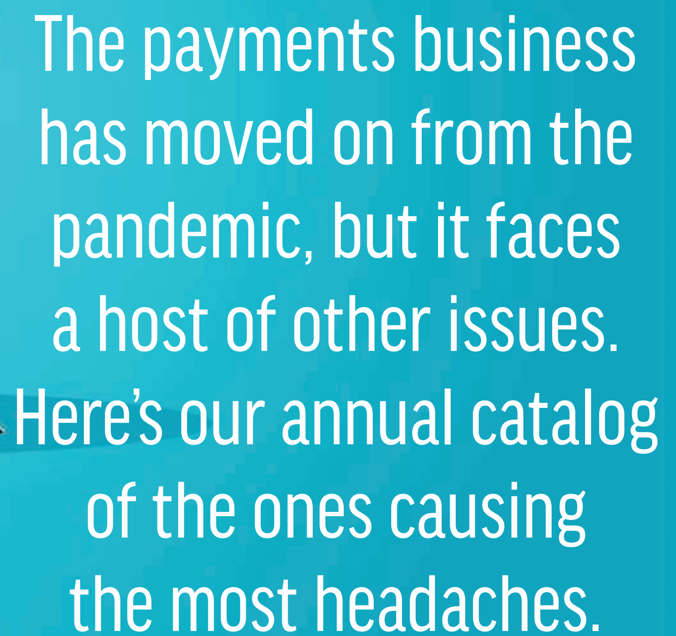
30% Projected annual growth rate for EWA

$32.4 MILLION Size of the global payday loan market in 2020

Source: Advasa

16TH ANNUAL

THE 10 MOST PRESSING ISSUES IN E-PAYMENTS



The payments business has moved on from the pandemic, but it faces a host of other issues. Here's our annual catalog of the ones causing the most headaches.

BY PETER LUCAS, JOHN STEWART, AND KEVIN WOODWARD

WELCOME TO DIGITAL TRANSACTIONS' ANNUAL CATALOG OF HEADACHES— the problems, pitfalls, and perils facing the business of processing digital payments. We review these issues not out of a sense of masochism but from a belief that problems defined and squarely faced are problems that are likely to be defanged.

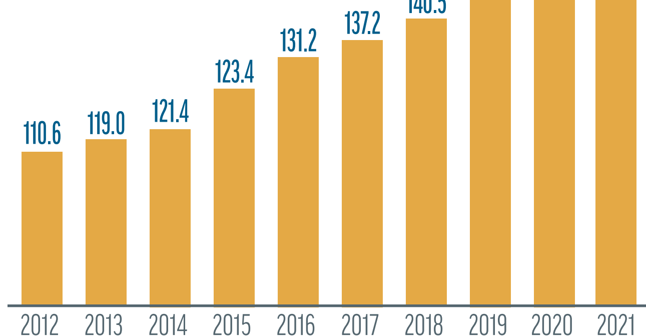
Defining is our part of the puzzle. Solving is yours. But we can help by laying out, in brief, what constitutes the issues and how they rank in severity. Not all problems are equally pressing, after all, and not all players in the payments industry face the same ones. Best to identify the issues you're struggling with and then attack them according to their severity.

You may take issue with how we've ranked these issues. For example, chip shortages are still a major hassle bedeviling a couple of significant sectors of the payments industry—point-of-sale equipment and chip cards. So why is this problem down there at number 9 on our list? The issue, while still very much relevant and not wholly solved, has been widely discussed for some time now. We couldn't exclude it, but several other problematic trends—the Durbin-Marshall effort to control credit card routing, for example, not to mention the newly energized CFPB—are of more recent vintage.

Our purpose isn't to ruin your day. Nor is it to cry out without purpose. If you have attacked some of these issues with success, please let us know. We'd be interested to hear about it. You can reach me at john@digitaltransactions.net.

CONSUMER ELECTRONIC TRANSACTIONS IN THE U.S.

(In billions)



Note: Figures include all consumer-based card and ACH volume.
Source: Digital Transactions estimates

1 Durbin-Marshall Legislation

The other shoe appears to have finally dropped. More than 10 years ago, U.S. Sen. Richard Durbin (D.-Ill.) got what is called the Durbin Amendment into law to regulate debit card transaction pricing and routing. Now, he is a principal sponsor of the Credit Card Competition Act of 2022. The bill—introduced in July—would require that all banks with $100 billion or more in assets offer acquirers a choice of two unrelated networks for routing. If one network is Visa, the other can't be Mastercard. The hope is other networks, including debit card systems like NYCE, Pulse, or Shazam, will compete for the business, driving down transaction costs for merchants.

Unlike the Durbin Amendment, which imposed caps on debit card fees applied to card issuers with more than $10 billion in assets as well as ordaining routing choice, this measure only tackles routing choice. Another Durbin and Marshall amendment, more focused on fees commissary users pay, would require the Defense and Treasury departments to issue a report on surcharges some veteran classifications pay to use credit and debit cards. Its prospect for passage is uncertain, as it wasn't added as an amendment to a defense spending bill, though it could be attached to that bill or another later this year.

Should it pass into law, some obvious implications surface, such as an issuer's ability to fund credit card rewards programs. But others may not be so apparent. Some in the acquiring industry see little benefit other than for the largest of merchants. Merchant advocates argue it could open new opportunities for non-credit card networks that may want to offer credit card routing services.

2 BNPL Default Rates

The numbers don't lie. With the explosive growth of buy now pay later loans, which are projected to grow 45% annually through 2030, many consumers are using the loans to spend beyond their means. That raises concerns that default rates, as well as delinquencies, may be poised to jump substantially.

A survey by Lending Tree found that 68% of BNPL users admit to spending more than they would if they had to pay for everything upfront. Millennials are the most likely to spend more with a BNPL loan than they would otherwise, with 75% acknowledging they overspend when using BNPL, followed by Gen Zers (69%) and Gen Xers (63%).

Consumers' use of BNPL loans to purchase beyond their means is not the only indicator default rates may be poised to increase. A recent study by Achieve, a digital personal-finance lender, found that many BNPL users are apt to use BNPL as a way to stretch out their credit limits on existing credit cards and other accounts. Achieve customers with BNPL loans also have more open credit lines and lower average credit scores than those without BNPL accounts.

In addition, delinquencies continue to be a nettlesome problem. Lending Tree found that 42% of consumers who've taken out a BNPL loan have made a late payment.

"The ongoing expansion of the BNPL's industry's reach comes alongside a period of historic inflation and rising interest rates that's putting a strain on household finances," Achieve co-founder and co-CEO Andrew Housser said in a prepared statement. "Buy now, pay later can be attractive for consumers seeking an interest-free option to pay for purchases over time. But even without finance charges consumers can still get over-extended using these loans."

3 The Regulatory Threat

After years of a relatively light touch, federal regulators are ratcheting up their scrutiny of the payments industry. According to payments experts, two trends driving the increased scrutiny are: a) innovation in payments in recent years has been outpacing regulators' ability to keep up; and, b) the new regulatory activism under the Biden administration.

Leading the charge is the Consumer Financial Protection Bureau, which has requested Google LLC, Apple Inc., Facebook parent Meta Platforms Inc., Amazon.com Inc,, Block Inc. (formerly Square Inc.), and PayPal Holdings Inc. to provide information about their payment products, plans, and practices when it comes to collecting consumer data, how it's being used, and whether their data gathering complies with data-privacy and -protection laws.

The CFPB has also looked at buy now pay later lenders and created the Office of Competition and Innovation with the aim of promoting competition in financial services and identifying stumbling blocks for new market entrants.

In addition, the Federal Trade Commission is also looking at big tech companies, while Sen. Elizabeth Warren is pressing Early Warning LLC, operator of the Zelle network, about fraud on the P2P network.

"President Biden has been very vocal about prioritizing consumer protections and this directive has clearly spurred federal agencies like the FTC and CFPB into action," Jeff Tassey, chairman of the Electronic Payment Coalition told Digitsal Transactions earlier this year ("Behind Washington's Tougher Stance on Payments," July). "It's important for regulators and lawmakers to remember that one size does not fit all when it comes to regulating the industry and protecting consumers. It's also important to remind them about how innovative payment technologies helped to keep small businesses open during the pandemic and fueled our economic recovery. We can't afford to stifle innovation."

4 P2P Fraud

Peer-to-peer transactions are growing increasingly popular, but unfortunately that popularity is high with fraudsters as well has honest folk. Lately, the issue has grown serious enough to catch the attention of Congress, as eight U.S. Senators this summer zeroed in on Early Warning Services LLC with a letter asking questions about "fraud and scams" on the company's increasingly popular Zelle network. Zelle competes with systems like PayPal's Venmo and PayPal itself.

One of the Senators—Elizabeth Warren, D-Mass.—later issued a report ripping into the seven major banks that own Early Warning for withholding data for a report she prepared concerning fraud and scams on Zelle. "At nearly every turn, most of the big banks have stonewalled, refusing to provide the information requested by members of Congress," she said. Warren singled out Wells Fargo in particular, claiming its rate of fraud on Zelle transactions was almost twice as high as for "other banks."

That was too much for Early Warning, which shot back with a terse release claiming "recent statements regarding Wells Fargo's fraud and scam rates are inaccurate. Wells Fargo's rates of reported fraud and scams are extraordinarily low and comparable to the Zelle Network as a whole."

Part of the debate concerns the distinction between "fraud" and "scams," and what entity should take responsibility for consumer losses in each case. Fraud is seen as outright theft of a consumer's account—an action clearly not authorized by the consumer. Scams are cases in which a clever fraudster gulls a consumer into sending him money—the transaction, though fraudulent, is authorized. A draft bill this summer in the U.S. House of Representatives would amend the 44-year-old Electronic Funds Transfer Act to explicitly cover instances where consumers authorize transactions as a result of fraudulent inducement.

5 Shopping Cart Abandonment

The downside of the e-commerce boom has to do with cases where shoppers simply give up before, or perhaps even during, checkout—a phenomenon known as shopping-cart abandonment. A report from Coresight Research this fall estimated the overall abandonment rate for the broad e-commerce industry ranges from 74% to 77% of all carts.

A number of factors account for online consumers giving up before they check out. So-called extra costs, such as shipping costs, fees, and taxes ranked high as a reason among both the retailers and consumers polled by Coresight. Complicated checkouts also ranked high as a motivator to walk away. Merchants cited the need to create an account as a potent turnoff, while consumers rated an absence of alternative payment methods as a prime motivator to abandon a full cart.

In any case, that eye-popping abandonment rate is plaguing an industry that otherwise could be racking up even bigger gains in retail sales. Coresight's recommendations to merchants? Simplify the checkout process as much as possible, with for example password-less logins and one-click checkout. Also, offer as many alternative payment methods as possible, including buy now, pay later, digital wallets, and prepaid cards.

LONDON BRIDGE

Hi Sarah,

Remember this piece of awesomeness that you've left behind?

Pieces like this don't stay for long and unfortunately, is nearly out of stock ! Don't miss your chance !

Complete your order now!

Take me to my cart

6 Protecting Open Banking

Open banking has opened the door for fintechs to offer products and services that compete with those offered by traditional banks, along with new services that traditional banks can't offer. Hence, consumers have been turning to fintechs to gain access to those services on their terms.

Large fintechs tend to share a portion of their customer base with banks, many of which lack the technology to adopt open-banking initiatives on their own, but which have the customer and account data fintechs need to adopt open-banking apps. So it's not surprising fintechs are initiating partnerships with banks to build what they bill as frictionless experiences for different slices of consumers. Such partnerships allow banks to stay relevant to customers that use fintech products by making it possible for them offer such services as the ability for gig workers to receive auto-deposits from multiple employers.

Despite open banking's bright prospects, there are concerns around data protection. That's increasing calls for more open-banking standards. At the forefront of the standards movement is the Financial Data Exchange, which in late 2021 introduced version 5.0 of its API, which increases market standardization of consent, user control, and consumer dashboards for financial-data sharing. As of July, FDX had 32 million consumer accounts using its API to power open-banking applications.

"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," Chris McLellan, director, operations, for The Data Collaboration Alliance told Digital Transactions earlier this year. "This way, data is managed as something with real value that shouldn't be subject to unrestricted replication."

7 How Not to Prevent Gun Violence

Amid the terrible toll of gun violence, many have called for the payment networks to do more. In September, American Express Co., Mastercard Inc., and Visa Inc. announced they would create a merchant code specifically for sales at gun shops. Such sales have been classified by acquirers as general merchandise. The move by the card networks follows a decision by the Geneva, Switzerland-based International Organization for Standardization to create a category code for gun-shop sales.

Though no action has been taken, there are questions about the utility of a new merchant category code, especially when a code traditionally classifies the type of business, not necessarily a type of product. "Correct and underlying product information is the major limitation," says David Shipper, strategic advisor for retail banking and payments at Aite-Novarica Group. Currently, there's no way to tell what products a consumer purchased based solely on the MCC. "Unless card networks mandate a separate card terminal for guns and ammo sales, there is no way to know if someone bought a gun or a canoe at a camping supply store, pawn shop, or other places that sell guns and other items," Shipper says.

Other limitations are that the store can choose the MCC that fits most of the business they do, he says. "Without SKU-level data, there is no way to know what was purchased. Did they buy a gun or hundreds of dollars' worth of ammo? Did they buy one $5,000 gun or ten $500 guns?" he asks. It's also easy to open a merchant-services account. Says Shipper: "Merchant acquirers can perform due diligence to confirm the type of business, but there is still a risk that the merchant will not self-identify as a gun and ammo store."

8 The Unattainable Goal of Zero Fraud

No merchant would pass up the possibility of having zero fraud in their payments, but realistically this is an impossible dream, especially as the volume of digital payments increases. Just as criminals followed consumers as they shopped more online in the past couple years, so too are they following them as in-store shopping volume increases.

That's the summation from Visa Inc., which released data that showed skimming fraud increased 176% in the June-to-November period over the previous 12 months, with few signs of relenting since then. "The only way to have zero fraud is to have zero transactions," Monica Eaton-Cardone, chief operating officer and cofounder of Chargebacks911, a fraud-mitigation services provider. "And even then there are no guarantees, because not all fraud schemes depend on actual transactions. Unfortunately, as long as there are thieves, there's always going to be a risk of theft."

A recent report from Juniper Research predicts that e-commerce fraud will swell to $48 billion globally in 2023, up from $41 billion this year. Drawing down fraud is a balancing act with identifying legitimate transactions and approving them. "When thinking about the notion of zero fraud, it is critical to think about its attainability. The idea, although compelling, is complex. This is because although fraud can be reduced and minimized, a level of error will always exist. No decision tool, either in technology, AI, process, or human decision, is 100% accurate just as no product is 100% risk-free," says Rafael Lourenco, executive vice president of ClearSale, an online fraud-prevention provider.

Fraudsters themselves are a major unknown. "The reality is zero fraud is not attainable, because fraudsters always find new ways to operate, changing tactics with new payment trends, for example," says Cynthia Printer, director of financial crime compliance at LexisNexis Risk Solutions. "However, a business can mitigate the risks of digital-transaction fraud by maintaining an effective anti-financial crime program and constantly re-evaluating its effectiveness."

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f. Total Distribution (Sum of 15c and e)	22,124	23,950
g. Copies not distributed	972	1,230
h. Total (Sum of 15f and g.)	23,096	25,180
i. Percent Paid and/or Requested Circulation (15c divided by f times 100)	59.7%	48.0%

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b. Total Requested and Paid Print Copies (15c) + Requested/Paid Electronic copies (16a)	13,205	11,506
c. Total Requested Copy distribution (15f) + Requested/Paid Electronic copies (16a)	22,124	23,950
d. Percent Paid and/or Requested Circulation (Both print & electronic copies) (16b divided By 16c x100)	59.7%	48.0%

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18. Signature and Title of Editor, Publisher, Business Manager or Owner:
    John Stewart, Editor Date: October 12, 2021

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9 The Chip Shortage's Ongoing Impact

Predictions that the chip shortage will continue for at least another year are starting to sound like a broken record. Pundits have been saying it over and over since 2020. The latest projections for when the supply of chips for payment terminals and cards will catch up with demand is late 2023, at the earliest. Because the chips needed for POS terminals and cards are more complex than those used in consumer electronics—they are more like microcontrollers than microprocessors—payment experts say they would not be surprised if the shortage lingered into 2024.

"There are some segments of the economy that rely on microchips that are seeing some relief from the shortage, such as consumer electronics, but manufacturing capacity varies by economic segment and not much has changed for the payments industry because of the types of chips used," says Jason Bohrer, executive director of the Secure Technology Alliance.

Unlike microprocessors used in consumers electronics, which don't contain any other components, such as memory, the chips used on POS terminals and in cards control a specific function. As a result, they are like having an entire computer on a chip, including the microprocessor, memory, and components needed to send and receive data.

While many chip manufacturers have stated plans to build additional capacity for this breed of chip, it takes years for such plans to come to fruition and increase supply, industry experts say. Not surprisingly, the shortage of chips has sent prices climbing. On average, chip prices have increased in the low double digits, a blow felt across the board in the payments industry.

10 Can Stablecoins Find Stable Ground?

It seems there is little stable these days about stablecoins—blockchain currency whose value is tethered to a national currency like the dollar. So its value doesn't swing wildly up and down, like that of Bitcoin, making it, in theory, a much more likely candidate as a medium of exchange, unit of account, and store of value.

Yet doubts about stablecoins abound, including concerns about the potential for runs, money laundering, and terrorism financing. Federal officials late last year grew so worried they recommended that Congress regulate this relatively new species of cryptocurrency.

Stablecoin developers are supposed to keep reserves in hard currency equal to the value of the coins they have minted. In at least some cases, however, they have been found to have used some cash along with commercial paper, short-term corporate debt, or other such non-cash assets. Such investments can generate income for the stablecoin sponsor, which makes them more attractive than cash, but that kind of backing could prove problematic, to say the least, were there a run on any of these coins.

For the time being, sponsors are chiefly interested in developing use cases that can maximize stablecoins' inherent advantages—a primary one having to do with enabling low-cost transfers in markets like remittances. The jury is out on how far the coins can go from there. DT

APPLE PAY LATER RECONSIDERED

Apple's venture into BNPL may prove more difficult for the computing giant than it thinks.

BY **JEFFREY TOWER**

Jeffrey Tower is executive vice president, global business development and strategy, at ChargeAfter Inc., New York, N.Y.

WHEN APPLE OFFICIALLY announced its new Apple Pay Later feature this summer, many in the industry weren't surprised. Yet it ushered in renewed anxiety for existing card-based BNPL market leaders, as it added another layer of competition to an increasingly crowded, card-based BNPL marketplace.

It also comes at a time when many card-based BNPL leaders are facing a series of unrelated challenges, ranging from rising interest rates and higher borrowing costs to new regulatory headwinds and inflationary pressures. Together, these challenges are knocking many leaders off their thrones and causing some analysts to question whether the card-based BNPL movement is truly sustainable.

While it's clear that Apple is trying to hedge in and take ownership of BNPL users—many of whom are young Millennials and Gen Zers who don't want to be tied to transitional forms of credit—Apple Pay Later may not be as big a threat to the system as initially thought.

In fact, the entry of Apple in the card-based BNPL market could even be good news for some providers, including banks and financial institutions. That is, if they can prove they are better-positioned to compete and win at the point of sale, particularly when compared to Apple Pay Later.

That's because, when viewed at scale, banks and financial institutions have all the right ingredients for BNPL: easy and more affordable access to capital; regulatory- and lending-compliance know-how; the ability to easily offer a broader range of credit products; and, most important, existing consumer trust. Yet, despite these strengths, many banks remain on BNPL's sidelines even as the product gains popularity with consumers, merchants and lenders alike.

APPLE PAY LATER'S STRATEGY

Among global businesses, Apple is known for creating one of the tightest ecosystems by controlling the

Tower: “The entry of Apple in the card-based BNPL market could … be good news for some providers, including banks and financial institutions.”

user experience across its devices. This ensures that its users interact only with the Apple brand, as evidenced by its software and now payment features.

Apple sees the card-based BNPL “pay in 4” providers, such as Zip, Afterpay, Klarna, Affirm, and PayPal, as direct threats to this tightly wound ecosystem. That’s because once a consumer uses his or her Apple wallet to pay through a competitor’s BNPL product, the competitor can then market to them, potentially drawing them away from Apple.

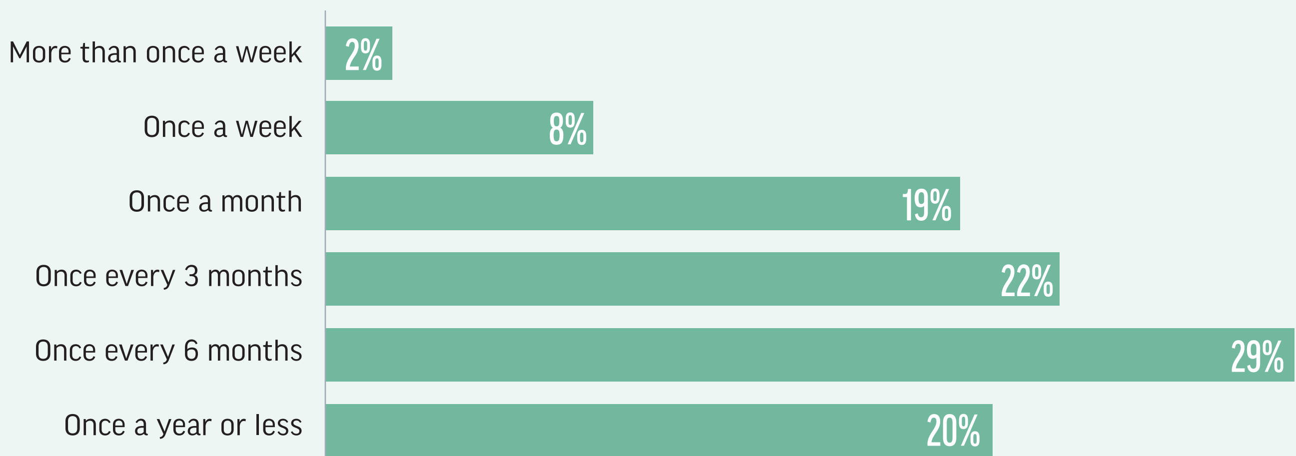
This is a key reason Apple is offering Apply Pay Later. The new product helps keep consumers in the Apple-only ecosystem and seals them off from competitors. Of course, there are additional layers of commercial considerations, such as acquiring and processing fees, that are a part of Apple’s go-to-market strategy. But the main objective is to keep the Apple user within the Apple experience and ecosystem.

However, Apple is at a disadvantage in that it intends to underwrite its BNPL transactions using its own balance sheet. That means losses will be a direct hit to the company. Plus, in the beginning, its BNPL product will likely not be available to all of its users—not necessarily a bad thing, particularly for those with questionable financial behaviors and spending habits.

Apple will reportedly use the newly acquired Credit Kudos, a company whose services leverage open banking to enable credit providers to increase approval rates. And it will use its own data on individual shoppers to decide who can, and cannot, use Pay in 4. The use of personal-shopping and behavioral data from a user’s phone and Apple devices does raise questions concerning privacy and will probably become a focal point of prospective regulatory oversight.

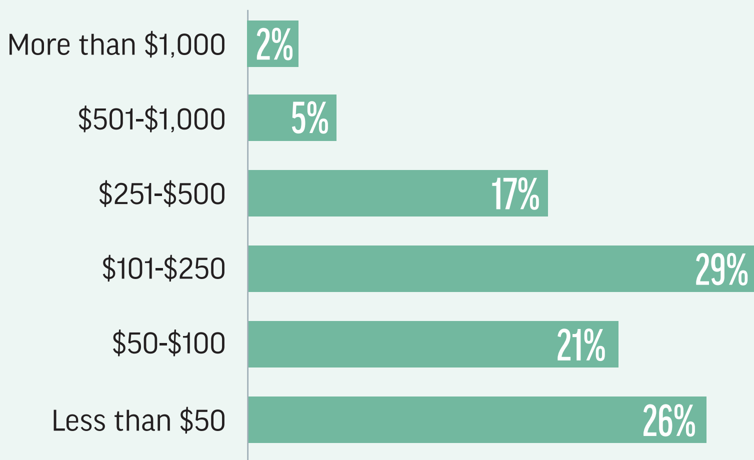
A HIGHER FREQUENCY

(How often BNPL users use the service)



Note: 2,005 self-reporting U.S. consumers surveyed March and April 2022. Source: C+R Research

Furthermore, Apple's entry into BNPL will open the brand up to direct compliance scrutiny in every country where the product is offered. While Apple does have a fair amount of payments experience, much of the pending regulation is not only unknown but also out of Apple's core competency, specifically as the balance-sheet holder and underwriter.



REGULATORY BURDENS

While the card-based BNPL vertical has been able to operate in an area mostly free of strict compliance and regulation, that's quickly changing. Regulatory bodies are concerned that consumers don't realize they're taking on debt or understand the ramifications of missed payments, even with a debit-card based Pay in 4 product.

Over the past several months, various governments have announced plans to introduce new laws to help ensure that card-based BNPL is conducted responsibly, including through soft-credit inquiries, credit reporting, and measures to ensure the avoidance of loan stacking.

This includes the United States, New Zealand, and Australia, as well as the U.K. finance ministry, which recently announced the following rules (which it hopes to draft into legislation by the end of the year):

- Lenders will be required to ensure their loans are affordable and their advertisements are fair, clear, and not misleading;
- Rules will be expanded to cover other forms of unsecured short-term credit that pose similar risks to consumers, like dentistry work;
- Lenders offering BNPL products will need to be approved by the Financial Conduct Authority (FCA), with borrowers able to take a complaint to the Financial Ombudsman Service (FOS).

While this could be problematic for Apple, financial institutions are accustomed to working within highly regulated environments. In fact, this is where financial institutions reign supreme with their ability to offer customers a wide variety of credit-based BNPL products that are clear, transparent, and regulated. Consumers also tend to have higher trust in banks, with 70% of BNPL users saying they would be interested in obtaining BNPL financing from their banks if such offerings were available.

Banks can quickly begin offering consumer financing to merchants that don't involve building out custom solutions on their own, which can be expensive, time-consuming initiatives and are not the core competency of the banks.

A LOOK AHEAD

Apple Pay Later is further validation that BNPL is here to stay, as it indicates that one of the world's leading brands sees it as a proven and growing payment type that's in high demand despite a broad range of existing service providers.

While many of these providers see Apple Pay Later as yet another threat, the brand will be operating from a disadvantage as it attempts to underwrite BNPL from its own balance sheet and is forced to open itself up to new regulatory and compliance scrutiny.

These disadvantages for Apple are key advantages for banks and financial institutions, which are more poised than ever to win at BNPL given their easy access to capital, existing consumer trust, and ability to not just survive but thrive in tightly-regulated environments. Now is the time for them to enter and begin winning the BNPL game. DT

WHY THE METAVERSE IS THE NEXT BIG OPPORTUNITY

With digital commerce showing huge potential, it's time for payments players to take this virtual world seriously.

BY **THAD PETERSON**

VIRTUAL REALITY (VR), augmented reality (AR), non-fungible tokens (NFTs), extended reality, mixed reality, Web 3.0, blockchain—all of these concepts have been lumped together into the term "metaverse." And a lot of other terms have been tossed into this same word salad. They're all attempting to define one thing: the next generation of online interactivity.

But it is difficult to envision a future-state technology if the terminology doesn't help to clarify things. Let's start with a basic definition of the metaverse from Louis Rosenburg, chief executive of Unanimous AI:

"A metaverse is a persistent and immersive simulated world that is experienced in the first person by large groups of simultaneous users who share a strong sense of mutual presence. It can be fully virtual (i.e., a virtual metaverse), or it can exist as layers of virtual content overlaid on the real world (i.e., an augmented metaverse)."

The key term here is "simulated world." In its purest form, the experience of the metaverse is completely immersive, requiring a dedicated headset and controllers to place the individual fully into a virtual world that's independent of the physical space. If you have not had the opportunity to experience a VR headset, it's worth trying if for no other reason than to understand the sense of immersion and departure from the physical world that it creates.

The experience can be incredibly intense and disorienting for many people, and for some it can induce motion sickness. On the less intense end of the spectrum, AR overlays digital imagery and messaging onto the physical world via AR eyewear, heads-up displays in vehicles, or displays on smart phones or traditional laptops.

The primary point of entry into the metaverse to date has been through

online gaming. Multiplayer games have been around for several years. Players work together or against each other, communicate in real time, and coordinate their character's actions with others.

With technology available to allow an immersive experience, it's a small step from playing Call of Duty on an Xbox to playing the same game on a VR headset. And, it's a much more interesting and entertaining environment.

But once an individual is in an immersive environment with the ability to move around and communicate with others in the space, it's an equally small step to move from combat to community.

Led by Meta (formerly Facebook Inc.), organizations are creating entire worlds for people to visit and interact with others, attend virtual events like concerts and lectures, and create communities of interest. This aspect of the metaverse is a logical extension of online chat, and chat rooms themselves were the precursors to these immersive communities found in the metaverse.

The current VR experience works well for gaming, but communities are much more complex. Since individuals need to be able to move around and take independent action, developers have to allow for a lot more activity than is typical in a gaming environment.

RAPID GROWTH

A persona that represents an individual in the metaverse is called an "avatar." At the current state of the art, they are fairly simple and, in terms of technology, primitive. But the technology is improving quickly as more companies and more capital pour into this activity.

Peterson

Peterson: "With commerce comes payments, and the major players are moving in."

Still, with all the buzz about the VR space, it is important to remember that it is still very early days for the technology. In 2021, only about 18% of the U.S. population had experienced VR at least once, and there were about 28 million VR headset users, or about 8% of the total population. Usage is growing quickly, but it's still a fairly low figure. AR is used regularly by about 83 million people in the U.S.

Growth will continue at a rapid pace, but there are a few issues that need to be addressed before the metaverse comes anywhere close to current online alternatives. These include:

- **Technology** – Managing thousands, or ultimately millions, of individual avatars and rendering an engaging and entertaining space is complex. The industry is still scaling up to support user demands for graphic intensity.
- **User interface** – A VR headset delivers an incredible experience, but with the most popular device, Meta's Meta Quest 2, priced at $399, it's not likely to achieve critical mass with respect to adoption any time soon. Other devices like AR glasses are starting to show up, but it will be several years before the majority of consumers will have access to a dedicated metaverse interface.
- **Interoperability** – Just as closed-loop "walled gardens" like CompuServe and AOL started the movement to online communities and commerce, there are many different metaverses that can be accessed online, including Meta's Horizon Worlds, Decentraland, The Sandbox, and the KEYS Metaverse, but they are all standalone. At this point, an individual's avatar is restricted to a single metaverse, and there are no channels for individuals to easily travel between the different spaces without separate log-ins. As with the Internet, where the interoperability of the worldwide Web drove adoption, the separate spaces in the metaverse need to be connected before criticality can be achieved.

These issues are being addressed. But until there is a fully interoperable "universe" of metaverses that can be accessed by lower-cost devices, the space will grow quickly, but far from exponentially.

COMMERCE = PAYMENTS

The appeal of an immersive experience is driving retailers and other businesses into the space. Adidas, Burberry, Gucci, Tommy Hilfiger, Nike, Samsung, and Louis Vuitton all have stores in the metaverse. In financial services, several organizations, including HSBC and J.P. Morgan, have set up shop in the space.

An immersive digital experience is an interesting opportunity for retailers to offer their customers

unique shopping experiences that are far richer than browsing for goods online. The metaverse is also creating opportunities for merchants to sell digital goods and services that are only viable in the space. Several boutique firms customize avatars. Others offer unique attire for avatars.

With commerce comes payments, and the major players are moving in. Visa and Mastercard are actively engaged in developing capabilities for a metaverse presence, and the commerce platform Shopify is going to support e-commerce for its merchants in the metaverse. Meta is creating its own digital wallet called Meta Pay. There are also a number of cryptocurrency wallets available to use for purchases in the metaverse.

Initially, the payment experience appears to be a simple extension of e-commerce with card-on-file (or the cryptocurrency equivalent) and digital wallets being the primary payment tools for consumers. But as was the case with the explosion of e-commerce when the Web achieved criticality, new methods of payment and value transfer can be expected in the metaverse, such as new forms of peer-to-peer payments and digital gift cards.

Beyond traditional payments, many current participants in the space are cryptocurrency users and investors. The metaverse Decentraland, for example, requires users to have a cryptocurrency wallet linked to their account to enable payments. This focus on cryptocurrency limits the potential for growth in this metaverse since many, if not most, future users do not use cryptocurrency and won't change their purchase behavior to participate in a new space.

BILLIONS INVESTED

E-commerce took off when companies like PayPal provided consumers with a way to use their existing payment credentials to make online purchases, and the metaverse will likely be no different.

Cryptocurrency is also, for now, mostly free of the regulatory constraints of traditional payments, and consumers could be confused if they think that the rules that apply to paying by credit or debit card also apply to a cryptocurrency purchase.

With all new commerce environments, new opportunities for fraud and theft inevitably follow. Will "avatar identity theft" create new opportunities for fraudsters to abscond with a user's virtual wallet? Will the purchase of digital goods create new opportunities to rip off digital merchants? It is likely that the new space will create a new set of fraud and theft scenarios for financial institutions, regulators, and enforcement organizations.

Billions are being invested in making the metaverse a vibrant and important component of the digital economy. Ultimately, the VR equivalent of a Web browser will emerge to enable an open, interoperable metaverse ecosystem.

Commerce is already happening in the metaverse, and it will continue to expand and morph as the space evolves. There will be opportunities to create new form factors, processes, and offerings to simplify value transfer.

It may not yet be time for many financial-services companies to move aggressively to participate, but at the very least, every organization should be spending time and resources to learn about the metaverse.

The metaverse is indeed "a thing," and it's a thing that will create a lot of value for companies that understand the space, and consumer behavior within the space, as the metaverse grows toward critical mass. DT

THE TRANSFORMATION OF BUSINESS PAYMENTS

The pandemic sped adoption of digital payments, but it also revolutionized supply chains.

BY **SVEN HINRICHSEN**

Sven Hinrichsen is senior vice president of strategy for Corpay Payables.

THE PANDEMIC ACCELERATED the digitization of business payments. Companies are seeing new cost and process efficiencies from their digitization efforts, especially with T&E cards and vendor payments. But most exciting are the new possibilities that open up for more efficient supply chains when you have digital, connected, and intelligent business-payment ecosystems.

A lot of non-invoiced spending happens on travel-and-entertainment cards, also known as multicards. Use of these cards plummeted as Covid-related travel bans kicked in. Multicard spend is back now, but what's changed for good is that companies are looking for tighter controls.

Prior to remote and hybrid work, people talked more about budgets and spending controls face-to-face. There was more awareness of company policies and of oversight. That dialog, and that awareness, doesn't happen as much any more, so companies want their policy controls programmed right into the card.

They want to use cards to empower remote employees to get what they need to do their jobs, with as little friction as possible. But they also want to make sure that the cards they're issuing are used only for spending within company guidelines. That is entirely doable with today's card-technology platforms.

Spending limits, geographical restrictions, and merchant category code designations are just some of the controls that can be implemented. To be sure, getting people to comply with T&E spending policies has always been a challenge. But automating policy controls keeps compliance front-and-center while speeding up purchasing.

A BIG SHIFT

In vendor payments, the predominance of paper checks is now eroding at an even faster pace than before. When the pandemic hit, companies that had centralized accounts-payable teams in one office were all of a sudden faced with creating a decentralized organizational structure. Instead of figuring out how to create a new check process or how to stand up electronic payments programs, many just decided to outsource the process.

That led to a big shift toward making more payments via the automated clearing house and virtual cards. As the number and size of ACH payments grow, one downside is an increase in ACH fraud. Outsourced

payments companies have rigorous fraud-protection processes in place—typically quite a bit more rigorous than an individual company can have, because they're doing it at scale.

Using virtual cards in an outsourced environment has even more benefits. Payment is nearly instantaneous, and fraud protection is part of the package. All cards are programmed for single swipe for an exact, invoiced amount. You get to hang on to your working capital longer. And customers get a rebate on their spending.

The biggest hurdle for these digital payment types has always been enablement. Historically, it's been up to each business to approach its vendors, see who will take an ACH or card, and then get them set up.

To get to a high percentage of digital payments and a meaningful rebate, you had to go after every single vendor. And you had to keep doing it.

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According to internal Corpay data, vendor churn is 20%-25% annually. That's a huge investment in labor that isn't going to pay for itself for a very long time.

The idea of putting as much spend on cards as you can to max out your rebates is very simple. A lot of us do that as consumers, and it's easy because the card-acceptance network for consumer purchases is now almost universal. But if you tried to do that with business spending, that network wasn't there.

So payment-automation fintechs have spent the last decade building large networks of vendors enabled for ACH and card payments that customers can plug into. They immediately get the benefit of that network, which increases the number of vendors they can pay electronically. It also maximizes card spend and rebates from day one.

Large vendor networks with payments and data flowing through them open up some exciting new options for something the world has long needed: faster, more flexible, more accessible supply-chain financing.

This has always been a big lift in a paper-based world. You have to negotiate terms with the vendor, and then you need to get the money to them on time. Well, when you have a big vendor network, it becomes possible for vendors to display their discount and financing offers in the network's portal.

Buyers can select the terms and send payment instantaneously via a virtual single swipe card, or schedule it to send just in time to meet the terms of the agreement.

SUPPLY CHAINS' LIFEBLOOD

All of this can be extremely flexible. Neither party has to commit to a long-term program. The parties can opt in for a month or a week or just for one big invoice if they're a little short of cash. As interest rates continue to rise, there'll be more and more demand for something like this because companies are going to have a harder time getting access to affordable financial solutions.

Payments are the lifeblood of supply chains. When money moves efficiently, it helps supply chains move more efficiently. The pandemic accomplished in a year what might have taken a decade of sales and marketing effort. That's a major evolution that reduces a big source of friction in the supply chain.

More digital payments and data flowing through these huge cloud-based vendor networks set the stage for the next evolution. Better supply-chain financing solutions are an obvious need.

As technology advances and we reach a tipping point where the majority of business payments is digital, it opens up possibilities to build adjacent products and services we haven't even imagined yet. DT

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