DIGITAL TRANSACTIONS

Trends in the Electronic Exchange of Value

IS IT TIME FOR PAY-BY-BANK AT RETAIL?

Consumers and merchants may be primed for it

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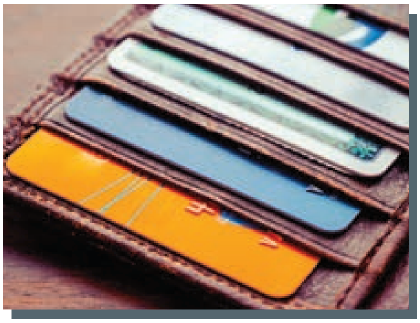

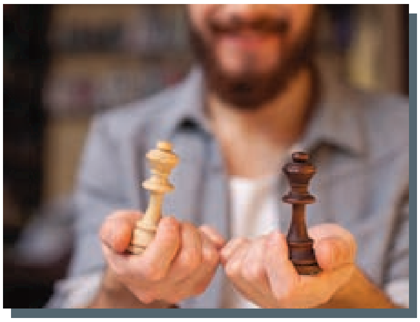

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GET SET FOR AN EMBOLDENED CFPB

THE CONSUMER FINANCIAL PROTECTION Bureau's victory at the Supreme Court last month answers for now the question of its constitutionality and may quiet the agency's critics. But make no mistake: the CFPB remains a potent agent of federal power operating with an aggressive agenda.

Indeed, some payments experts fear the decision, which the high court reached by a surprising 7-2 vote, will give rise to more heartburn for the industry. It will certainly encourage the agency in its charge to rein in "lawless" actors in financial services—whether there's real harm or not, or whether indeed the targeted companies are abiding by the law. No matter. With its funding now secure, the agency may plow ahead with little fear of Congressional oversight.

Recent history indicates the payments industry has cause to rue this high court decision. The CFPB has found cause to investigate and seek rules concerning such businesses as digital wallets, open banking, credit card late payments, and buy now, pay later lending. Its targets over the years have included major payments companies like ACI Worldwide Inc. and Block Inc., operator of the popular Cash App wallet.

It didn't have to turn out this way. A case involving the CFPB and payday lending came before the U.S. Court of Appeals for the Fifth Circuit, which in an October 2022 decision ruled the CFPB's funding source—which is the Federal Reserve rather than, as with many federal agencies, Congress—renders the agency unconstitutional. That's the case that wound up at the Supreme Court, seven of whose Justices saw nothing notable about the agency's drawing its funding from the Fed. The concern now, say some experts we've talked to, is that the CFPB can proceed with little or no Congressional oversight.

The decision aside, payments experts were also surprised by the lopsided vote on the Court. Only two of the court's conservative Justices opposed the decision, while the majority opinion was written by strict constructionist Clarence Thomas. "The decision wasn't a big surprise, but the margin was," Eric Grover, principal at the consultancy Intrepid Ventures, told us.

So, more mischief from the regulatory state? Maybe. Ben Jackson, our Payments 3.0 columnist (page 14), says there's still a downside for the CFPB, despite the high court's misguided verdict. "Looking at the big picture, the Supreme Court's decision is a win for the Bureau and may eliminate some future court challenges to rules," he concedes. "But it may raise the stakes of the next election for the CFPB, because a change in the control of Congress could lead to a legislative effort to restructure the CFPB in the next Congress."

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Trends in the Electronic Exchange of Value

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THE FED TOUCHES OFF THE LATEST INTERCHANGE BATTLE

The National Retail Federation and the Merchants Payments Coalition have lined up against the Federal Reserve, arguing that while a rate reduction on debit card transactions is welcome, the Fed's proposed pricing does not go far enough.

The two industry trade groups sent letters to the Fed last month on the final day for comments on the regulator's proposed interchange rate reduction plan for debit. In October, the Fed requested comments on the plan and set a deadline of Feb. 12 to receive comments. In January, the Fed extended the deadline to May 12.

Last fall, the Fed proposed an update to all three components of the interchange fee cap—the current base component, *ad valorem* component, and fraud-prevention adjustment—established under Reg II of the Dodd Frank Act, also known as the Durbin Amendment, which was signed into law in 2010. The amendment applies to debit card issuers that have at least $10 billion in assets.

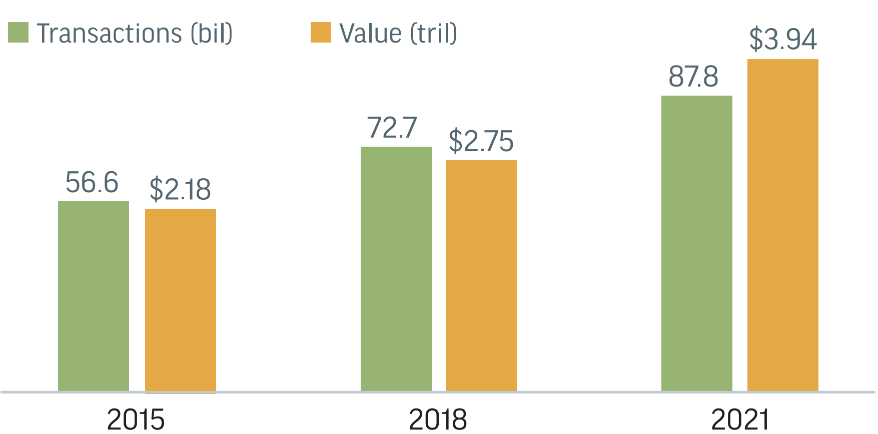
Using data voluntarily reported by large debit card issuers, the Fed proposed cutting the maximum base amount from 21 cents per transaction to 14.4 cents, and lowering the fraud-loss recovery component from five to four basis points. The Fed also proposed raising the fraud-prevention component from a penny per transaction to 1.3 cents.

In its letter to the Federal Reserve, the NRF argued that the debit cap should be lowered to 10.5 cents per transaction and that the Fed should set tiered interchange rates based on banks' debit card transaction volume. Interchange is paid by merchants and constitutes a revenue stream for card-issuing banks.

Both the NRF and the MPC contend the Fed's proposed rate reduction would give debit issuers average profit margins of 270%, which they say is nine times the 30% average profit margins large banks make on their businesses overall.

"The [debit interchange] rate ought to be capped at 6 cents per transaction, as the average cost of a debit transaction for banks is 3.9 cents," says Doug Kantor, an MPC executive committee member and general counsel for the National Association of Convenience Stores. "[Large] banks earn a 35% margin on debit transactions, which is higher than the profit margin on their business as a whole."

DEBIT'S DRAMATIC CLIMB



Source: Federal Reserve Payments Study, triennial release

But banks aren't happy, either. In response to the Fed's proposal, the American Bankers Association and eight other bank and credit union groups sent a letter to the Fed urging it to withdraw its proposed rate adjustments. The groups also argue the proposal would violate the law by prohibiting banks from recovering costs they incur in "providing affordable debit card programs."

Should the proposed rate adjustments go into effect, the banking groups calculate consumers would pay an estimated $1.3 billion to $2 billion more annually in account fees. Meanwhile, they say, it is unlikely merchants would pass any cost savings on to consumers.

The proposed adjustment is overdue as debit card issuers' costs have declined about 50% since the Fed began gathering data from large issuers on those costs, argues Eric Grover, principal at the Minden, Nev.-based consultancy Intrepid Ventures.

"The Fed should have lowered the cap sooner, but the proposed cap is reasonable and proportional to debit-processing costs," says Grover, who nonetheless has long argued the Durbin Amendment should be repealed. "Banks will complain and there may be lawsuits filed, but a significant reduction in debit interchange will happen."

Grover points to how banks and merchants have dug in their heels on the matter. "This a forever war. Banks want Durbin repealed, and no matter how big the proposed rate reductions, merchants will complain it is not enough," Grover says. "This is an old issue that [is] not going away."

—Peter Lucas

HOW CONSUMERS AND BUSINESSES ARE ADOPTING INSTANT PAYMENTS

Consumers and businesses are warming up to instant-payment options for such transactions as bill payment, mobile-wallet funding and defunding, account-to-account transfers, and immediate payroll for employees, the Federal Reserve says.

A pair of studies surveying businesses and consumers about instant payments and the payments landscape, released last month by the Fed, reveals that 86% of businesses and 74% of consumers used faster or instant payments in 2023. In addition, 74% of businesses and 79% of consumers reported looking to their financial institutions to provide instant-payment services.

The studies were conducted by Federal Reserve Financial Services, a collaboration of the 12 Federal Reserve Banks, which oversees payment services and is responsible for marketing instant or faster-payment services, such as the FedNow network and FedACH.

For the studies, the Fed surveyed 2,001 adults across a variety of age groups and 2,005 businesses of varying revenue sizes across multiple industries.

On the consumer side, paying friends and family (55%), transferring money between accounts (30%), and paying bills (27%) are the main use cases for instant payments, according to the study. Factors driving consumers to embrace instant-payment options include convenience, ease of use, and immediacy, the study says.

When asked about the pain points with other payment options that make instant payments look more attractive, 45% of consumers noted fees charged, 25% cited lack of speed, and 18% said processing errors.

Consumers, particularly younger ones, appear willing to pay fees where they perceive value, as with an instant payment, the study says. On the other hand, 25% of consumer respondents say they are challenged by the slow speed of payments and prefer to have better options.

Among businesses, some 50% believe instant payments will be useful for digital-wallet funding, while 25% see instant payments as useful for earned wage access. Some 48% of businesses are using instant payments to reduce the cost of payments.

Pain points with conventional services that are driving businesses to adopt instant payment methods include high costs (44%), slow or untimely payments (35%), and lack of payment process automation (30%).

"The growing demand for faster and instant payment services suggests that tools like the FedNow Service will continue to play a crucial role in helping financial institutions meet their customers' needs," Mark Gould, chief payments executive for Federal Reserve Financial Services, says in a statement. More than 700 financial institutions have signed on so far to participate in FedNow since its launch last summer.

—Peter Lucas

DORSEY SLAMS REPORTS OF A DOJ PROBE

Block Inc. chief executive Jack Dorsey last month fired back at news reports that the U.S. Department of Justice is investigating the company for alleged compliance lapses at Block's Square and Cash App units.

The reports "lack full context," Dorsey said during Block's quarterly earnings call in May.

News of the investigation was first reported by NBC News. The DOJ is reportedly looking at whether Block failed to properly assess risks associated with some customers and processed cryptocurrency transactions for terrorists. Justice also is reportedly looking into whether Square processed transactions for countries economically sanctioned by the United States.

"In general, these sorts of stories can lack full context," Dorsey said. "First, we do not believe that there is any new investigation into Block, but rather that these reports relate to the existing inquiry by the DOJ that we've previously disclosed."

In 2022, Block's Compliance Emerging Risk team, which investigates threats, conducted "a thorough review" of transactions potentially associated with sanctioned countries, Dorsey contended.

"We voluntarily reported these to the Office of Foreign Assets Control, we were transparent with them, and we stand by the scope of transactions that were included in the report," Dorsey said. "OFAC then issued us a No Action Letter in which they determined no further investigation or action was needed at the time. This is how this process is supposed to work and this outcome was not originally included" in news stories.

Addressing fears that Bitcoin could help finance terrorism, Dorsey noted Block uses advanced technologies to identify potential bad actors. These include blockchain analytics from firms that screen transactions in real time. Other measures include restrictive limits for on-chain Bitcoin withdrawals and moves to ensure identity verification for customers engaging with Block's Bitcoin products.

Bitcoin trading constitutes a portion of Block's business as Dorsey has long advocated for cryptocurrency as a mode of payments.

A TALE OF TRANSACTIONS

(Square's payment volume, in billions)

Source: Block

"Our work is to constantly be steps ahead of [criminals'] attacks through better use of technology," Dorsey said. "It's an always-on part of our business, and it always will be."

Less than 3% of Block's resources are dedicated to Bitcoin-related projects, and those costs are covered by the profits from Block's Bitcoin exchange, which is Cash App's fourth-largest gross profit stream, Dorsey said in a shareholder letter released with the earnings call.

Dorsey noted in the letter that 1.6 million Cash App Card actives have used Cash App's Bitcoin Round Ups feature to convert spare change from everyday transactions into Bitcoin.

Dorsey added that Block is developing a new mining chip, in addition to an entire mining rig system for "further decentralizing both the supply of mining hardware and the distribution of hashrate, the computing power devoted to mining Bitcoin."

New initiatives planned for the popular Cash App during 2024 include rolling out Afterpay, Block's buy now, pay later offering acquired in 2022, to Cash App cardholders, officials said. With 24 million active Afterpay users, Ahuja said the BNPL service represents "a built-in audience" for Cash App. Block has seen "strong attach rates" during testing, she added.

For his part, Dorsey has stressed moves at Square to fix point-of-sale reliability issues that resulted in an outage in September that effectively shut down transactions for an untold number of merchants. The outage was followed by the retirement of the executive running Square and Dorsey's decision to take over direct control of the unit. "With Square, we want to focus on reliability, and make sure we stay up," Dorsey said.

One step the company plans to take is to put Square merchants under contract. "It's something we were against for many years," Dorsey said. But later, "we took a different take on it." Contracts allow merchants "to get free hardware," he said, adding "Contracts give sellers better predictability."

—Peter Lucas

THE CLEARING HOUSE ADDS REQUEST FOR PAYMENT

The U.S. payments industry has celebrated the emergence in recent years of two major platforms for real-time payments, but what has insiders particularly excited is the potential for something called the request for payment, or the RFP, as they style it.

"The RFP is the first real shift in how money is collected since the lockbox," says James Colassano, a senior vice president at The Clearing House Payments Co., the New York City-based developer of the Real Time Payments network.

With real-time processing backing it, the RFP allows billers and merchants to receive nearly immediate payment by sending a request through the network to customers and clients who have received services.

The Federal Reserve's FedNow system, which went live last summer and now features more than 700 financial institutions, offers the service. TCH's real-time network has featured the capability since its RTP network started up in 2017, but now it's moving to grow the service dramatically this year, Colassano says. TCH is owned by 20 of the world's biggest commercial banks.

"We're looking to expand use cases this year," says Colassano. "Banks are now building out that infrastructure."

While banks are responding to the potential of RFP, use cases for the service keep proliferating, Colassano says. As a result, TCH is trying to keep things simple for the time being. "We decided we'd have one set price [for each request] regardless of the size of the bank or the use case," he adds.

Still, executives at TCH are under no delusions about the potential for a form of billing that carries with it the potency of a real-time payment response, particularly for businesses that depend crucially on timely payment. "The RFP is going to be a paradigm shift," Colassano says.

TCH is managing the rollout carefully, he adds, cognizant of the newness of the payment service among billers and sellers, let alone recipients of the requests. "We have to introduce it in a way that's managed so we understand the risks, how risky use cases are to start," he says.

With that caution in mind, TCH is "just starting" what it calls phase two of its introduction of RFP, having launched phase one last year. The network has 76 senders so far, but more are soon to come online. "There is a pipeline," notes Colassano.

—John Stewart

PRIVACY FOR SALE

BY GIDEON SAMID
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THE BIDEN ADMINISTRATION dashes ahead with an interdepartmental effort to design a digital dollar, following the European Union and China, which are very excited about the tight surveillance power given to government through the emerging technology of digital money. The U.S. effort, which was kicked off by a presidential executive order in March 2022, is formally exploratory. But when you listen to the planners, the objective is quite clear.

You can't fault a government for striving to know more and more about its citizens. But you can fault citizens in a democracy who do not defend their privacy, dignity, and aversion to being minutely observed.

It's a big historic irony. Digital money lingered as a theoretical curiosity developed by academic pioneers (e.g., David Chaum, Gideon Samid), but in 2009 it swept into the public arena with the emergence of Bitcoin, where privacy was the big attraction of the new technology. Central banks, shaken and daunted, bounced back quite soon, turning the new technology from a privacy bastion to a privacy slaughterhouse.

Privacy advocates are few and feeble. For a long while, payment privacy appeared to be a lost cause.

And just then, the clouds receded. Good old capitalism rose to the rescue. "People want payment privacy," argued some payment analysts, "hence, they will be willing to pay for it." In the free-market economy, this implies an incentive to develop a means to sell privacy for profit. Forget about expensive Washington advocacy groups, hold off on congressional hearings and top-down campaigns. Build a bottom-up payment- privacy product and present it to the market.

This is exactly what is happening—taking a privacy-assuring money-trading protocol (e,g., BitMint*LeVeL), and getting it implemented by a dedicated privacy-selling enterprise. The enterprise will offer the public, say, a $100 digital coin with a surcharge for, say, $103.00. This post-quantum digital coin could be traded with cryptographic privacy, which is quantum resistant.

When the coin owner wishes to pay for a meal in a restaurant, she hands the coin to the waiter, who instantly verifies with the mint that the coin is redeemable for its nominal value ($100), and so accepts it. The diner never identifies herself to the restaurant owner, nor to a card company, nor to the government. It's cash-equivalent, only without the banknotes. The restaurant gets paid, and the diner enjoys her privacy for the $3 surcharge. The privacy vendor is the money maker.

The public, then, will make a choice. If privacy is not important, there's no need to use privacy coins. But if it is, for whatever reason, then it is available. The government would probably lay its heavy regulatory paw on these privacy vendors, but, being a bottom-up movement, the trend would be hard to stop.

Some astute investors believe that enough people value privacy so much that a very high surcharge will be sustainable. A recent idea called for privacy coins marked with an expiration date that would rush their redemption. That could give rise to another round of privacy coins (bringing more business to the privacy vendor). The product might even impose a surcharge on the merchant, since, by making it unnecessary to identify the payor, the merchant would no longer need the credit card companies. In this scenario, how much will a merchant be willing to pay?

I am still gathering thinkers from all around to shape this concept into a business plan. The technology is good, but behavioral issues and regulatory thinking are not yet well covered. So privacy may be the hottest topic in digital payments for the second half of this decade. DT

TIME FOR SECOND THOUGHTS ON FINTECHS

BY BEN JACKSON
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SOMETIMES THE BEST advice is counterintuitive, which is why I think that payments executives need to slow down and get back to basics.

When technology is adding new options and speeding everything up, it is easy to fall into a habit of being reactive as each new thing comes up. But, in the long run, this is likely to lead to unexpected and unintended outcomes.

An example of this reactivity to new tech is JP Morgan Chase chief executive Jamie Dimon's statement that fintechs are a threat to banks. Another example is The Clearing House's attack on fintechs in a 2020 letter that argued they were unfairly avoiding interchange caps by partnering with small banks.

These examples show how new kinds of opportunities can lead traditional providers to view the developments as threats that will exploit their weaknesses rather than as something they can incorporate as an add-on to their traditional businesses.

But this view of half the picture—threats and weaknesses— offers a clue to the basic analysis framework that any payments company can use to reorient itself. Using the strengths, weaknesses, opportunities, and threat, or SWOT, framework can help companies figure out how to integrate fintech and other new technology into their businesses.

Taking the time to do this analysis correctly could lead to shifts as companies figure out how to convert weaknesses to strengths and threats to opportunities.

Of course, as we talk about shifting categories in a positive way, it is important to recognize they can shift negatively, as well. Strengths can become weaknesses. Opportunities can become threats.

Consider the recent consent orders against banks that have partnered with fintechs. A bank charter that is a strength when it comes to a new fintech business opportunity can become a liability when the bank does not meet its regulatory requirements and faces the threat of regulatory action.

The fluidity of the categories seems to argue against using the SWOT framework. But that fluidity allows for creativity, as well.

Take the example of the big banks. Their size seems to put them at a disadvantage in issuing for fintechs because of the reliance on interchange in the fintech sector. But forcing a move away from dependence on interchange should lead them to ask what other business models are available to an issuer with their size and resources.

With a large product suite, they should be able to create other opportunities for program managers. Looking at it another way, they might decide the third-party issuing business is not for them. Maybe they'll use their scale to compete directly, instead.

In May, the Innovative Payments Association held its annual conference, and I was asked what the theme of the conference was. We had speakers on artificial intelligence, faster payments, bank partnerships, and fraud, among other topics. Our goal was to give the attendees a look at the big picture concerning the forces that were shaping the industry.

One attendee told me the value of the conference came from having a couple of days to think about the emerging big picture, away from day-to-day responsibilities. It is easy for a columnist to do this kind of thinking because I'm not worried about the next quarter's numbers.

Companies need to assemble SWOT teams with the same kind of freedom. These teams should include, or have access to, all departments so they can build out ideas and strategies while avoiding the pitfalls of innovation.

The organizations that invest in generating long-term strategies will be the ones that will be the most successful in the long run. DT

IS THE CCCA'S FATE ALL ABOUT MARKETING?

The payments industry and the merchant community are pushing messages against and for the Credit Card Competition Act. Congress will decide who wins.

BY PETER LUCAS

SINCE THE REINTRODUCTION a year ago of the Credit Card Competition Act, the bill's proponents and opponents have unleashed high-octane marketing campaigns to sway legislators and the public to their respective points of view.

Rarely does a day go by when either side doesn't release a new ad or put out a press release or study that spells out the pros and cons of the legislation. From attack ads to ads that play on consumer fears—and every marketing tactic designed to sway opinion in between—both sides are spending untold sums in a fierce battle to win—or stop—passage of the bill.

Indeed, the intensity with which both sides are pitching their messages is far greater than when the payments industry and merchants went to war more than a decade ago over the Durbin Amendment to the Dodd Frank Act, which regulates debit card interchange. This is especially true of the payments industry, which was relatively docile back then compared to the ferocity with which it's campaigning against the CCCA.

While it can be argued that banks were distracted by the fallout from the 2008 financial crisis when they lobbied against the Durbin Amendment, credit card issuers are determined not to make the same mistake this time around. The reason is simple: The financial stakes are far higher with the CCCA than they were with Durbin Amendment, experts say.

"Fewer banks were affected by the Durbin Amendment and the amount of money at stake for banks and merchants is much greater [with the CCCA]," says David Shipper, a strategic advisor at Datos Insights.


Kantor

Kantor: "We raised the question about China Union Pay processing credit card data."

"These campaigns give legislators talking points for or against the CCCA and legislators are the ones that will decide the fate of the CCCA during this Congress."

The two main combatants in the current war are the Electronic Payments Coalition, which represents banks, and the Merchants Payments Coalition. Both sides have taken an issue advocacy position around the CCCA, which calls for financial institutions with $100 billion or more in assets to enable at least one network other than Visa or Mastercard for credit card transaction processing.

The intent of the bill, which has not yet been scheduled for a vote, is to require large card issuers to offer merchants a presumably lower-cost network alternative for credit card transactions.

Neither the EPC nor the MPC will disclose the reasoning behind their respective marketing-communications strategies. Doing so, they say, would provide the opposition with a blueprint for how to defeat their efforts. What both sides will say is that their strategies are geared to respond to developments within the payments industry that relate to the CCCA.

The EPC's message is multifaceted. First, the group argues that the status quo offers plenty of network competition. Further, changing the status quo would crimp card issuers' revenues to the point where they may not be able to fund cardholder rewards.

Second, any savings merchants may enjoy from the CCCA are unlikely to be passed along to consumers, as merchants did not pass along savings from the Durbin Amendment, the group argues.

Finally, the EPC contends changing the status quo will weaken network security, which protects consumers and merchants from fraud and in which Visa and Mastercard have invested heavily. It is unlikely many alternative networks will make the same investments, the group argues.

Against this reasoning, the MPC argues that passage of the CCCA will unleash network competition, which in turn will reduce merchant's credit card acceptance costs. Merchants could then pass those savings along to consumers in the form of lower prices or by holding the line on pricing despite persistent inflationary pressure.

A CHINA SYNDROME

Issue-oriented campaigns, especially those centered on a bill or referendum, are about hope and fear, says Kent Syler, a professor of political science and public policy at Middle Tennessee State University.

In the case of the CCCA, the MPC is offering a message of hope while the EPC is pitching a message of fear.

"Fear is a big motivator in politics, and when dealing with change the fear side has an advantage unless the status quo is so egregious that no one is happy with it," says Syler, who served as a Congressional aide for 26 years. "Introducing an element of risk that changing the status can hurt you can be a very effective message, because people tend to be risk-averse by nature."

While the merchants' campaign is centered on a message of hope, the MPC has not shied away from playing the fear card. A 30-second television commercial released by the MPC in April, for example, is clearly aimed at playing on consumers' fears about Chinese-owned companies handling their personal data.

In the ad, which the MPC casts as a "consumer protection alert," viewers are warned that Visa and Mastercard have left the door open through their business dealings with China UnionPay to outsource credit card processing to that state-owned network.

The ad says the CCCA contains a provision that would block any foreign, state-owned network rom processing credit card transactions in the United States. The ad then closes by urging consumers to call their representatives in

Washington and tell them to vote yes for the CCCA.

The MPC bought air time for the ad and similar digital banner ads in targeted markets around the country. The ad was developed in response to the Senate Banking committee's investigation of how foreign, state-owned companies are posing a risk to consumer financial data, the MPC says.

"We talked to the Senate Banking committee about this [issue] and we raised the question about China Union Pay processing credit card data," says Doug Kantor, an MPC executive committee member and general counsel for the National Association of Convenience Stores. "We thought this was an important issue and felt we should highlight it since it pertains to the CCCA."

The ad is a classic example of playing on consumers' fears around a broader issue and tying those fears to a specific issue, in this case the CCCA, advertising experts say.

"For people concerned about Chinese control over their data, this ad can be a powerful message," says Wendy Melillo, an associate professor of journalism at American University in Washington D.C. who studies advertising and persuasive communications. "The power of issue-oriented ads is that they galvanize people to take action on an issue they are passionate about."

To drive her point home, Melillo cites the ad campaign against Proposition 8 in California in 2008 to prohibit same-sex marriage. Prop 8 passed, although it was later overturned in the courts.

"That campaign helped get voters in a state very welcoming to the LGBTQ+ community to pass Prop 8, which shows just how effective issue advertising can be when it comes to convincing people how to vote," Melillo says.

The key to a successful ad campaign is frequency of views. In today's fragmented media landscape, the target audience needs to see an ad 30 to 40 times for the message to resonate. Some 25 years ago, by contrast, marketers needed get their ad in front of consumers 10 times for their message to stick, Syler says. "Frequency is extremely important," he adds.

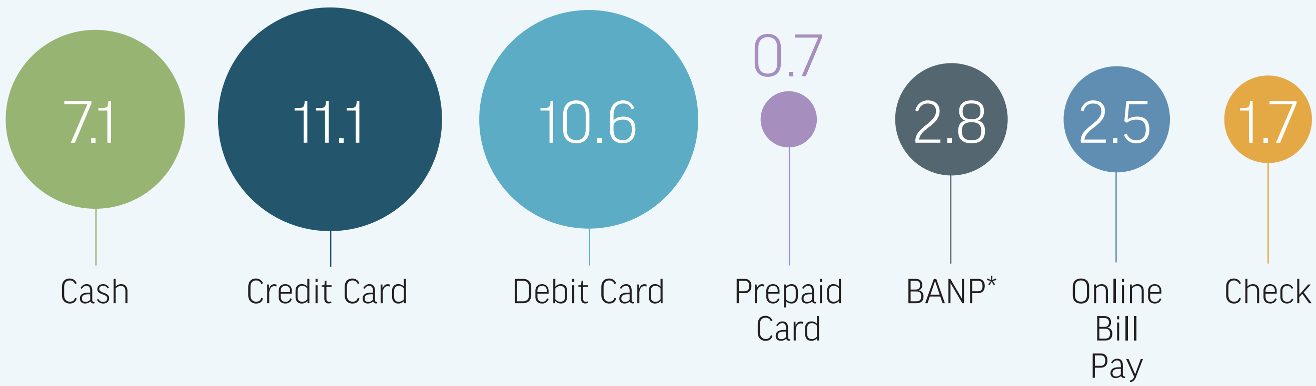
Neither the EPC nor the MPC will reveal their ad budgets or provide details for the frequency of their ad messages. Nevertheless, if both sides are spending millions on their ad campaigns, the frequency of those messages is unlikely to go unnoticed by legislators, advertising experts say.

'A DRACONIAN BILL'

Another key element of the two groups' opposing campaigns is the

CREDIT IS STILL KING—BARELY

(Average number of payments per person by type, U.S., October 2021)



*Bank account number payment. Source: 2021 Diary of Consumer Payment Choice, Federal Reserve Bank of Atlanta use of studies on how consumers and merchants feel about the CCCA itself. Both sides have cited several studies, and in some cases conducted their own research, around the impact of the CCCA on consumers and merchants.

While information from such a study or survey is unlikely to reach consumers directly, studies are effective lobbying tools for use in persuading legislators on how to vote. Studies can be used to supplement one-on-one lobbying efforts by using the data to show legislators what their constituents think about a particular issue, says Jacob Neiheisel, an associate professor of political science for the University at Buffalo College of Arts and Sciences, Buffalo, N.Y.

"Lobbyists can use the data to show if their message is resonating with a legislator's constituents," Neiheisel says. "This tactic goes hand-in-hand with lobbying, which is an inside tactic."

One piece of research the EPC has used against the credit card bill is a report from the Federal Reserve Bank of Richmond. It shows that, after the Durbin amendment passed, just 1.2% of merchants reduced their prices, despite their debit card fees being cut nearly in half.

"That study is one the merchant community has not been able to attack," says EPC executive chairman Richard Hunt. "We want people to see that the CCCA is a draconian bill that is a serious threat to a safe and secure payment system."

In any issue-oriented ad campaign, experts say, one point to pay close attention to is what's not being said. In the case of the MPC's campaign, that is the merchants' silence on the matter of what networks would serve as the alternatives to Visa and Mastercard if the CCCA passes.

"That is not spelled out in the bill," says Glenn Grossman, director of research at Cornerstone Advisors, a Scottsdale, Ariz.-based consultancy. "An alternate network may not be as secure as Visa and Mastercard, which see fraud patterns across their networks. Adding less secure networks as alternatives is a fraudster's dream."

Just how secure an alternative network may be is a key point, because if a debit network such as Pulse or Star becomes an alternative, odds are it will have to spend heavily to rival the security of the Visa and Mastercard networks.

Indeed, for some experts the notion that a debit network can readily take over credit card processing in bulk is little short of a pipe dream.

"How can a debit network spend to build the same kind of network infrastructure as Visa and Mastercard and be price- competitive with them," asks Don Apgar, director, merchant payments, at Javelin Strategy and Research. "On paper, the CCCA may save merchants money, but in reality, alternative networks have a lot of hoops to jump through to securely handle credit card transactions,"

Adds Grossman: "Unintended consequences are not always something politicians take into consideration."

DEFINING THE ISSUE

As to which side's message is winning out so far, the signs are pointing to the credit card industry. In early May, a call by CCCA co-sponsor Roger Marshall (R-Kan.) to attach the bill to a Federal Aviation Administration reauthorization bill failed by a vote of 85-12.

The failure to attach the CCCA to another bill with a high probability to be voted on before a new Congress is seated next year—or even get the bill to a vote this year—is a strong indicator the payments industry's message is resonating with legislators, observers say.

"The easiest way to defeat legislation is to stop it before it comes to a vote," says Syler. "That says the opposition defined the issue before the other side did and is fighting the media battle on its terms, which is what you want." DT

Hunt: "We want people to see that the CCCA is a draconian bill that is a serious threat to a safe and secure payment system."

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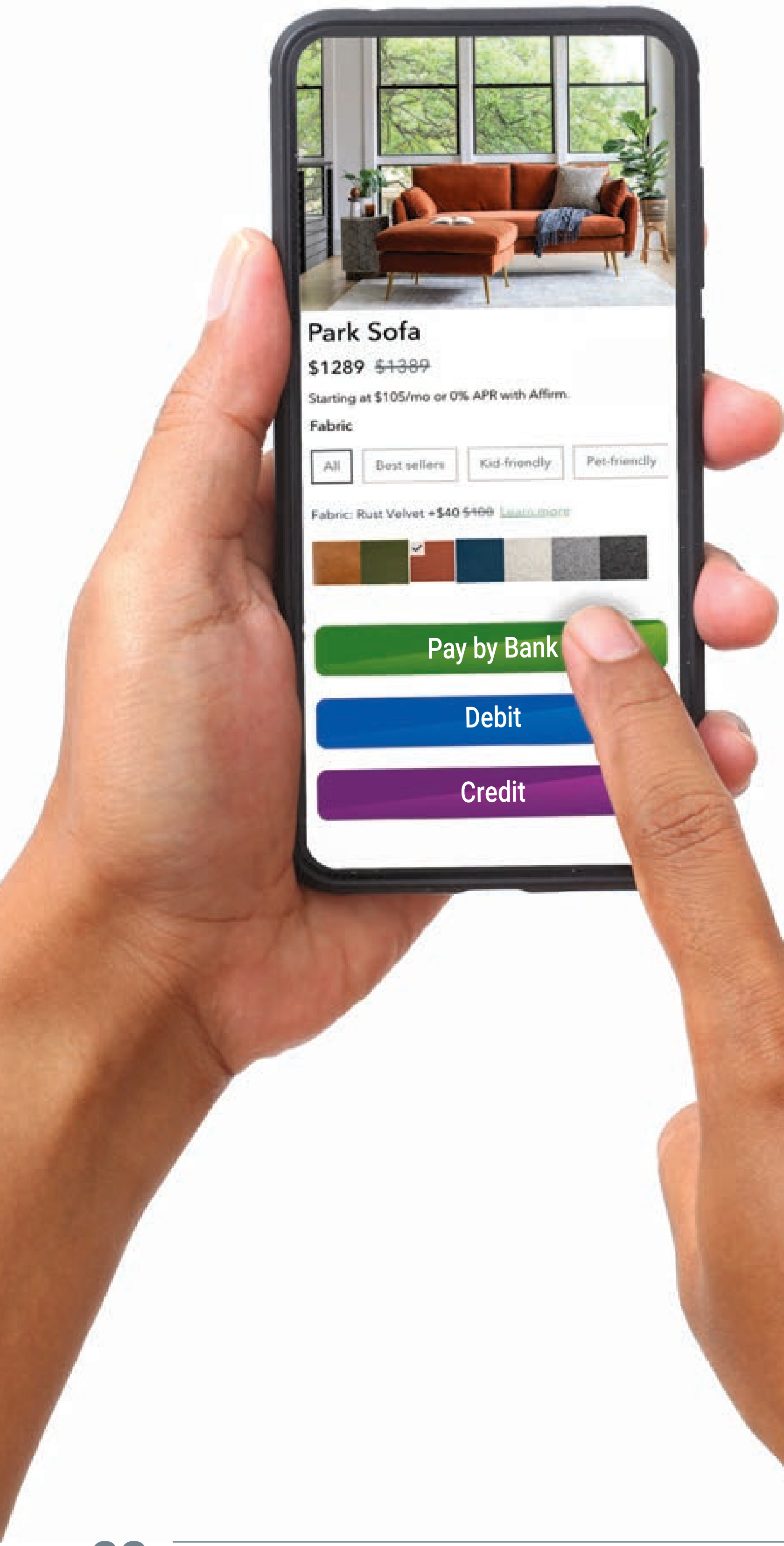
IS IT TIME FOR

PAY-BY-BANK AT RETAIL?



Consumers and merchants may be primed for it.

BY KEVIN WOODWARD

New technology, consumer affinity for digital payments, and the allure of cheaper payment processing may be setting the stage for broader use of pay by bank in the United States.

Paying by a bank account is not unfamiliar to most consumers. Already, many use the electronic payment method to pay mortgages, rent, utility bills, and car payments. That usage may soon evolve beyond traditional obligations to include online commerce.

The factors driving this activity have been around a while, but the advent of updated technologies, growing consumer ease with digital payments, and a ready merchant disposition to accept whatever payments consumers choose to use—especially if they are cheaper than traditional credit and debit card processing—appear to be setting the stage for broader use of pay by bank.

The questions are, how likely is it that this wider market will develop soon, and how may it manifest itself in the United States, a traditionally card and cash-oriented consumer-payment market.

Defined as a payment direct from a consumer's bank account or a merchant's bank account, pay by bank sidesteps the credit and debit card rails. That's a tempting proposition for merchants, assuming pay by bank could be a cheaper form of payment.

As with any payment-method introduction or expansion, it takes more than merchants to broaden acceptance. Consumers have to want to pay with it and financial institutions have to see value in it. The formula may be well known, but getting the recipe to turn out is another issue.

Still, many are working toward the eventual expansion of pay by bank. Milwaukee-based processor Fiserv Inc., for example, already is preparing.

"The ability to do account-to-account payments has been around a long time," says Chris Rennie, Fiserv's director of product management. Pay by bank is the ability to expose that experience in a prominent way digitally, pair it with more modern user-interface schemes, take advantage of modern card-on-file technology, and create a new experience, he says.

Current pay by bank incarnations use the automated clearing house system, which, according to open-banking specialist Plaid Inc., may levy a fee ranging from pennies for smaller transactions up to 1% to 1.5% of the transaction value, often with a $5 cap. That compares to a credit card processing fee typically ranging from 1.5% to 3.5%. Fiserv says pay by bank's cost can be up to 50% less in fees.

Incidentally, Visa Inc. attempted to acquire Plaid, but withdrew from the deal following U.S. Department of Justice concerns and instead acquired Tink AB, a European open-banking company that will form the basis of a pay by bank push the card network announced in May.

At bottom, pay by bank is "really about enabling merchants to accept this tender and get the lower cost and opportunity to consumers," Rennie says. Indeed, merchants have been complaining about credit and debit card acceptance costs for years, with a 19-year-old interchange lawsuit reaching a settlement only recently, though official acceptance is pending.

'Not in a Coffee Shop'

The prospect of lower fees for an electronic payment is enticing to merchants. So, given much lower fees, sellers will actively seek pay by bank services, many observers say.

Credit card processing fees—which range from 1.5% to 3.5%, according to Bankrate.com—are a longstanding merchant pain point.

"Nobody wants to keep paying these interchange fees, with so many parties in the transaction," says Booshan Rengachari, chief executive and founder of Finzly, a banking-technology provider with U.S. headquarters in Charlotte, N.C. A base interchange rate may have other fees tacked onto it, resulting in the discount rate that includes all fees.

But lower fees alone won't be enough to ignite pay by bank. Consumers will have to view pay by bank transactions as being as easy to complete as a credit card transaction, whether that's made with a dip, a tap, or online.

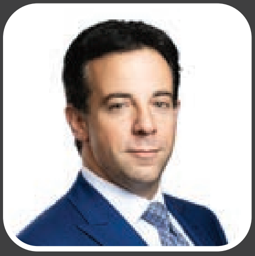
"Consumers are used to pay-by-card at point of sale, and with wallets storing card credentials, it has been easier for consumers to rely on cards for online transactions as well," says Suresh Ramamurthi, chairman of NetxD Inc., a digital-banking and asset-tokenization platform with U.S. headquarters in Lawrence, Kan. "It is important for merchants to make the pay-by-bank option as frictionless [as possible] to drive adoption."

In some markets, a pay by bank transaction might have a fee of 0.2% or 0.3%, says Nilesh Vaidya, global industry head for retail banking and wealth management at Capgemini, a technology consultancy.

But even with a price incentive, pay by bank still needs consumers to want to use it. That means creating use cases and making it easy to use.

Vaidya says the first opportunities will be found in higher-value purchases that would otherwise incur high card-processing fees. "The opportunity will not [be] in a coffee shop," he says. "It's more [likely] if someone is buying a refrigerator or making a down payment on a car. These kinds of high-value payments will be key."

This assumes, though, that consumers would be comfortable forgoing credit card rewards, especially those on larger transactions. "High-value transactions are going to be challenging," says Ben Isaacson, senior vice president of product strategy at The Clearing House Payments Co. LLC. TCH operates the Real Time Payments network and other payment services. "I understand why merchants don't want to pay 3% credit card interchange. I also understand why the customer wants the 2% reward."



Isaacson: "High-value transactions are going to be challenging."

'A Major Inflection'

Pay by bank could create questions for financial institutions like Michigan State University Federal Credit Union, East Lansing, Mich. Agreeing that interchange costs will be the top motivator for merchants to adopt pay by bank, Ben Maxim says, as an issuer, the credit union will have choices to make. Maxim is chief digital strategy and innovation

officer at the credit union and chief operating officer at Reseda Group, a credit union service organization the credit union owns.

"One of our biggest non-fee revenue [sources] is interchange," Maxim says. Additionally, the credit union is growing and could reach $10 billion in assets in a couple of years, the point at which the interchange it could assess for debit card transactions would be capped by the Durbin Amendment. "Then layer on less spend on credit cards, that could exacerbate the matter. It definitely puts lots of pressure on [us] to find alternative revenue sources," he says.

While pay by bank's potential fee diversion may be a concern for card issuers, "consumers don't care what the rails are," Maxim says. "But they care about the use." If they want to tap a card or smart phone against a point-of-sale terminal, he says, it's often because they view it as easier to do than dipping or swiping a card.

Broader payments-industry trends also could affect pay by bank development. Financial institutions will consider it as their fintech competitors adopt it. "What's really going to make it viable is that the banks embrace the fact they want to remain in the conversation," Maxim says. "Whoever the merchants start to favor, that's who's going to win."

As a fintech, Link Money is plowing ahead on pay by bank. In February, e-commerce platform Radial Inc. added the San Francisco-based firm's Pay by Bank service as an online checkout option. Radial pegs the potential reduction in fees at as much as 70% to 80%.

And Pay by Bank can help reduce fraudulent transactions because consumers are required to authenticate payments in their banking apps, Radial says. The liability for Pay by Bank transactions lies with Radial.

"There's been a major inflection in the desire for large enterprise merchants to launch pay by bank in the U.S.," says Eric Shoykhet, a Link Money cofounder. The credit card interchange settlement is one factor in that consideration because, if approved, the agreement could limit surcharges to 1% of transaction value, down from as much as 4%. As surcharging may come under more consideration from merchants, they also are thinking about the impact on consumers, who may not like the extra fees.

"Because of that, a lot of merchants who are planning to [surcharge] are starting to think about if the customer faces surcharges, what is a low-cost way to provide payments," Shoykhet says. Walmart Inc., for example, is testing pay by bank for online checkout in a limited pilot. This combination is triggering many merchants to consider pay by bank, he says.

'Comply or Get Behind'

In Shoykhet's view, the major factor in pay by bank adoption is consumers. "People are used to the account-linking flow," he says. "They're very familiar with this flow." A Visa analysis found that 95% of consumers connect their financial accounts to third-party providers and 34% are aware that open banking is part of their connected financial-services activity.

Financial institutions may be willing to offer pay by bank and merchants might be eager to accept it, but getting consumers comfortable with it and its differences from their beloved credit and debit card payments might be an issue.

"The use cases for pay by bank are limited only by the merchants' willingness to adopt the

Maxim: "Whoever the merchants start to favor, that's who's going to win."

Shoykhet: "There's been a major inflection in the desire for large enterprise merchants to launch pay by bank in the U.S."

payment and the shoppers' willingness to use it," says Ben Jackson, chief operating officer at the Innovative Payments Association.

"With that in mind," he continues, "the near-term uses for pay by bank will probably be extensions of bank bill pay, where people or businesses don't want to connect to a bill-pay system, want the funds faster than bill pay allows, or are planning one-off payments.

"So, contractors and service trades like plumbers and [heating and air conditioning providers] might create pay by bank portals on their sites or even through mobile devices to displace checks. Subscription services might want to use pay by bank, and places like health clubs might want to move from card payments or automatic billing to pay by bank. Online and mobile shopping will certainly adopt it as one of the options."

One consumer incentive, already deployed by fuel retailers when consumers pay using an ACH-based payment that is not a debit card, is to offer a discount or rewards. Pay by bank, with its cheaper processing costs, affords some financial incentives.

Acquirers, too, will have a stake in pay by bank. It could be sold as a complementary payment service. They may not have much say in it, though, which is not out of the ordinary course of business. Other payment types and devices have been developed with independent sales organizations, their agents, and acquirers easily adapting their sales strategies to them.

"I don't think ISOs will be the ones making that decision," says Brian Goudie, chief executive at Las Vegas-based Aurora Payments. "They will comply and get with it or get behind."

'It's About the Experience'

One factor that could affect pay by bank adoption among merchants is their ability to surcharge. Surcharging at the point of sale can cover much of their credit and debit card processing costs without introducing a new way to pay. But some customers, such as at a nail salon, may opt for a lower-cost payment method to avoid the extra fees.

Pay by bank won't be a one-size-fits-all or a wholesale replacement for the deeply rooted payment card system. Goudie suggests some verticals, such as hotels, may stick with cards, but nail salons may be optimal because of the low value and low risk of the transaction.

And pay by bank is better suited for e-commerce payments, argues Stewart Watterson, strategic advi-

Goudie: ISOs "will comply and get with it or get behind."

sor at Datos Insights, a Boston-based payments-advisory firm. “In-store will prove most difficult due to consumer habit and the lack of interoperable hardware at the point of sale,” Watterson says. “The current POS acceptance devices will not lend themselves well to other payment rails. Merchants have deeply integrated the current POS systems into their own operating systems.”

Whether online or in-store, pay by bank will have to be as simple to use as paying with a card or tapping a card on a phone—or simpler.

“Consumers are the smartest people and fast learners,” says Finzly’s Rengachari. “The devices we have today—the smart phones—both a child and a grandmother can figure out to play a game.”

Above all, adoption of pay by bank is not about the technology being in place to enable it. “It’s about the experience,” Rengachari says. “All that matters is to provide an easy experience. We don’t have that kind of experience yet.” DT

Vaidya: “The opportunity [for pay by bank] will not [be] in a coffee shop.”

THE TECHNOLOGY BEHIND PAY BY BANK

Pay by bank as a broader payment method may be gaining traction because of recent advances in technology that connects bank accounts and hastens the speed of a transaction.

First up is open banking, a technology that enables third-party providers to link a consumer’s bank account with a merchant, easily enabling a payment that doesn’t use credit and debit card rails.

Already, one financial institution, BNY Mellon, has a pay-by-bank service that uses open banking. Dubbed Bankify, the service enables organizations to receive consumer payments from bank accounts. Incidentally, New York City-based BNY Mellon does not issue credit cards. Developed in conjunction with Trustly, an open-banking services provider, Bankify was designed for consumer-to-business payment flows.

Open banking is the vital underpinning for pay by bank. Visa Inc. data finds that 95% of U.S. consumer accounts have open-banking connections, while there are more than 12,000 secure connections made to financial institutions.

The other technology that is spurring pay-by-bank consideration is real-time payments. With The Clearing House Payments Co. LLC and the Federal Reserve offering RTP and FedNow, respectively, the temptation to capitalize on them for new consumer use cases is strong. Many current pay-by-bank configurations rely on the automated clearing house network, which offers same-day ACH processing and multiple daily settlement windows.

“Real-time payment is the basis for these transactions so people can quickly transfer the money,” says Nilesh Vaidya, global industry head for retail banking and wealth management at Capgemini. “The real-time payment is essential.”

Real-time payments also may expedite pay-by-bank adoption, some suggest. “While pay by bank is a very common payment method in many European countries, and countries like India that have a robust domestic instant payments solution, it has primarily been limited to bill payments as a use case in the U.S.,” says Suresh Ramamurthi, chairman of NetxD Inc, a digital-banking and asset-tokenization platform company. “The growing adoption of TCH RTP and the FedNow service is expected to change that and drive the growth of pay-by-bank volumes.”

NETWORKS, MERCHANTS, AND THE TORTURED STORY OF INTERCHANGE BY FIAT

Market pricing is preferable to legal settlements, which in turn are preferable to government regulation. Will the payments business ever learn that lesson?

BY **ERIC GROVER**

MANY IN THE payments industry breathed a sigh of relief at Mastercard's and Visa's announcement in March of their landmark settlement of a longstanding antitrust suit over credit-card interchange and network-acceptance rules.

Not everyone is happy, however. Mastercard and Visa want to be free to set interchange prices and network rules to maximize total value for cardholders, merchants, and banks. Merchants would like payments to be free and to generate incremental sales. But it's in the nature of settlements that neither party gets everything it wants.

At trial, either party might have achieved total victory. But each would have risked a catastrophic outcome, and merchants' attorneys would have had a deferred or no payday. Indeed, there is one clear winner in this litigation: the attorneys, who stand to make up to $170 million from the case, are licking their chops at the settlement.

If the settlement is approved by Judge Margo Brodie in the U.S. District Court for Eastern New York, it will have a momentous impact on credit-card acceptance fees and merchants' ability to influence tender type. It will not, however, end the forever war over payment-industry fees, a war being waged on multiple fronts, by litigation, legislation, and regulatory diktats, at the state and federal levels in the U.S., and abroad.

Interchange fees are used by two-sided payment networks to balance participation on both sides of the network and thereby maximize total value. They fund fee-free accounts, a smorgasbord of cardholder benefits and rewards, and issuer innovation.

A BILLION-DOLLAR TRANSFER

In the settlement, Mastercard and Visa committed to reduce interchange fees by roughly $30 billion over five years. Every published interchange rate would be decreased by at least 4 basis points, and average interchange by at least 7 basis points.

The massive settlement would transfer billions of dollars from cardholders and credit card issuers to large merchants, two-stage digital wallets like PayPal, and merchant acquirers serving small merchants.

Interchange rates for large merchants would be reduced more than the average, and these sellers will reap the entire windfall immediately. Reductions for smaller merchants will be less.

Merchant acquirers will enjoy a bonanza by retaining interchange cuts. Digital-wallet-anchored payment networks like PayPal will benefit from lower funding costs, which they are unlikely to pass on through any reduction in their take rate.

Lower interchange will put a damper on competition among credit card issuers over rewards that many U.S. consumers take for granted. Caps will also make it nearly impossible for Mastercard and Visa to use interchange to woo new issuers and win greater payments share from existing issuers.

Besides all this, the settlement prohibits Mastercard and Visa from boosting issuer compensation with synthetic interchange by increasing acquirer fees and making net issuer fees negative.

To prevent payments networks from circumventing interchange price controls, synthetic interchange is banned for debit in the U.S. by the Durbin Amendment and in the European Union for credit and debit.

Mastercard's and Visa's fettered interchange could offer an opening to a combined Capital One and Discover, on top of disrupting Durbin's straitjacketed debit market.

If Discover cardholders are fueled by compelling rewards, if enough of them strongly prefer Discover, and if there are more of them and their spend increases, America's long-struggling number-four credit-card network could hike interchange.

Higher interchange would enable Discover to enrich its rewards, incenting greater use, and, critically, improving its prospects of persuading major U.S. credit-card issuers to offer Discover in addition to Visa, Mastercard, and American Express. In a similar vein, the premium-interchange AmEx network will become more attractive to U.S. banks.

CONSUMERS TRUMP SELLERS

Whoever in the payments value chain can shift payments share captures richer economics. The payments industry defends interchange fees as a means of recouping issuer costs. That's a utility model. The primary reason, however, that interchange flows from merchants to issuers—and then, to a large extent, on to cardholders in fee-free products, benefits, and rewards—is that consumers' payments preferences trump those of merchants.

This is why it's a penny-wise, pound-foolish strategy for retailers to aggressively push consumers to pay with cheaper payments products. This also means that, while payments networks must adequately serve merchants to increase payment-network volume and share, it's more important for them to persuade financial institutions to issue their payments products and to incent cardholders to use them.

The proposed settlement attempts to address this asymmetry by giving merchants a greater ability to influence payments mix and, consequently, acceptance fees. It would permit surcharging up to 3% for interchange and network fees, whichever is higher, if competing payment networks such as American Express and Discover are comparably surcharged, or, if they aren't, up to 1%.

American Express's rules prohibit surcharging unless all other cards are comparably surcharged. It would be good for Mastercard,


Grover

Grover: March's interchange settlement "will not end the forever war over payment-industry fees, a war being waged on multiple fronts."

Visa, Discover, credit card issuers, and cardholders if AmEx sticks to its guns.

Consumers don't like surcharges. They don't like paying to pay. Discounts are a more palatable means of encouraging consumers to use different tender types.

The settlement invites merchants to negotiate deals with issuers, under which they would offer discounts to consumers paying with particular issuers' cards. Today, Costco enjoys the lowest credit card acceptance fees of any merchant in America because it gives 100% of its credit card volume to Visa.

If a large merchant—say Amazon—provided discounts to consumers paying with cards from a particular issuer and network, and thereby steered more payment volume to them, it would enjoy better terms.

CONSENTING PARTIES

The proposed settlement authorizes merchants to band together to collectively bargain with Mastercard and Visa. This provision is reminiscent of Sen. Richard Durbin's Credit Card Fair Fee Act of 2008, which envisioned merchants, under government supervision, collectively negotiating fees with the payments industry.

Under this initial attempt by Durbin to make the payment industry a public utility and gut its economics, if merchants and the payments industry were unable to find accord, government "payment system judges" would determine the merchant-discount fee that would obtain in a perfectly competitive market. This they would set as the price ceiling.

Merchants don't have a great track record of successful collaboration. Notably, their grand payments coalition, Merchant Customer Exchange, launched in 2012 with great fanfare, failed soon afterward.

Prices and practices set in the market by mutually consenting parties best dynamically allocate resources to maximize total value. Prices and practices established by agreement to settle a lawsuit are unfortunate, but still preferable to prices and practices imposed by politicians and regulators.

By lawsuits, legislation, and regulatory diktats, payment networks' freedom to compete continues to be whittled away. DT

HOW FINTECH CAN COPE WITH THE INVESTMENT CRASH

The days of easy money may be over, but that doesn't mean worthwhile startups can't start up.

BY **SCOTT DAWSON**

Scott Dawson is head of sales and strategic partnerships at DECTA.

"HARD TIMES CREATE strong men, strong men create good times, good times create weak men, and weak men create hard times." So said author G. Michael Hopf in the quote which has become something of a catch-all sentiment for "decadence."

This dynamic is illustrated well by The Great Depression in the 1930s, when economic turmoil challenged communities and individuals, making it necessary to adapt, innovate, and endure severe economic hardships. This gave rise to a tougher generation that understood the value of hard work, saving pennies, and supporting the wider community.

The metaphor also works if we change "men" to "companies," and even serves to shed some much-needed light on the direction in which business in the 21st century is likely to go. In good times, investors, flush with cash, invest in thousands of "weak" companies.

These businesses fail, and investors are forced to find more reliable sources of profit. Then, once again flush with cash, they return to splurging billions of dollars on any startup that has managed to design a logo.

With fintech investment now a quarter of what it was a year ago, it seems hard times are back in earnest. Key to this has been interest rates. The very same mechanism that means that fuel and food are now more expensive than ever before also means that it is more expensive to borrow large sums of money.

Following the Great Recession of 2008, many first-world nations adopted Zero Interest Rate Policy (ZIRP) as a means of boosting investment. If companies can borrow at zero or close to zero percent interest, then they should, economists say, start profitable businesses, create jobs, and stimulate the economy.

Theoretically, this approach is solid—except for the fact that it doesn't always work. Japan did just this, going so far as having negative interest rates in the 1990s "lost decade," and it didn't work.

But a byproduct was the emergence of massive investment funds like Softbank Vision Fund, which in turn supported many of the big names of the ZIRP-era: Doordash, Uber, WeWork, Revolut, Slack, FTX, and Klarna, among others. (That being said, FTX has since collapsed due to fraud, while WeWork went bankrupt and Uber posted its first profitable quarter this year, despite having been founded in 2017.)

However, every crisis is an opportunity. Fintech now has a chance to get more practical about creating companies that actually add value, that are of service to the community, and that actually solve problems instead of jumping from one VC cash infusion to the next.

OPPORTUNITIES IN CRISIS

Fintech investment in 2023 was a quarter of what it was in 2022, and one-fifth of its peak in 2021. In the United Kingdom, one of the world's great fintech hubs, investment is down 57%. This isn't the same across the board. The fraction of venture-capital funding going to fintech startups was down 5% in 2022 and 7% since its high in 2021.

The creation of unicorns is also down significantly: 59 companies had exits of over a billion dollars in the second quarter of 2021. In the same quarter of 2023, the figure was only two. In short, VCs seemingly just aren't that into fintech any more.

Compare this to the previous decade. PayPal, Revolut, Venmo, Stripe, and Klarna became multi-billion-dollar businesses almost overnight, and remain so by giving people


Dawson

Dawson: "The days of easy money in fintech are over."

access to services that traditional financial-services companies couldn't offer: instant payments or buy now, pay later financing.

To find these diamonds in the rough, the venture-capital world had to burn through hundreds of not-so-shiny diamonds, often at great cost. Those 59 startups with exits in 2021 aren't likely to be household names today, if they even still exist.

Anyone who has been at a fintech conference in last 10 years might have been given a business card and tote bag by a company with a clever name, slick logo, and scads of VC money, but with no offering that solves any problems. Such companies might not provide a new or better solution to an existing problem or have a real addressable market, and quite often they have no plan to become a profitable business.

This preference for growth over profit is key, and is one of the defining aspects of the ZIRP era. Of course, there are examples where this approach was been responsible for massively successful companies. Amazon dramatically cut the prices of books to the point that physical bookstores went out of business, eventually expanding its customer base so much that it could not fail to turn a profit. In fact, it is selling so much that even the pennies it makes on a sale add up to hundreds of billions of dollars in gross profit each year.

That being said, Amazon's rate of growth is falling, despite a marked upturn during the pandemic, from an average of around 40% year-over-year quarterly growth in the early 2010s to 30% later in that decade and now a flat 20%. It has now transitioned from a period of rapid growth to a profit-driven model, something that many other growth-oriented companies have failed to do.

THE ROAD AHEAD

The days of easy money in fintech are over. Gone are the shotgun-blast investments in hundreds of startups, hoping for a few unicorns. The good news is that this reckoning is forcing VCs to sharpen their focus to seek out rare gems: companies with genuine profit potential and solutions to real problems. This makes for a stronger, more reliable sector.

Fintech investment continues of course, but at a slower, more deliberate pace. This pushes some startups, wary of the volatile VC roller coaster, to explore alternative funding options. This shift could be a positive turning point if it means prioritizing problem-solving over hypergrowth, leading to a more sustainable and impactful industry.

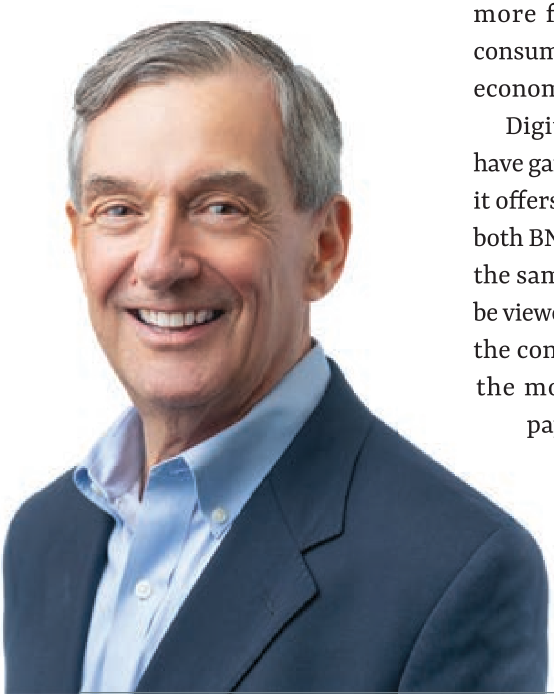
The road ahead may be bumpy, but this reality check could be just what the sector needs. It's time to build for value, not just valuation. DT

IT'S TIME FOR DIGITAL REVOLVING CREDIT

It isn't a credit card and it isn't BNPL. Instead, it's the best of both worlds.

BY **TIM HARRIS**

Tim Harris is chief executive of FuturePay Holdings Inc.



AS A PROVIDER OF e-commerce financing solutions, we've watched with interest the latest calls for buy now, pay later (BNPL) transparency. We've also often seen this method of installment lending compared to traditional credit cards, whose application process involves credit checks that help consumers avoid excessive debt.

Wouldn't it be ideal, though, if consumers had an alternative to both BNPL and conventional credit cards?

When it comes to e-commerce financing, digital revolving credit offers similar convenience, but with more flexibility to accommodate consumers' budgets in a still-volatile economy.

Digital revolving credit seems to have garnered far less recognition, yet it offers many of the conveniences of both BNPL and credit cards—without the same consumer pitfalls. It could be viewed as a happy medium between the convenience of credit cards and the more structured, short-term payment programs required by BNPL providers.

Since a digital revolving account can stay open indefinitely, the business goals of this method align with those of the merchant, fostering long-term customer relationships. Both the e-commerce merchant and the financing provider thrive when purchasers maintain their accounts over extended periods of time.

Developing these shoppers into repeat customers who will reuse their credit for ongoing purchases is a significant achievement.

This is because happy, long-term customers develop brand loyalty in the process. By contrast, a short-term BNPL installment loan account terminates the customer relationship after the transaction is paid off.

UNDER SCRUTINY

A digital revolving credit account is also far easier for consumers to manage. First, borrowers are not bound to a rigid fixed payment schedule, as they are with BNPL. Users can choose to spread their payments over time, making smaller monthly payments across an extended period.

Customers tend to be more comfortable when they have increased flexibility in how they make payments on their accounts, allowing them to exert greater control over their finances.

BNPL applicants generally aren't subject to a hard credit pull, removing some of the protections that exist to keep borrowers out of debt problems. At the same time, digital revolving credit accounts are subject to the same regulations and credit underwriting that are common with traditional credit card programs.

Since an open-ended, revolving account allows customers to reuse their credit line, it's also easier for shoppers to keep track of multiple purchases over time, since transactions are consolidated in a single account.

BNPL providers have come under scrutiny of late in this area, since consumers have opened multiple individual installment loans simultaneously, financing everything from groceries to utility bills.

This has been seen particularly with younger consumers who have avoided the credit cards of their parents' era in favor of newer electronic methods. But when used without strict financial discipline, the BNPL repayment process can become overwhelming, making it easier for consumers to fall behind.

MORE FLEXIBLE

A more flexible payment schedule can also be a better option in an inflationary economy. In this scenario, ordinarily reliable consumers with steady incomes and stable credit histories can find themselves with reduced cashflow.

In these instances, customers who use digital revolving credit can adjust their payments to fit their budgets until their financial situations change. By contrast, BNPL loan payment schedules offer no such flexibility—and can hit borrowers with costly late fees if those users can't live up to their commitments.

As much as Gen Z and Millennial consumers have tried to avoid the credit cards of their parents' generation, the misuse of BNPL shows they might need more accommodating financing alternatives. Digital revolving credit enables these younger shoppers—and the rest of the buying public—to take advantage of a more flexible, easier-to-manage e-commerce financing option—one that's designed to help them remain viable, long-term customers. DT

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