DIGITAL TRANSACTIONS

Trends in the Electronic Exchange of Value

FEDNOW AT YEAR ONE

The Fed has done much since launching real-time payments a year ago. It has much more to do.

Volume Twenty-one, Number Seven • DigitalTransactions.net • July 2024

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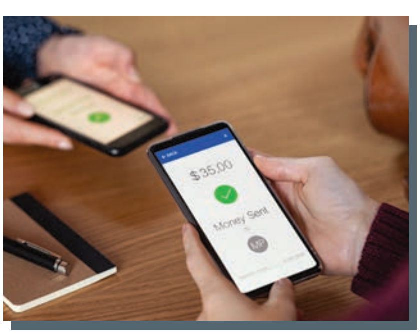

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the gimlet eye

THE LESSON FROM EBAY

IF, AS SEEMS TO BE THE CASE, the future belongs to e-commerce, does that mean the future also belongs to the corollary of e-commerce, digital-payment apps? We chewed on this question as we pondered the significance of eBay Inc.'s decision last month to ditch American Express, and then, just days later, its announcement that it would start taking Venmo.

The significance of these moves, and their timing, are not to be underestimated. Yes, eBay carefully hedged its bet in its AmEx "cancellation" by delaying the actual termination for two months, until Aug. 17. That's to be expected to clear out accounts, reset software, and give users time to make any wallet adjustments they deemed appropriate. But how convenient that, a mere eight days later, eBay stands ready to announce it will accept Venmo, the mobile-payment powerhouse that threatens to overshadow its parent, PayPal.

No doubt acceptance cost played an important role in the dual decisions. Anybody who follows payments knows AmEx is expensive for merchants, the more so for e-commerce transactions, where seller risk is higher. Meanwhile, Venmo is the favored choice of Millennial and Gen Z users, and demographics is destiny. As AmEx enthusiasts—and they are out there, and are well taken care of by their favorite card company—age and level off, are their numbers to be overtaken soon by the Venmo crowd, who appear to be less enamored of credit cards?

EBay apparently is betting the answer is yes. It may also be betting that Venmo user cohort may, sooner than we all think, overtake the AmEx crowd in sheer numbers. Venmo had an estimated 85.1 million users as of last year, up from 52 million in 2020. AmEx cardholders totaled 141 million worldwide last year. The T&E giant is the fourth-largest global card network, but eBay is looking at growth.

Many observers simply figured the decision came down to cost. AmEx offers many advantages to merchants and cardholders alike, but it's not cheap to accept. This at a time when seller sensitivity to acceptance cost has reached new heights, and the Credit Card Competition Act—backed by most if not all merchant groups—is vying for passage in Congress.

We tend to think, however, that there may be more to it than that. No doubt eBay will hear from some angry AmEx cardholders on and after Aug. 17—assuming the online marketplace stands by its deadline. And certainly AmEx itself may in the meantime find a key concession that will unlock eBay's inner sanctum. But none of this erases an obvious fact: the future lies with the young, and with their preferred payment methods.

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Trends in the Electronic Exchange of Value

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THE BIG CREDIT CARD SETTLEMENT APPEARS HEADED FOR A TRIAL. WHO WILL WIN?

With the judge in the massive credit card interchange litigation apparently insisting on a trial, a new and unsettling element of uncertainty now hangs over the nearly 20-year-old case, in which merchants allege anti-competitive behavior by the big credit card networks in setting interchange fees.

The latest development emerged in June, nearly three months after the networks and merchants came to terms on a landmark interchange settlement that calls for rate reductions by Mastercard Inc. and Visa Inc. that are estimated to save merchants nearly $30 billion in card-acceptance costs over a five-year period.

Margo K. Brodie, chief judge for the U.S. District Court for the Eastern District of New York, indicated in June she wasn't satisfied with the agreement and would soon issue a written decision on the matter.

The latest twist in the case comes as merchant groups have also soured on the deal. "Judge Brodie seems to believe the settlement doesn't work. The next step is to go to trial," says Doug Kantor, general counsel for the National Association of Convenience Stores. "That's the right call and a good thing."

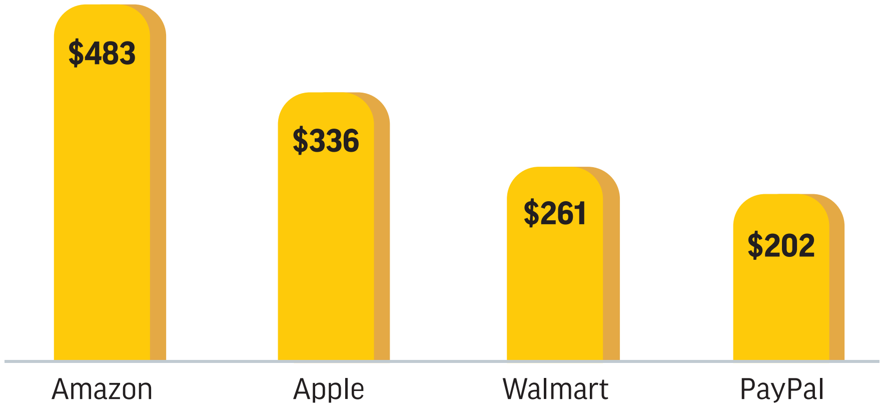
Card-industry experts caution that a trial before a jury could lead to lopsided results for either the merchants or the two big networks.

"If, as seems likely, the dispute is put before a jury in Brooklyn, the outcome is potentially catastrophic for either party. Mastercard and Visa will have to make an aggressive affirmative case before twelve jurors for the enormous value the credit-card ecosystem provides and the critical role interchange fees play in balancing participation on both sides of the network," notes payments consultant Eric Grover, in an email message.

One key casualty stemming from the collapse of the settlement agreement could be an often overlooked provision that permits merchants to encourage customers to use less expensive payment media at the point of sale. Such so-called tender steering has long been prohibited by network rules but could deliver significant savings for sellers, some experts estimate.

WHAT COULD HAVE BEEN

(Estimated annual savings from the interchange settlement, select entities, in millions)



Source: Crone Consulting

Richard Crone, principal at the payments advisory firm Crone Consulting, estimated late in March the settlement would save big merchants and digital-wallet providers hundreds of millions of dollars in acceptance fees, as the agreement provides for a three-year, 4-basis-point reduction in rates. But merchants could as much as triple their savings, he estimated, if they move 1% of their most costly payments types to lower-cost payment media, such as in-house credit offerings.

Other key provisions of the settlement included a requirement that each network ensure its average effective credit card interchange rate is at least seven basis points lower than the average effective credit card interchange rate for the 12-month period ending March 31, 2024. This limit was to be in effect for five years.

Now, the picture has suddenly clouded with the apparent move by Brodie to hear the case. "The judge was pretty clear she expects to reject the settlement," Kantor says. Objections filed with the court, he says, have been "overwhelming" in "pointing out the settlement is not adequate in addressing anticompetitive issues." Executives at Visa and Mastercard could not be reached for comment on the apparent move to go to trial.

For his part, Grover argues the networks could come out of the trial with a win. "I think the credit-card networks would have a good chance of a clean and total victory at trial," he notes. "However, the Russian-roulette metaphor applies. There's a bullet in one of the revolver's chambers. They could lose big. We just don't know how many chambers there are."

—John Stewart

APPLE PAY LATER, WE HARDLY KNEW YE

Apple Inc. said last month it will shut down Apple Pay Later, the buy now, pay later product the tech giant released just over a year ago. The move comes after installment-payment specialist Affirm Inc. confirmed it would be part of Apple Wallet when Apple's annual software updates for iPhones and computers emerge this autumn.

Apple Pay Later, self-funded through the Apple Financing LLC subsidiary, launched in March last year, having been announced the year before. Affirm announced its upcoming inclusion in Apple Wallet in a securities filing last week following Apple's Worldwide Developers Conference.

Apple acknowledged the end of Apple Pay Later in a statement. Released to 9to5Mac.com, the statement says "users across the globe will be able to access installment loans offered through credit and debit cards, as well as lenders, when checking out with Apple Pay. With the introduction of this new global installment-loan offering, we will no longer offer Apple Pay Later in the U.S." Existing Apple Pay Later loans will continue to be serviced, though no new applications will be accepted. Apple has provided no data on Apple Pay Later use or volume.

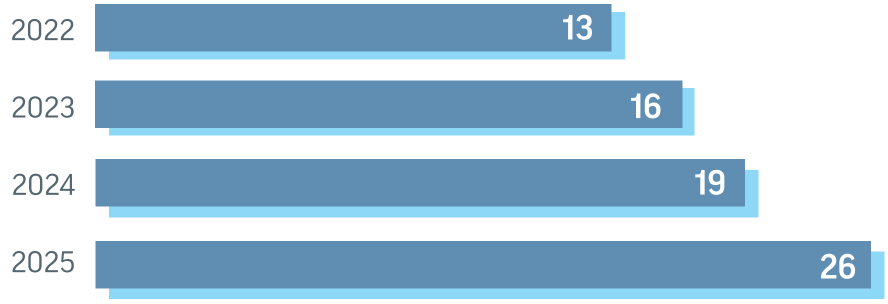
Apple's exit from directly supplying BNPL services apparently does not reflect a diminished view of the payment method. Indeed, the addition of Affirm is likely the first of other possible providers. Apple, in an earlier presentation, says users will be able to access installment loans from eligible credit and debit cards when making a purchase online or in-app with an iPhone or iPad, a feature expected to be available to any Apple Pay-enabled bank or issuer in supported markets.

The buy now, pay later payment method accounted for 5% of all North American e-commerce transaction value in 2023, according to the 2024 edition of the Worldpay Global Payments Report, which forecasts that value will grow to 6% by 2027.

There may be several reasons Apple is leaving the BNPL market, suggests Ben Danner, a senior analyst at Javelin Strategy & Research.

A BUMP FOR BNPL

(global volume, in billions, including projections)



Source: Market.us

"Unsecured lending is both an art and science; it requires a significant amount of capital and risk provisioning. Traditionally, Apple prefers that a partner accept the balance-sheet risk," Danner says via email.

Another factor could be that BNPL may have a profitability problem. "It's difficult to make a profit in lending with 0% interest loans with no fees. The Apple model seemed like it was doomed to fail from the beginning," he says.

A third factor may be that third-party BNPL providers have honed their models. "Affirm is a market leader and has been in the business for many years now. They have an established place in the U.S. market and a wide base of customers that would overlap significantly with potential Apple Pay Later users," Danner says. "Apple's decision to discontinue APL is about offloading risk onto Affirm while giving its customers further flexibility of payment."

Still, Apple's move to exit BNPL may not be without countervailing risks. "The real issue is, can Affirm sustain the volume that Apple might bring? And can Affirm avoid another Peloton partner, that was accountable for so much of their revenue? Affirm must balance the benefits of a large partner with the importance of diversification." Peloton is a provider of subscription-based exercise bicycles.

The demise of Apple Pay Later will have little impact on Apple Pay's standing among consumers, Danner figures. "Survey data shows that Apple Pay is the top universal mobile-wallet app, and I don't think the discontinuation of APL will change this position. Apple Pay is fundamentally a different product than what is being offered by the BNPL vendors and enables you to use your credit card to harvest rewards points, or your debit card."

—Kevin Woodward

AN INTERCHANGE TUSSLE IN THE HEARTLAND

Groups representing Illinois financial institutions, along with the Electronic Payments Coalition, say they will fight to overturn the Illinois Interchange Fee Prohibition Act, which was passed in May and is set to go into effect July 1 next year.

Opponents of the bill are continuing an ad campaign to educate Illinois residents and small businesses about what the groups say are the complications the law will create.

Passed as part of a larger bill at the tail end of the Illinois Spring legislative session, the Interchange Fee Prohibition Act exempts merchants in the state from paying interchange on sales tax. In exchange, the law caps at $1,000 per month what merchants are paid by the state for collecting sales tax.

As a result, Illinois merchants will pay interchange only on the pre-tax amount of a purchase. Interchange refers to the fee, typically a percentage of the transaction, that sellers pay to processors on card transactions.

Prior to the bill's passage, Illinois merchants paid interchange on the total of the receipt, including sales tax, and were reimbursed at 1.75% of the total sales tax collected monthly. The deal was reportedly one of the most generous sales-tax discount programs for local merchants in the country.

"Our aim is to make businesses and consumers aware of the damage this law can cause to the payments system in Illinois," says Ben Jackson, executive vice president of government relations for the Illinois Bankers Association. "This is one state tinkering with a safe and secure global payment system."

One of the complications related to enforcing the law is that Illinois, like many states, has different sales tax rates for different products, such as food, gas, alcohol and tobacco. That will make breaking out interchange on sales tax a cumbersome task for payment processors, the EPC says.

"It will also likely require merchants to have to purchase new POS equipment and upgrade their processing system," an EPC spokesperson says. "Implementation will be costly and complicated, especially for small merchants."

While most states have passed laws capping the fee earned by merchants for collecting sales tax on behalf of the state, Illinois is the only state or country to have passed a law exempting merchants from paying interchange on sales tax, according to the EPC.

Illinois merchants pushed for the provision to help offset any financial losses they would incur from the

sales-tax discount cap, according to Jackson.

"Merchants, especially large ones, were receiving a substantial sum from the previous discount [formula]," says Jackson. "The cap was something Governor [JB] Pritzker has been pushing for and merchants pushed for the interchange exemption."

With the Illinois legislature in adjournment until November, groups representing Illinois banks and other stakeholders in the payments industry see an opportunity to use the next five months to build public support for overturning the bill. and even to challenge the law in court, Jackson says.

The EPC adds that, between now and July 1, 2025, it will continue to explore all avenues to see the interchange exemption is repealed.

So far, Jackson notes, the response to efforts to overturn the new law has been strong. "This is the fastest I have seen consumers and small businesses react [to a piece of legislation]," he says.

—Peter Lucas

VISA: 10 BILLION TOKENS AND COUNTING

Visa Inc. says the 10 billion tokens it's issued since 2014 are just the tipping point, as it expects Visa's tokenized transactions to grow exponentially over the next several years. Visa announced the 10-billion milestone early last month.

As of April, 29% of all transactions processed by Visa used tokens. Tokenization uses a cryptographic key that replaces sensitive payment data, such as that found on credit and debit cards, and that can be embedded into any device. Perhaps best known as a critical component of mobile-payments apps like Apple Pay and Google Pay, tokens have made their way to vehicles for in-car payments.

Visa's 1-billionth token was issued just in 2020. More than 8,000 issuers have enabled Visa tokenization, the network says. And in the past 12 months, more than 1.5 million e-commerce transactions use Visa tokens every day, Visa adds.

"We aim to make as many transactions tokenized as possible, and are continuing to invest in increasing our token penetration today and in the future," says a Visa spokesperson by email.

"We expect the percentage of Visa's tokenized transactions to grow exponentially over the next several years. Our 10 billionth token milestone is just the tipping point. Digital commerce continues to grow, and we're seeing incredible demand from merchants who see the value of this technology for their businesses."

Visa also touts that tokenization caused a six-basis-point improvement in payment-approval rates globally and has helped reduce fraud by up to 60%. Visa's tokens can be processed over other networks.

Visa also is employing tokenization as part of its newest service, the Visa Flexible Credential. This service enables consumers to access multiple accounts via a single credential. "The Visa Flexible Credential lets consumers choose how they pay with a single card—whether that's debit, credit, installments, or more. Consumers can also preset their choices. For example, by creating a rule to pay with credit for purchases over $100. This is all compatible with tokens behind the scenes," Visa says.

Visa isn't alone in adopting tokenization as a security measure and a way to drive digital-payments growth. American Express Co. has offered tokenization and related measures since 2015. That same year, Visa and Mastercard Inc., which also launched a tokenization capability in 2014, signed a reciprocity pact that lets each access the other's tokens. Tokenization is also critical for mobile payments using a smart phone.

—Kevin Woodward

MONTHLY MERCHANT METRIC

Total Gross Processing Revenue %

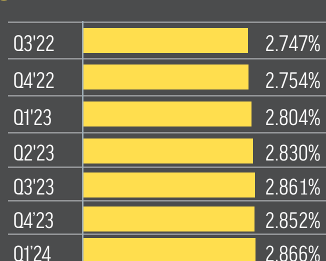
This is sourced from The Strawhecker Group's merchant datawarehouse of over 4M merchants in the U.S. market. The ability to understand this data is important as SMB merchants and the payments providers that serve them are key drivers of the economy.

All data is for SMB Households defined as households with **less than $5M in annual card volume.**

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

Household - Standalone Merchants are considered as a Household with one store and Chained outlets under a common ChainID are combined together and considered as one single Household

Total Gross Processing Revenue % - Sum of total discount, total transaction fee revenue and total other fee revenue divided by total volume



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PAYMENT CHOICE AS THE KEY TO CONSUMER SPENDING

Providing consumers more ways to pay and engage with merchants plays a key role in driving consumer purchasing decisions, according to Fiserv Inc.'s Spring 2024 Carat Insights Report.

One way for merchants to engage on a deeper level with consumers is to offer apps featuring loyalty and rewards programs that are easy to use. When asked to provide the key reasons why they favor a merchant's app, 79% of respondents said quantity of rewards motivated them, 75% said relevance of rewards, and 73% cited exclusivity of rewards.

Overall, 73% of respondents deem loyalty programs important to the brand experience, up from 67% from the same period a year ago.

Ease of use is another factor influencing consumer usage of merchant apps, according to 84% of respondents.

"It's important to remember that consumers want a memorable experience and are prone to repeat habits, so apps should be developed in a way that allows users to quickly access what they need," the report says. "For instance, the Kroger app highlights past purchases, making it easier to find your favorite items and promotional offers."

Fiserv surveyed more than 2,100 consumers in the United States in March for the report.

When comes to payment types for online purchases, debit cards are the most popular (37%), followed by credit cards (33%), and digital wallets (15%). Prepaid/gift card usage is increasing, however, with 63% of consumers saying they have used a gift or prepaid card online the past month, up from 55% in during the same period in 2023.

Buy now, pay later is also gaining popularity with online shoppers with 34% of saying they have used BNPL to pay for an online purchase the past month, up from 31% in 2023.

Account-to-account payments are proving to be a popular option with consumers, especially for bill payment. Some 32% of respondents say they use pay-by-bank for bill payments, while seven in 10 respondents say they would be likely to use pay-by-bank over other bill-payment options due to consumer protections.

Other purchases consumers make using pay-by-bank include retail/grocery purchases (12%), loading funds into accounts (10%), and other types of payments (46%). Overall, 78% of respondents say they are aware of pay by bank, up from 54% a year ago.

Reasons consumers prefer to use pay-by=bank include security (72%), ease of use (71%), and making a payment without accruing debt (69%).

In the healthcare sector, health and wellness merchants, such as pharmacies, are finding acceptance of health savings account cards stored within digital wallets can build customer loyalty.

While 17% of consumers have an HSA card, about six in 10 have loaded the card into their digital wallet. Millennials (24%) are most likely to have access to HSA cards, with eight in 10 Millennials loading the card into their digital wallet.

"For merchants that do accept HSA cards, offering features that allow full or partial payments, depending on funds, can encourage consumer use and build brand loyalty," the report says.

"Specifically, some merchants with digital wallets within their mobile apps offer a feature that automatically deducts a qualifying health or wellness product from a customer's HSA card or account. If needed, the consumer uses another payment method to cover the remaining balance."

Top reasons consumers will pay with an HSA card at a specific pharmacy or health care merchant include earning cash back on qualifying purchases (53%), earning loyalty points from the merchants (42%), special promotions on qualifying products (35%), and exclusive or early access to sales on qualifying products (32%).

"To increase purchases, merchants should highlight what products are HSA card-eligible, such as first aid kits, over-the-counter medications, and mobility aids," the report says.

—Peter Lucas

PAYMENTS IN THE AGE OF AI

BY
GIDEON
SAMID
gideon@bitmint.com

JUST BEFORE HIS early death in 1957, John von Neumann designed a self-reproducing automata. The brightest mathematician of the 20th century, von Neuman realized the implications of his design and attempted to hide it from the public. A self-reproducing entity can spawn "children" entities (copies) marked by random mutations that render some of them more advanced than others.

By allowing the more advanced automata (and not the others) to reproduce themselves (with more random mutations), and then repeating this process generation after generation, we create capabilities not even imagined otherwise. As Darwin taught us, that is how an amoeba evolved into human beings. Von Neumann taught us how to unleash this sequence in cyberspace, and then watch with awe what comes forth.

Indeed, the fear of AI is well-founded. But it is too late to suck this genie back into the bottle. As far as payments is concerned, AI is both an enemy and a friend. AI creates havoc in identity-management procedures, which are the backbone of online payment. Voices and physical looks are connivingly AI-generated and beat even the most sophisticated payments security.

On the other hand, AI gives us more-advanced tools with which to fight AI-generated, credible fakes. We are now in an AI-dominated battle. And as payments becomes more automatic, faster, global, and fine-tuned, security challenges are rising, too. A big boost to security will come from shifting to digital-coin payments, where the identities of the payor and the payee may remain unknown. But these solutions will not prevent an AI-generated look-alike from claiming the benefits earned by a payment, defrauding the actual payor.

I have written in this column before that AI already, today, scans our spending habits as reflected in our credit card accounts. The AI mechanism, which creates ever-smarter generations of artificial "thinkers," is becoming ever more sophisticated in its ability to draw behavioral and character conclusions from lists of payments any of us may make over a few months. The way AI reaches its conclusions is beyond us humans. So, if AI decides that either payor or payee is "suspicious," and the transaction is stopped, then humans cannot argue against it. Lots of injustice in store.

The challenge of setting guardrails for AI has been much-debated, but barely resolved. Still, we can't drop this challenge. We build nuclear plants with guardrails because we don't want a nuclear eruption. It's the same for AI—it can erupt!

In coming columns, I will share some guardrail ideas. But right here I will put forth what I consider the most critical principle: don't deploy AI and then become so dependent on it that you cannot shut it down if it goes wild. We must ensure there's a plan B to replace a disconnected AI capability that, for some unknown reason, went too far. This is a principle that lends itself to regulation, and it is a solid, common-sense initiative.

Remember that the hardware and software that constitutes the AI operation can itself be hacked, impacting the AI-generated conclusions we so blindly rely on. This risk gives rise to the dual AI principle: for critical situations, let two independent AI entities chew on the same data, then compare their conclusions.

Payments in the age of AI will be a trying challenge. Many people I talk to have a totally unrealistic sense of what AI is. One banker told me he saw a three-minute video about it on Tik Tok. That is why I opened this column with a very brief introduction to what this beast is. More to come. DT

CAN FINTECHS CONTROL THEIR DESTINY?

BY BEN JACKSON

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A NEW REGULATORY framework is coming to fintech.

While none of the regulators has proposed a new rule yet, my prediction is that the Consumer Financial Protection Bureau will create a new regulation that will apply directly to fintechs. This will be done to address concerns that come from relying on issuing banks to discipline their third-party partners.

The failure this spring of Synapse, which provided software for fintechs, left people without access to their money and showed FDIC insurance is not the end all, be all for protecting deposits. Recent consent orders against issuing banks showed regulators are concerned about the way banks are overseeing third parties.

Even the Government Accounting Office put out a recent report recommending Congress update the financial regulatory structure because gaps exist in oversight and consumer protection.

The CFPB did attempt to apply consumer protections to digital wallets in its prepaid-accounts rule. Many companies avoided falling under the rule by marketing themselves as debit accounts and arguing that the rule doesn't apply. But the rule itself says the structure of an account is not the determining factor of whether something is a prepaid account. So there was room for the CFPB to exercise oversight over those products.

Two things prevent the prepaid-accounts rule from being the solution to the issues raised by Synapse's failure. The first is that PayPal challenged the prepaid rule in court, arguing that digital wallets should not fall under the rule. The most recent ruling (which I wrote about in my May column) agrees with PayPal. The second reason is that nothing in the prepaid rule solves the problem of what happens if the fintech fails, but the underlying bank doesn't.

It is much more likely that regulators will see the need for a new fintech rule. While it is possible that Congress could fill the gap with legislation, that is unlikely to happen in an election year. And, though it seems any rule created under one administration is not likely to survive into the next, both sides of the aisle have grievances with tech companies. So, the industry should not take comfort in the idea that a political change in Washington could protect it.

What would a new fintech rule look like?

At a minimum, we can expect a focus on information gathering and record keeping.

Rules exist today for know-your-customer, but a new rule might strengthen the requirements for information collection and verification. Nothing prevents the CFPB from adding additional requirements for non-banks. Perhaps device fingerprinting or some biometric would become part of the digital-wallet KYC regime.

Regulators also may codify the way account records are created, maintained, and shared across the value chain. They may require that all fintech accounts contain enough information to guarantee pass-through insurance, and that all the accounts have regular updating of the balances owed to each customer. Another requirement might be that fintechs maintain reserves that become *de facto* self-insurance for their depositors.

These are just some possibilities. Remember that the prepaid rule started as a short rule designed to standardize disclosures for general purpose reloadable prepaid cards. It quickly ballooned into a rule that attempted to cover every possible problem that could arise with prepaid cards and digital wallets.

The other reality is that states that feel like the feds are not acting quickly enough may attempt to impose their own rules and legislation.

The fintech industry needs to start thinking about how it is going to make the case that it can safely hold consumer funds and convince regulators, and maybe legislators, to write a rule it can live with. DT

PAYMENTS PERSONALIZATION EQUALS GIG MARKETPLACE DOMINANCE

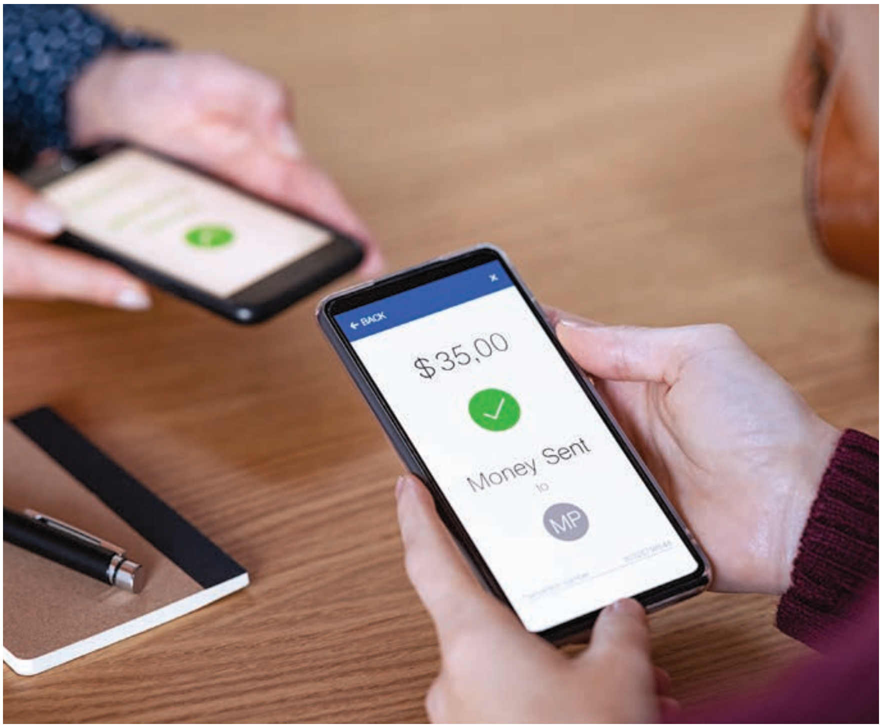
Companies that can make immediate worker payouts are poised to outcompete those that can't.

BY GABRIEL GRISHAM

Gabriel Grisham is senior vice president of global sales at PayQuicker.

PERSONALIZATION IN BANKING and financial management is critical. Today, customers have high expectations for a cohesive financial experience, and the banks and companies that refuse to adapt will certainly be left behind.

According to a survey from J.D. Power, 78% of banking customers expect a personalized banking experience—but personalization doesn't end at the bank. People want personalization throughout their financial experience, from money management to how and when they receive a paycheck.



Companies with gig workers and independent contractors are launching personalized payment programs to meet this demand, but not every company is getting personalization right.

At its core, personalization in payments is about doing what is fast, easy, most convenient and, most important, most relevant for the client or employee. Companies that meet workers on their terms will reap the rewards. Banks that invest in personalized services have seen a 5% to 15% increase in revenue, and companies that lean into personalized payment methods stand to unlock similar value in their workforce—the front line of their business.

Companies will see loyal, consistent, and productive gig workers and independent contractors repeatedly coming to the organization. To advance personalized payment platforms and create a truly bespoke experience, companies should incorporate four key components in their payment strategy. Here's what they are:

MULTIPLE PAYMENT METHODS

Today, people have multiple ways to make a payment, from credit cards to wire transfers to digital wallets. People can even transfer money between friends and family with the simple touch of a button.

Employees expect the same level of flexibility when receiving a paycheck. Gig and independent contractors in particular want the option of receiving a payment through multiple means— plastic or virtual cards, direct bank transfers, the automated clearing house, and so on. And companies need to provide multiple payment methods to payout a provider.

Payout orchestration is critical to personalization. Payout orchestration enables one company (the payor) to connect to numerous payment processors simultaneously and in real-time, and determines the fastest, most cost-efficient, and preferred way to send a payout to the recipient.

Gig and independent contractors are a diverse group of people, and may include individuals who are unbanked or underbanked, or have access to different technologies to collect payments. It is important for a company to have the ability to tap into the myriad payment methods available to meet each individual's needs.

Beyond personal banking habits, gig and independent workers also need to create consistency across working platforms. These workers typically work for multiple organizations, but managing different payment methods on different platforms is difficult.

By providing multiple payment methods, payors allow gig and independent workers to tailor their work experience to best fit their needs and more easily manage their jobs and income. Gig and independent workers are more likely to choose and return to organizations that provide their preferred payment method.

A VARIETY OF CURRENCIES

The advantage of gig and independent work is flexibility. Gig and independent workers can take on a job at any time, and often at any location, on demand. For workers, there is a tremendous advantage to this flexibility in that it creates a personalized work-life balance that best fits their needs.

But companies have an advantage, too. Gig and independent workers give companies access to a global workforce, tapping into talent and skill sets far beyond what is available locally. This can be highly valuable to companies. But, of course, to access it you must be able to pay workers in their preferred currency.

Often, companies think currency diversification is too challenging. It requires managing fluctuating exchange rates, not to mention understanding local banking infrastructure and legal payment requirements.

But partnering with a third-party technology company can streamline the management of these functions to ensure that employees can be paid in their preferred currency while also navigating local rules and regulations. This allows companies to create a hyper-personalized payment experience that attracts global talent.

Domestic employees are also increasingly requesting payments in alternative currencies. According to a global poll by financial-consultancy firm the deVere Group, 33% of Millennials and 50% of Gen-Z would like to receive their salary in some form of cryptocurrency.

In another survey from SoFi at Work and Workplace Intelligence, 42% of workers said that they would like to receive non-fungible tokens as performance rewards.

These trends illustrate the importance of creating a payment platform that can deliver payments in a variety of currencies.

ON-DEMAND PAYMENTS

On-demand work is not a new concept. Employees have always been able to pick up on a job or work on a project basis. Historically, when someone finished a job, they were paid immediately. Modern banking changed that, making workers wait for a check or ACH payment, even for just one day of work.

Under this system, it can take days or even weeks for an employee to receive a payment. That is too long, and it can deter workers from accepting gigs or returning to the organization.

On-demand workers expect on-demand payments. They complete a task or a sale, and should be able to receive a payout for their work, completed in real time. The concept of real-time payouts is exploding across industries, and it can help attract workers.

PayQuicker's research found that 83% of gig workers think it is important to be paid in a timely manner, and this opinion could affect the jobs they choose to take. On-demand pay should be seen as a requirement for any worker that falls under the on-demand umbrella, including companies using gig and independent workers in today's market.

AUTOMATION IN PAYMENTS

What we've discussed so far are actions that companies should take today to advance personalization in payments. But artificial intelligence, automation, and other progressive technologies are sure to alter the payments landscape once again.

Payments companies are already leveraging payments data to track consumer preferences, common payment methods, and frequency of payments to build a payments service that meets market needs. In the future, AI will unlock even more features. For example, employees may be able to direct payments or portions of payments to different accounts, or even to pay bills or make investments directly from a paycheck.

From the company's perspective, AI could streamline payments departments, allowing them to automatically process invoices, deliver payments, and record payments for accounting teams. To stay ahead of these coming developments, companies should be investing in AI tools today.

Personalization in the payments landscape is just as important as personalization in banking and financial management. It is essential to a successful payment transaction. The companies that are already investing in personalization are poised to win— and this applies to every industry. Companies that empower individuals to dictate how and when they get paid will gain a true competitive advantage. DT


Grisham

Grisham: "Artificial intelligence, automation, and other progressive technologies are sure to alter the payments landscape once again."

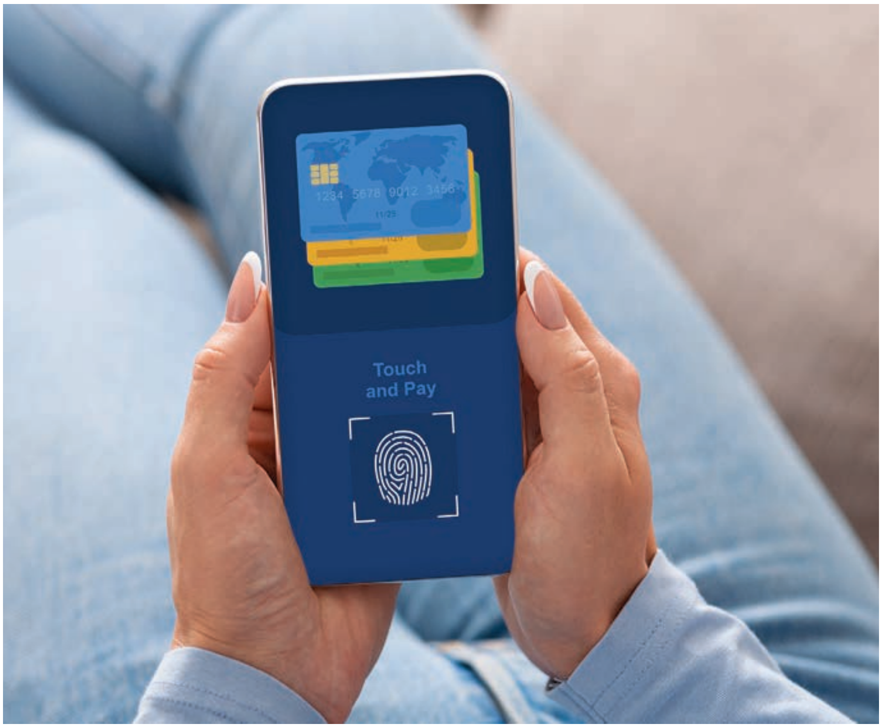
THE DAWN OF THE DIGITAL PAYMENT IDENTITY

In the Visa Flexible Credential, has the payments industry found its ultimately secure identity solution?

BY KEVIN WOODWARD

NEW WAYS TO USE technology, changing consumer preferences, and comfort with digital payments may all be fostering the first steps toward a digital-payment identity.

But is it time for a digital-payment identity? Visa must think so, at least as an identifier for multiple payment types held by the same individual. The card brand in May presented a new way for consumers to hold multiple payment options under one digital identity with its announcement of the Visa Flexible Credential.



The credential, already live in Asia, enables a consumer to designate a single card product to toggle between different payment options controlled by the consumer. In a Visa example, the consumer may be at the checkout and realize his checking-account balance may not cover the purchase. Instead of using the default debit card, he opens the issuer's app and swaps the funding source to points or a credit card.

Visa says the technology gives issuers the ability to let their customers access different funding sources on an existing payment card. A U.S. test of the technology is slated for later this year. Though Visa doesn't define it as a digital-payment identity, the credential stands in for the customer.

This rethinking of the payment card, from a single-use object to one enabling other payment options, is a unique tack, observers say. It's also one that some say consumers and the payments industry are ready for.

RISKS AND PITFALLS

First, however, what is a digital-payment identity, and what are its benefits and potential pitfalls?

"A digital-payment identity is a form of identification or verification that is digitally connected to a person's payment means," says Michael Seaman, founder and chief executive of Swipesum, a Clayton, Mo.-based payments provider. "A digital-identity wallet enables a person to manage their personal information, money, and online transactions, allowing them to facilitate or transfer payments digitally without a physical form of identification."

Stephen Faust, chief executive of Dash Solutions, a Birmingham, Ala.-based payments and financial-services provider, says a digital-payments identity, in its essence, is a "digital version of the user tied to payment executions." It encompasses the digital representation of a consumer within the payments ecosystem, including their credentials, preferences, and transaction history, he notes.

While the prospect of a digital-payment identity may have many benefits, there are potential pitfalls.

"When it comes to authenticating consumers, most of the issues that arise have more to do with convenience than security," says Seth Geftic, vice president of product marketing at Huntress, a Columbia, Md.-based managed security platform provider.

"In many ways, biometric authentication is easier and more convenient than traditional methods, such as remembering your password," he says. "But sometimes the technology just doesn't work right, like having a smudge on your camera phone that you were unaware of. Since that is outside the user's control, it can cause more frustration than forgetting a password, which they realize is them."

Another potential cautionary element may be simply integrating all this data into a secure and easy-to-use system.

"There are risks to any digital integration," says Swipesum's Seaman. "Some of the pitfalls of digital-payment identities are the risks associated with data loss, security breaches, and theft. However, institutions can manage and mitigate these related risks with thoughtful systematic designs and well-considered government policies."

THE PAYOFF

The benefits, however, may be enough to sway merchants, financial institutions, and even consumers.

Some benefits might be enhanced security, streamlined checkout experiences, potentially reduced fraud, and greater consumer convenience, Faust says.

Meanwhile, the payoff for payments companies could be manifold, says Seaman. "Digital identities have the potential to unlock new opportunities within the electronic payments industry. For consumers, it eliminates the need for authentication using complex logins and documents and streamlines transactions and transfers.

"Fraud protection is another significant benefit to digital identities. In today's digital world, businesses need to take extra precautions to mitigate fraudulent transactions, but with digital identities, verifying payments happens before the transaction even takes place," Seaman says.

"This not only dramatically decreases the time it takes to verify and process a transaction, but can improve the customer experience by making onboarding and authentication frictionless," he adds.

'SEAMLESS AND SECURE'

Still, questions linger, such as, why did Visa announce its Flexible Payment Credential now? And why is this notion of a digital-payment identity feasible now?

Visa says it's because of new technologies, such as artificial

Geftic: "Instead of typing in what you know or what you have, you'll authenticate by using what you are."

intelligence, along with consumer familiarity with digital payment methods and a desire for more digital-payment options. In addition to the Visa Flexible Credential announcement in May, the card brand also announced further tap-to-pay initiatives, a payment passkey service, a pay-by-bank development, and a focus on account-to-account payments.

Other technologies, not unique to payments, are also a factor in the credential's emergence now, Faust says. "Its development is propelled by technological advancements, such as biometrics and tokenization, a shift in consumer behaviors towards digital-first interactions, and the evolution of payment rails supporting various transaction types," he says.

The drivers are both technology and consumers. "It's a combination of both," Faust says. "Technological advancements enable new possibilities, while consumer behaviors and expectations shape the demand for seamless and secure digital-payment experiences."

Technologies such as passkeys and biometrics allow the burgeoning digital-payment identity to unfold with security and consumer confidence in place, observers say. "Biometrics have been around for a long time, but they have only become mainstream in recent years," says Geftic.

"There are several reasons for this," he adds, "but none more impactful than the widespread availability of cameras and fingerprint scanners on phones and laptops, which makes biometric face scanning and fingerprint authentication easier than ever."

"Now that consumers are already used to using biometrics in their everyday lives (face scanning to unlock an iPhone, for example), adding this layer of security to payments is seen as a convenience rather than a nuisance," Geftic notes.

THE POWER OF PASSKEYS

Not long after announcing the Visa Flexible Credential, the card brand also said it has issued 10 billion tokens since 2014 and that, as of April, 29% of all transactions processed by Visa used tokens.

Passkeys are a relatively new authentication tool designed to avoid the worst aspects of password reliance. A passkey consists of a key pair that includes one public key, which is registered with the Web site or app being used, and one private key, which is held only by the user's device.

Seaman

Seaman: "There are risks to any digital integration."

Public passkeys are linked only with the Web site or app they were created for, which protects users from being tricked into using a passkey to sign in to a fraudulent site or app.

The private key never leaves the user's device, such as a mobile phone or computer, so it can't be leaked from a Web site or app. And consumers never have to remember or reset their passkey. In May, Visa announced the Visa Payment Passkey Service, which relies on standards from the Fast Identity Online Alliance that can confirm a consumer's identity and authorize an online payment with a scan of a biometric input, such as a face or fingerprint.

"Instead of needing passwords to access an account, which could fall into the wrong hands through phishing, they are moving to fingerprint and face scanning," Geftic says. "In this case, your biometric information acts as your identity authentication method. Instead of typing in what you know (your passwords) or what you have (generating a one-time passcode), you'll authenticate by using what you are (your face or finger)."

As part of the drive to make the online checkout better in speed, and the number of steps more secure and easier to use for consumers and merchants, the notion of a digital-payments identity ecosystem could alter the payments industry.

"A well-developed digital-payments identity ecosystem could lead to a more efficient, secure, and user-friendly payment experience for all stakeholders, ultimately driving greater adoption and innovation within the industry," Faust says. DT

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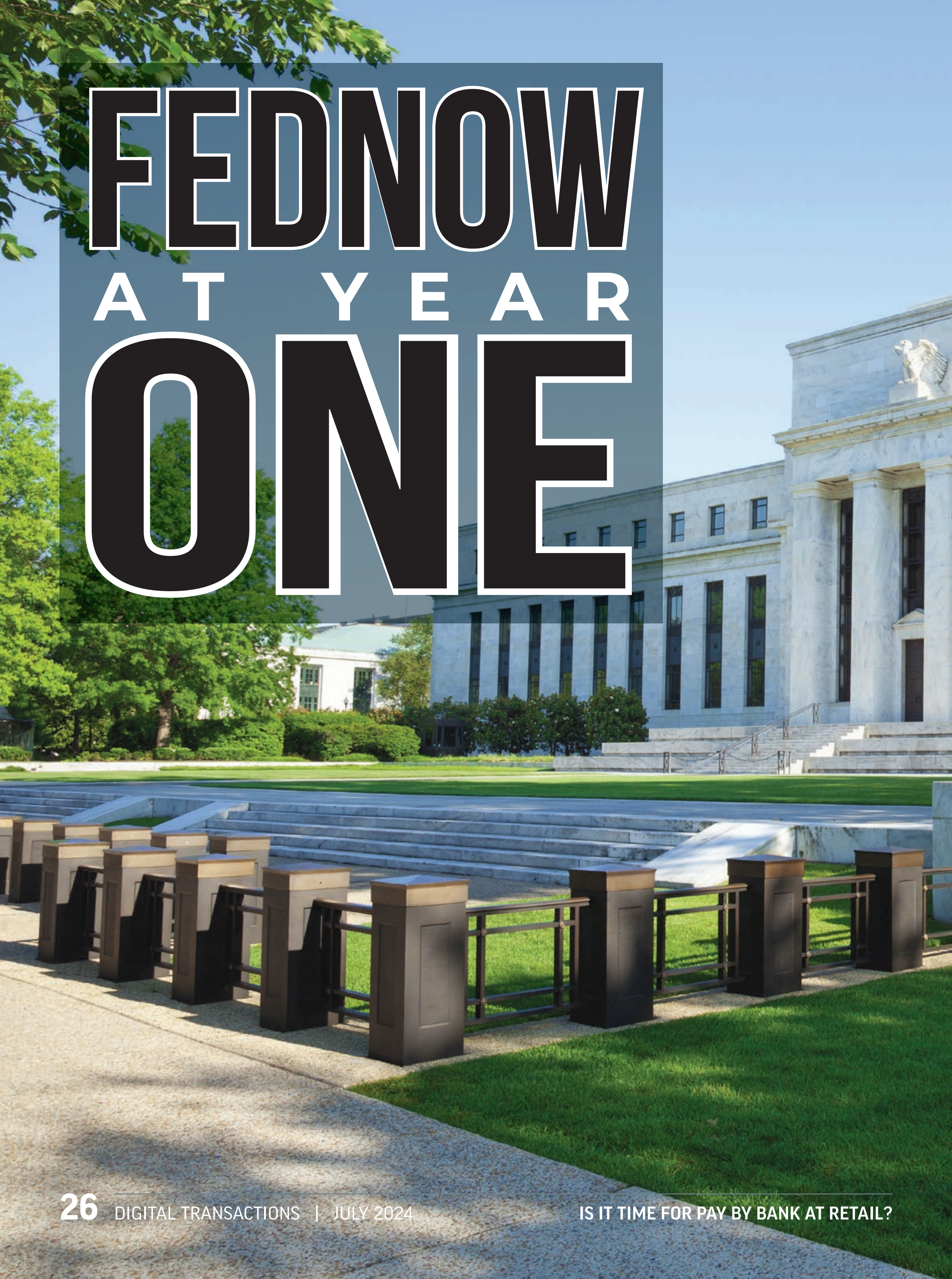

IS IT TIME FOR PAY BY BANK AT RETAIL?

As the Federal Reserve's real-time payments network celebrates its first birthday, the payments industry takes stock of its impact on instant transfers.

BY PETER LUCAS

Launched with great fanfare in July 2023, the widely and long-anticipated FedNow has largely enjoyed a successful first year.

One area where the network has excelled is in establishing connections with financial institutions. FedNow has links to more than 700 FIs, more than the rival Real Time Payments network, which was launched in 2017 by The Clearing House Payments Co. As of June, the RTP network had connections to about 630 financial institutions, more than double the number a year ago.

The speed with which FedNow has connected to financial institutions is considered a big win for the network, as it demonstrates real-time payments are a high priority for the nation's financial institutions, large, small, and mid-size. That bodes well for the future of real-time payments in general, payment experts say.

Another check in the win column for FedNow is that is has succeeded in broadening real-time payments connectivity to small and mid-size financial institutions, something payments experts say is necessary for real-time payments to become ubiquitous in the United States. Indeed, the majority of financial institutions connected to FedNow are small to mid-size institutions.

Where FedNow has not fared as well is in transaction volume. While the Federal Reserve has yet to release monthly volume for FedNow, payments experts believe the network's volume is a fraction of the 1 million daily transactions handled by the RTP network. As with any new payments rail, building volume takes time. And the RTP network did not have high volume its first year out of the gate, payments experts note.

Another area where FedNow has work to do lies in the fact that the majority of banks connected to the network are only set up to receive transactions. Even with links to more than 700 financial institutions, FedNow needs to grow the number of originators on the network if it is to substantially grow its volume, observers say.

In payments, this is what is known as "a chicken and egg scenario," says Jennifer Lucas, Americas Payments Consulting Leader for EY (Ernst & Young Ltd.). "It's hard to build products and services that can build volume for a network when the network doesn't connect everywhere," she says.

Another factor that might make financial institutions hesitant to join FedNow as an originator is concern in the marketplace about the risk of sending an irreversible payment over a network that has a thin track record. For some observers, the Fed may be behind the nascent system, but it's still a nascent system.

As a result, until FedNow can achieve a better balance between originating and receiving banks, it won't move the needle for real-time payments in the U.S. much beyond niche status, says Michael Greenwood, a research analyst for Juniper Research.

"FedNow has given a boost to real-time payments in the U.S. and done well in some areas, but its volume is low compared to the RTP network and it

still has only connected to a fraction of the financial institutions in the U.S.," Greenwood says. "The next challenge for FedNow will be in boosting usage on the origination side."

'THE SECOND AND THIRD INNING'

That will be a challenge. There are more than 11,600 financial institutions in the U.S., according to San Francisco-based Plaid Inc., an open-banking specialist.

Another speed bump for FedNow's growth engine is that several of the largest banks in the country, including Bank of America, Chase, Citibank, and Capital One, have yet to connect to FedNow. Instead, those banks are connected to the RTP network. Indeed, BofA, Chase, and Citi are among the 20 major banks that own The Clearing House Payments Co., RTP's parent company.

Having the largest national banks on board gives the RTP network connectivity to about 70% of the demand-deposit accounts in the country. The RTP network's appeal also extends across financial institutions of all sizes, with connections to about 90% of the banks and credit unions in the U.S. market

"For us, the heavy lifting is done as we have the [account and bank] reach," says Rusiru Gunasena, senior vice president for RTP product development for The Clearing House, which enjoyed a big March quarter statistically (chart, page tk). "The challenge for FedNow going forward will be to achieve the same level of reach as financial institutions grapple with joining a network that doesn't have the same reach as the RTP network."

While there are certain to be growing pains for FedNow, there will be plenty of use cases that can generate volume for both networks, Gunasena adds.

But the fact remains that the nation's central bank is behind FedNow, an undeniable advantage. Payments experts predict the network will become a force in real-time payments in the next few years.

"While the immediate impact of FedNow has not been that sizable, the promise it holds to make real-time payments more common in the U.S. is still there," says Nick Babinsky, chief product officer for Solutions By Text, an Addison, Texas-based provider of text-payment and messaging solutions. "The real impact of FedNow on real-time payments will start to be seen in the second and third inning."

EMERGING USE CASES

Signs that FedNow is gaining momentum are already emerging, especially when it comes to rapidly increasing volume at some banks.

"We've seen banks go from a few hundred FedNow transactions a month to a few thousand, and then a few hundred thousand," says John Wilson, director and product line manager for instant payments at FIS Inc., a big Jacksonville, Fla.-based transaction processor. "We expect to see continued volume growth for FedNow in 2025, then substantial growth in 2026."

Another indication of FedNow's impact on real-time payments is that it has represented a choice of networks for financial institutions looking to implement real-time payments, prompting many fence-sitters to connect to FedNow or the RTP network.

One reason FedNow has been successful connecting to small and mid-sized financial institutions is that those financial institutions view the Federal Reserve as the primary non-card network operator.

"With FedNow, the Fed is establishing that real-time payments will be part of the U.S. economy, and that gets more foundational conversations around real-time payments started," EY's Lucas says. "The Fed's involvement in real-time payments carries a lot of weight."

Having a choice of networks also prevents financial institutions from being forced to join a real-time payments network to meet customer needs because no other option exists.

"Not being forced down a path cuts both ways for FedNow and the RTP network," FIS's Wilson says. "Smaller financial institutions tend to be hesitant to join the RTP network, but understand the Fed's payment strategies, which makes choosing a network easier for them."

The Fed's brand power alone, however, is not enough to drive volume over FedNow. Use cases will play a critical role in building volume, payments experts say. One of the most intriguing of the use cases to emerge so far is digital-wallet drawdowns, which enable funds to be moved from a digital wallet to a bank account in real time.

The appeal of these drawdowns for consumers is that they can move money out of a stored digital wallet and into a bank account immediately. Otherwise, money would be moved via the automated clearing house, which can slow the transfer of funds by as much as 24 hours, payment experts say.

Other use cases expected to drive volume for real-time payments include payroll, earned wage access, disbursements, push credits, pay-by-bank purchases online, and account-to-account payments. Bill payment is yet another frequently mentioned use case.

Dutch fintech Adyen NV is working with merchants to implement FedNow for such use cases as instant payouts, topping up their Adyen account, and enabling instant transfers for embedded and enterprise bank account holders at Adyen.

"We see FedNow as a strategic opportunity to help settle funds as fast as possible with an instant offering that can be faster than same-day ACH," says Trevor Nies, senior vice president and global head of digital at Adyen.

LEVERAGING AI

Enabling those use cases falls on the shoulders of fintechs and payment-service providers. Fiserv Inc. for example, is embedding many of the aforementioned use cases into its platform to kickstart adoption of real-time payments.

"There really are no [technical] obstacles to embedding capabilities for these use cases, it's really a matter of prioritizing needs within the market," says Matt Wilcox, president, digital payments, at Milwaukee-based Fiserv. "Where immediate accessibility to funds is critical, real-time payments will be key."

RTP'S BIG START TO 2024 (Records set in the first quarter of 2024)

Quarterly Volume
76.4 million

Quarterly Value
$42.3 billion

Monthly Volume
26,977,228 IN MARCH

Single Day
1,255,696
TRANSACTIONS

1 million Transaction Days
14 in Q1
compared to three in all of 2023 (A NEW RECORD)

Source: The Clearing House

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While many of the use cases for real time payments involve consumer-to-business and business-to-consumers payments, the motherlode of transaction volume lies in government-to-consumer and business-to-business transactions, experts say.

Tapping into B2B volume will be slow going because speed of transaction is not necessarily a priority in B2B payments. What's more important is the messaging around the transaction, such as what the payment is for. This, indeed, is more important than the speed of the transaction, says Juniper's Greenwood.

One advantage of real-time payments in the B2B world is that it can dramatically improve the recipient's cash flow. "Even the relatively short payment delays from ACH can increase day sales outstanding and keep working capital from being available to other business needs," says Brandon Spear, chief executive for TreviPay, a B2B and invoicing platform provider.

Apps that leverage artificial intelligence for messaging around B2B transactions can be just the ticket for unlocking B2B volume over FedNow, according to Greenwood. "Integrating AI around B2B messaging can enable messages to be machine-read by another app and automatically logged in to an accounting app upon receipt," he says. "Those are the kinds of the tools businesses want."

Getting government agencies onboard with real time payments is another way to provide a big boost to network volume. "Think of what it would mean for the IRS to use FedNow to send refund checks or the Social Security Administration to send out checks, that would be a seismic shift," says EY's Lucas.

Veeraghanta: "One of the strengths of FedNow is that it settles transactions directly, you don't have to open an account on a separate network."

'PLENTY OF VOLUME'

Two points of differentiation the RTP network has over FedNow, at least for the time being, are speed of transaction and higher caps on transaction dollar amounts. The RTP network can complete a transaction in about five seconds, compared to 20 seconds for FedNow, according to Abhishek Veeraghanta, founder and chief executive of payments-platform provider Pidgin Inc.

Despite those differences, payment experts do not see them as negatives for FedNow, as the difference in transaction speed is unlikely to be that noticeable to most consumers. Plus, FedNow's cap of $500,000 per transaction is adequate for most transactions and will likely be raised over time. And transaction speeds will shorten as the network gains its footing.

"One of the strengths of FedNow is that it settles transactions directly, you don't have to open an account on a separate network," says Veeraghanta. "FedNow is demonstrating its value, and the use cases for both networks will define themselves."

One drawback for both FedNow and the RTP network is their lack of interoperability. While the inability to share data between the two networks is a chasm that will eventually have to be bridged, fintechs and payments platforms are getting around it by encouraging financial institutions to link to both networks to ensure senders can reach their desired endpoints.

"If the receiving bank is not in the originating bank's network, the originator can simply waterfall to the next network," says Fiserv's Wilcox.

With plenty of volume available from cash and check transactions alone to be moved over real-time payment networks, the prospects for FedNow and TCH remain bright.

"Between cash, check, wire, and ACH, there's plenty of volume to go around for FedNow and the RTP network," says Lucas.

IT'S PAST TIME TO DUMP THE MAG STRIPE

The next step in card security should be obvious. So why does the industry hesitate?

BY CLIFF GRAY

Cliff Gray is principle at Gray Consulting Ventures, a payments advisory.

BETWEEN EMV AND tokenization, merchants today can accept credit and debit cards with little risk, card-present or not. Network tokenization is merely the latest evolution toward the ultimate goal, the demise of the payment account number, or PAN.

So why do the brands, the very authors of EMV and network tokenization standards, continue to flood the ecosystem with machine-readable PANs?

EMV standards have proved incredibly effective in reducing counterfeit fraud. EMV chip technologies leverage encryption and low-level device communications to hide card data from the bad guys. While functionally different from tokenization, encryption effectively hides card data while the transaction is in flight, from the very point when the device reads the chip until the data reach the safe confines of the issuing network.

As with tokenization in the e-commerce world, encryption in the card-present world keeps raw PANs out of a merchant's environment. That reduces scope under the Payment Card Industry data-security standard (PCI). It also reduces potential breach liability.

Beginning in 2015 with the liability shift, fraud rates dropped by 76% within the first three years. When an EMV card was used with an EMV-compliant device, the merchant was no longer liable for fraudulent transactions. This helped drive the hardware conversion required for a complete EMV ecosystem. The latest available data put U.S. fraud rates for EMV transactions at about 0.03%.

Tokens have been standard equipment for some time in the e-commerce space, eliminating multiple challenges for the merchant. Tokens provide a safe means to manage customers' payment

credentials and significantly reduce PCI scope.

Tokens made instant sense to the gateway community, as well. From the early days of e-commerce, gateways recognized the stickiness value of tokens and semi-integration, and quickly developed their own token-vault technology. Because the gateway issues proprietary tokens, its tokens work only on that gateway, which makes it difficult for a merchant to change gateways. Tokens sold themselves, and everybody won.

In a market familiar with razor-thin pricing, the revenue models behind tokens quickly reached zero. The gateway industry has largely abandoned charging for token services, at least on a per-transaction basis.

Recently, however, there have been rumblings about Visa charging for their new Token Management Service, which replaces the legacy Visa Token Service. Therein lies the rub behind network tokens. Because the network issues the token, a merchant can change its gateway relationship without having to convert its stored tokens. Suddenly, gateways have lost a measurable product advantage.

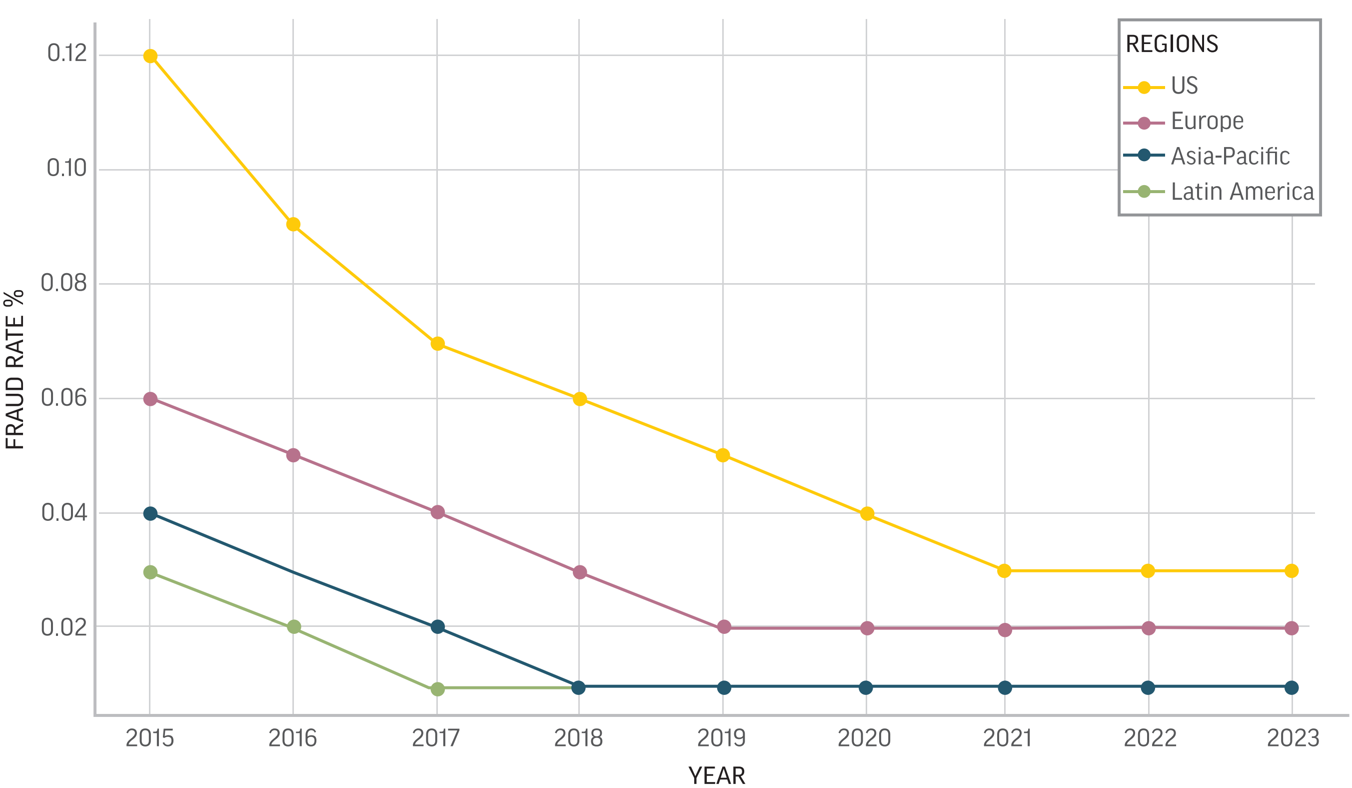
But the larger point is that tokens and encryption are proven, effective methods of reducing fraud, which they do by keeping the PAN secret. As methods of rendering account numbers worthless, they are practically foolproof.

And therein lies quite another rub.

WHY DO WE SWIPE?

By 2021, nearly all branded credit and debit cards issued were EMV-compliant. Thanks to Covid, they all support tap by default, not just dip, like they did in the early days. Foolishly, every single card also flaunts a 1960s-era magnetic stripe on its back, complete with in-the-clear PANs—right next to that modern chip that is so expensive to hack it's just not worth it.

EMV FRAUD RATES IN REGIONS WITH AND WITHOUT MAGNETIC STRIPE ACCEPTANCE



Gray: "EMV was always meant to replace the mag stripe. Only one thing left to do—no more stripes."

Bad enough that cards are still rocking those ancient mag stripes, but it takes two to tango. Mag stripes would be harmless relics if point-of-sale equipment didn't read them.

Most terminals today support fallback functionality, which means when the EMV chip on the card isn't working, or is unreadable, the device will allow a read of the magnetic stripe as an alternative source of the payment credentials.

This is convenient for card fraudsters and malicious merchants alike, presenting an easy vector to inject fraud at the point of sale. Mag stripes are simple and cheap to copy, a process known as cloning. Cloned cards with dummy, non-working chips but valid mag stripe data work fine on a terminal that supports fallback. And the fallback procedure is rarely questioned by retail personnel. They pay little attention to the device, since it's the cardholder doing the swiping these days.

Skimmers are another example of how easily mag stripes get hacked, like those seen with regularity on gas pumps. Taking advantage of an industry that still lags in EMV adoption, pump skimmers are able to collect card credentials right off the stripe, without interfering with the underlying purchase. Some even report approval status, so the bad guys can sell the hot card numbers at a premium.

Both Visa and Mastercard have plans to phase out magnetic stripes on issued cards in the coming years. The quandary is, why the slow schedule? Mastercard seems to be the faster of the two. Starting this year, it no longer requires mag stripes on cards in certain EMV regions like Europe. This rule will follow in the United States in 2027.

By 2029, no new Mastercard credit or debit cards will be issued with magnetic stripes worldwide. The complete elimination of magnetic stripes on all Mastercard cards, including those in circulation, is expected by 2033. While Visa has expressed similar phase-out plans, it has not been forthcoming with specific schedules.

The result? Merchants across the country will be expected to accept an obsolete credential for the next decade, one that largely undermines the previous decade's progress in security.

WHY THE WAIT?

No technological migration of this scale happens overnight, and rarely happens without great cost. The card brands have spent billions over the previous decade to improve network security, adopt EMV, and implement network tokenization. Meanwhile, merchants have borne a significant cost for a new generation of EMV-compliant equipment.

It's time to call out the elephant in the room: the next step in making the PAN obsolete is a freebie. Issuers simply need to stop printing the mag stripe.

Then, everybody wins. Merchants will stop getting drubbed for mag-stripe downgrades, and will enjoy both a lower interchange cost and the liability shift on risk—for all transactions, not just some.

At the same time, issuers win with lower fraud and issuance costs, and acquirers win with reduced fraud, fewer chargebacks, and improved interchange fees. Cardholders win with improved account protection and ease of use.

Better yet, there's no new technology to build, certify, or implement. No new software to install. No policies to amend, since PCI, EMV, and brand rules in their current form all cover the implications of a swipe-free ecosystem. EMV was always meant to replace the mag stripe. Only one thing left to do—no more stripes.

There may be hope on the horizon. Leading point-of-sale hardware technology these days is all about mobile—iPhones and Android are the new Verifone. Along with all the other advantages these modern platforms bring to the industry, what they don't bring just might be the game changer - swipe readers. DT

HOW TO MAKE PAYMENTS FLOURISH

The contrast between the approach in the U.S. and that in Europe underscores the importance of competition and innovation.

BY **ERIC GROVER**

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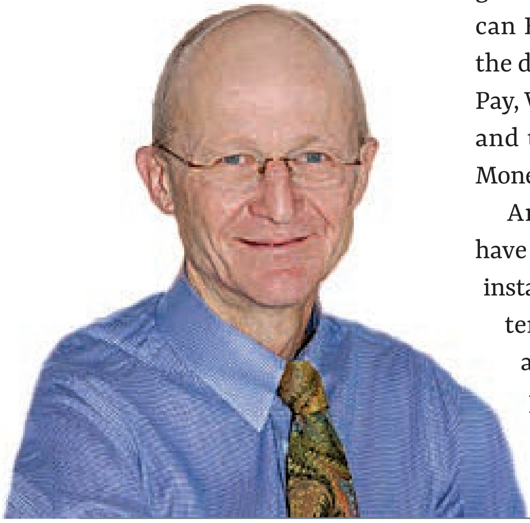

MANY U.S.-DOMICILED payment networks are relevant, even dominant, globally, whereas few European payment systems are.

Europe and the United States are both served by a patchwork of retail, peer-to-peer, and interbank payment networks. But the U.S. is one enormous market. California, Florida, New York, and Texas don't have their own payment systems. Yet, France, Germany, Italy, Poland, and Spain have their own distinct payment systems, payment habits, and preferences.

The lesson is that bigger home markets provide stronger platforms for building global payment networks.

The U.S. has the two genuinely worldwide retail "card" payment networks Mastercard and Visa, and also has the world's reserve currency and leading currency for trade and foreign-currency-denominated debt. Europe has the global cross-border payment- messaging network Swift.

The U.S. also has the tier-two global payment networks American Express, Discover, and PayPal; the digital wallets Apple Pay, Google Pay, WhatsApp Pay, and Amazon Pay; and the money-transfer networks MoneyGram, Ria, and Western Union.

And both the U.S. and Europe have private-sector and central bank instant-payment systems. While system interoperability may eventually make these systems relevant planetwide, that's a long way off. The instant-payment networks Mastercard Send and Visa Direct are global now.

Many American payment systems were started with the view that, while the U.S. was the launch market, their opportunity was global. National European payment systems, however, often don't even view their opportunity as pan-European, much less global.

EU POOHBAHS

Still, a traditional or alternative payment system with a better mouse trap and headquartered in Paris or Warsaw could deliver value in the U.S. market, and indeed on six continents. Critically, it would have to leverage its home-market user base and brand, and employ a mix of M&A, partnerships, and organic growth to achieve network critical mass abroad.

American and European payment-system landscapes and dynamics are more similar than not. Still, habits and preferences differ. While cash varies enormously by country, Europeans overall use far more cash than Americans.

Indeed, the ECB's "Study on the payments in the euro area 2022" reported that 59% of payments in the euro-zone at the physical point of sale were made in cash. Yet, the Federal Reserve's "2024 Findings from the Diary of Consumer Payment Choice" reported that only 18% and 16% of all U.S. consumer payments in 2022 and 2023, respectively, were made in cash.

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Payment Facilitation: Elevating Your Payment Solutions

In today's electronic ecosystem, software companies have an array of options to create unique payment experiences for consumers. Two prominent options are traditional merchant processing and payment facilitation. Let's explore their differences and implications.

Traditional Merchant Processing

Since 1973, traditional merchant processing has been the norm. Businesses obtain a Merchant ID (MID) from a sponsoring bank, unique to each location or entity. This involves an underwriting application process, typically taking 2–3 days for approval.

Traditional processing offers various point-of-sale and e-commerce solutions, including integration with hardware
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- Choose from flexible onboarding options with real-time automated checks for a quick, digital experience.

Electronic Payment Acceptance Options
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Methods of Payment Acceptance
- Partnering directly with ISV developers, we offer bespoke payment interfaces through APIs and iFrames, seamlessly integrating into existing systems.

Payment Facilitation

Payment facilitation streamlines merchant onboarding and settlement. Software companies apply to become facilitators,
obtaining a master MID to onboard sub-merchants swiftly. Sub-merchants can start processing within minutes of approval.

Payment facilitation supports split payments, enabling transactions to be divided between multiple recipients pre-settlement. It also facilitates marketplace processing, though with some limitations on billing options, primarily offering flat rate or tiered pricing.

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At Payarc, we collaborate with software companies to craft unique payment experiences. Our suite of options, from APIs to iFrames, seamlessly integrates into existing workflows. Our sales engineers ensure customization for each software experience.

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A more robust revolving-credit market and market interchange fees funding a buffet of benefits and rewards make credit cards a more compelling consumer proposition in the U.S. In 2023, 57.3% of U.S. general-purpose card payments by value, and 40.3% of transactions, were credit. Whereas, in the first half of 2023, only 8.8% of EU general-purpose card payments value and 8.1% of transactions were credit.

The U.S. payments industry has been more innovative, pioneering the general-purpose card networks, credit cards, digital currencies, GPR prepay cards, digital wallets, and mobile acceptance.

EU payments regulation is more prescriptive. Brussels imposed price controls on interchange fees, mandated payments risk-management methodology, and required that banks allocate capital to provide fee-free payments.

While protectionist winds are blowing stronger on both sides of the Atlantic, the U.S. payments market is relatively open. EU poohbahs relentlessly call for "strategic autonomy" in payments, which is a euphemism for payments protectionism.

Nonetheless, there's payment-system innovation in Europe.

Given its range of 44 countries, there's greater diversity of alternative and traditional payment systems in Europe than in the U.S. That facilitates experimentation with different models, but a focus on home markets, lack of scale, and shareholders who are often only interested in their domestic markets have all hindered any scaling of European payment networks to international relevance.

PICKING WINNERS

In 1985, there were 34 U.S. debit networks, most of which were regional, all owned by banks. Without encouragement from Washington, the market consolidated. Today, the U.S. is the most competitive debit card network market in the world, with half a dozen commercial national players and a handful of smaller cooperatives.

To the EC's and ECB's discomfort, the most plausible European retail-payment-system consolidators would have been a tier-two U.S. payment system like Discover or processor First Data. EU processing consolidators Nexi and Worldline own national debit networks, but have processor—not network—DNA.

But Europe has a fascinating and evolving patchwork of primarily national payment systems providing mobile, P2P, and retail payments. Through interoperation and M&A, there are early efforts to scale and extend delivery footprints and use.

In November 2022, Norwegian banks' Vipps and Danske Bank's Danish and Finnish MobilePay merged, creating a mobile-payments network of comparable size to Sweden's Swish. In August 2022, Poland's leading mobile-payment system, Blik, acquired Slovakia's Viamo, and in 2023, it entered Romania. Italian mobile-payment network Satispay launched in Germany and Luxembourg in 2020 and in France in 2022.

Owned by Western European banks and processors, the European Payments Initiative is the EU's latest politically favored payments champion. With its acquisition of Dutch e-commerce phenom iDeal and technology provider Payconiq, there's a kernel to build on.

The result of all this? The state picking winners and losers, while increasing regulation, is not the path to greater payment-industry dynamism, innovation, and value on either side of the Atlantic. Consumers, merchants, banks, and fintechs would benefit from more competition and innovation if more European payment networks became relevant across the continent and worldwide.

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