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Trends in the Electronic Exchange of Value

17TH ANNUAL

THE 10 MOST PRESSING ISSUES IN E-PAYMENTS

The Credit Card Competition Act's Long Shadow

The Fed and Real Time Payments

The Chargeback Challenge

The Threat from Generative AI

Slow Checkouts

Fraud's Ugly Permanence Online

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Will SoftPOS Ever Take Off?

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The In-Car Payments Quandary

Volume Twenty, Number Eleven • DigitalTransactions.net • November 2023

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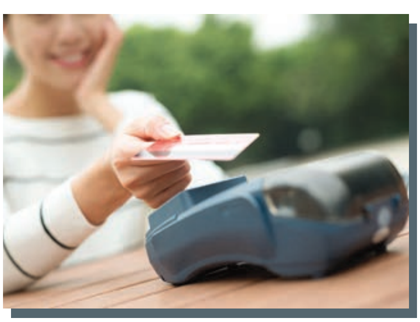

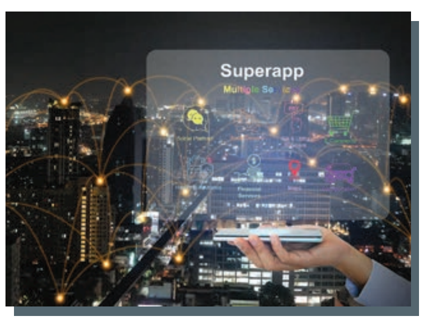

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PRICING BY FIAT IS NOT IDEAL

THE JURY IS OUT—and will remain so for some time—on the Credit Card Competition Act and its chances of becoming the law of the land. One of the bill's sponsors—and probably its prime mover—is Sen. Richard Durbin, Democrat of Illinois, and on the debit card side of the payments business, his franchise is doing quite well indeed.

As I am writing this note, the Federal Reserve is set to take up in a few days the question of whether a ceiling on the fee merchants must pay for debit card acceptance is too high and should be lowered. The Fed's debit card regulation, inspired by legislation sponsored by Durbin, is 12 years old, and its stipulated fee of 21 cents per transaction has stood for that entire time while processing costs have, many argue, shrunk (the regulation also includes a penny for fraud prevention and 0.05% of the transaction to cover the cost of fraud, but the focus of everyone's attention is on the 21 cents).

By the time you read this note, the Fed's ruling on the matter of lowering that 21-cent limit may have been released. No matter. It seems virtually a sure thing the nation's banking regulator will fiddle with that number in some way. If so, as we hinted at the start, it will represent a double victory for Durbin.

Why? Recall that his amendment had two parts. The price per transaction was only one. The other part had to do with transaction routing. This required that merchants must have a choice of networks for debit transactions, at least one of which could not be either Visa or Mastercard. It took 12 years, but the Fed finally enforced that provision earlier this year, and now merchants, particularly in e-commerce, can go with any number of alternative networks.

As we noted, you by now know the outcome of the fee matter. Our bet is that the Fed has reduced it from that longstanding 21-cent standard. If so, good for merchants—and good for the industry.

If we're wrong, then it's back to the 21-cent fee and the status quo. But if we're right, while the lower fee is worth celebrating, it's our feeling the means by which this came about is not ideal. Our conviction—repeated a number of times in this space over the years—is that pricing matters are best determined by market forces, not by the fiat of some regulator.

If external forces hinder that market regulator, that could be cause for legal recourse. But rule by fiat is bound to give rise to complications the industry will regret.

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GOLDMAN FACES SOME HARD DECISIONS IN CREDIT CARDS

The pressure at Goldman Sachs Group Inc. to exit, or at least radically modify, its consumer-credit and payments businesses has been mounting and may have hit its summit.

At least some executives at the company are pushing senior management to exit credit card deals with Apple Inc. and General Motors Corp., *The Wall Street Journal* reported last month, citing sources familiar with the matter.

The movement to unload these businesses has apparently only increased in recent months among Goldman managers, with at least some senior executives having become disenchanted with the company's consumer credit strategy, according to the *Journal*.

The rising sentiment within Goldman to sell the consumer card businesses, in particular, follows close on the heels of its sale of GreenSky, a consumer-lending firm it had acquired only in 2021. The move also builds on recent actions the Wall Street giant has reportedly taken to negotiate a withdrawal from supporting Apple's credit card and the iPhone maker's buy now, pay later service.

For Goldman Sachs, "the card business will be more complicated to exit" than were other consumer-lending ventures, says Javelin's Brian Riley.

The actions to withdraw from the consumer credit card business are apparently driven by Goldman's lack of familiarity with consumer credit, coupled with a high credit-risk burden, observers say. Apple launched its credit card in 2019, while Goldman began supporting GM's cobranded card program only in early 2022, taking over from Capital One Financial. Spokespersons at Apple and Goldman did not respond to a request for comment.

The pressure on Goldman to unload its credit cards is building in large part because of that inexperience with consumer lending, observers say. "Goldman Sachs does many things right, particularly as an investment bank, but was off the mark when it entered the rough-and-tumble world of consumer credit," says Brian Riley, co-head of payments at Javelin Strategy & Research.

But now Goldman faces more problems, and of a different nature. "The card business will be more complicated to exit" than other consumer-lending forays, he says. Goldman "seemed to have oversimplified the nuances of building a healthy loan book," Riley adds. "Competing with established players in the credit card business for decades takes more than just the ability to lend."

And there are more reasons unloading the business will be tricky for Goldman, Riley argues. "The issue they face today is how they unfold their credit card business. It will likely be at least as costly as it was to exit GreenSky," he says. Goldman paid $2.2 billion for the lender, selling it only months later at a loss.

Also, market conditions would likely complicate a sale, should Goldman determine to go in that direction. "In contrast to a BNPL [player], where lending is on short-term contracts, a card business must reserve large blocks of cash to meet its credit line commitments, and the payback is measured in years, not months," he says. "Also, the buyer would likely need to be an established credit card lender, and in today's world, the market is focused on liquidity and the unsteady environment."

—John Stewart

MERCEDES PAY+ ADDS MASTERCARD FOR IN-CAR PAYMENTS

Automaker Mercedes-Benz is enabling in-car fuel payments for users of its Mercedes pay+ service. Announced in late September, the service also integrates Mastercard Inc.'s Secure Card on File for Commerce Platform technology.

Available initially only on select Mercedes models in Germany, the fuel-payment app joins a parking-payment app the giant carmaker announced in March that incorporates Visa Inc.'s Delegated Authentication and Cloud Token Framework. It is similar in scope to the Mastercard platform in enabling payment organizations to tokenize primary account numbers for use in e-commerce and in-app transactions.

Mercedes says both Mastercard and Visa cards work with the parking and fuel-payment applications and that it is the first automaker to incorporate the Mastercard code into its vehicles. Effectively, the tech makes the car a secure device for payments.

Mercedes pay+ now can be used for in-car fuel payments at participating gas stations in Germany.

The fuel-payment app, which Mercedes calls Fuel & Pay, starts automatically on the car's infotainment system upon the car's arrival at any of more than 3,600 participating stations in Germany and as soon as the driver shuts off the engine and selects the pump.

"Even before refueling, the system will calculate the maximum total amount based on the current fuel price and the amount of fuel when the tank is full. And, rather than authorizing the payment via a mobile device, the driver will complete their transaction seamlessly through fingerprint authentication," Mercedes says. The fingerprint sensor is embedded at the bottom of the infotainment screen.

When done, the amount of fuel and its cost are displayed on the screen in the car. Payment is automatically made through the card selected in the user's Mercedes profile. An email receipt is then issued.

The service is available on Mercedes models with a select group of infotainment series. In some instances, a fingerprint sensor, if not already equipped, can be added. Motorists using eligible cars without a sensor can authorize payment by scanning a QR code displayed on the in-car screen with a mobile device.

No U.S. models are eligible for the Mercedes pay+ service yet, though in March Mercedes told *Digital Transactions* it is expected to be available at an undetermined time.

Mercedes is not the only automaker to jump into in-car payments. Early in September, Hyundai Motor North America launched Hyundai Pay, a service available in the 2024 Kona crossover in the United States. Initially, parking payment is the first use case, but expectations are that other use cases will follow, a Hyundai executive says.

—Kevin Woodward

Mercedes pay+: The latest in mobile payments?

DATA COMPROMISES SET A RECORD IN 2023

Data compromises in the U.S. market for the first three quarters of 2023 totaled 2,116, a record high for the first nine months of a calendar year, according to the Identity Theft Resource Center. The previous high was set in 2021, when 1,862 compromises were recorded over the first nine months of the year.

The record comes despite a 22% decline in data compromises in the third quarter of 2023 from the second quarter. In the third quarter, there were 733 publicly reported data compromises, compared to 951 in the second quarter.

As data compromises fell in the third quarter, so did the number of victims, compared to a year ago. Some 66.7 million consumers were victimized by data compromises in the quarter, a 39% decrease from the same period in 2022.

Overall, the number of consumers victimized by data compromises in the first three quarters of 2023 is also down compared to a year ago. An estimated 233.9 million consumers were victimized by data compromises through September, compared to an estimated 425 million victims during the same period in 2022, a 45% decrease.

Cyberattacks continue to be the most frequently reported root cause of data breaches, with 614 notices issued in the latest quarter. More than half of the breached entities (386) did not report an attack method.

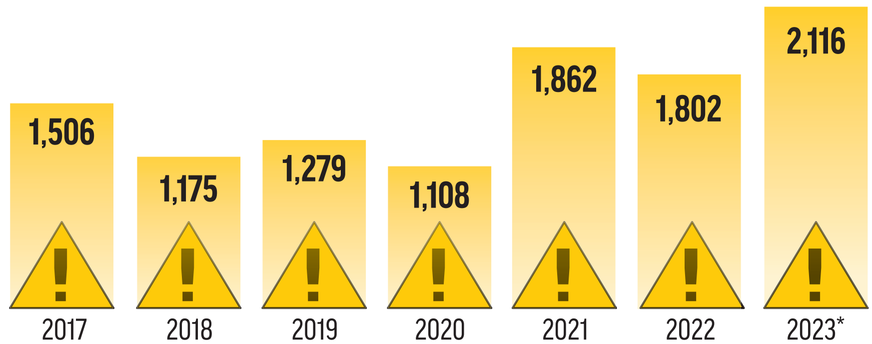
Phishing attacks were the most commonly reported attack vector used by hackers during the third quarter. Among the period's 614 breaches, 80 were the result of phishing, followed by zero-day attacks (69), ransomware attacks (64) and malware attacks (17). Zero-day attacks occur when cyber criminals exploit a previously unknown app vulnerability for which there is no patch.

"While setting a record for the number of data breaches is attention-grabbing, unfortunately, it is not surprising," says Eva Velasquez, president and chief executive at the Identity Theft Resource Center, in a statement. "There are a handful of reasons ... ranging from the drastic uptick in zero-day attacks to a new wave of ransomware attacks as new ransomware groups enter the criminal identity marketplace."

Financial services was the most frequently targeted industry by hackers during the third quarter, with 204 reported attacks. Healthcare was the second most frequently targeted industry, with 113 reported data compromises during the third quarter. No other industry reported attacks in the triple-digit range, the IRTC says.

—Peter Lucas

THE BUILDUP IN BREACHES



*Through the third quarter. Source: Identity Theft Resource Center

MONTHLY MERCHANT METRIC
Total Same Store Sales YOY Growth %

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

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

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

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

Q1'22	11.40%
Q2'22	5.28%
Q3'22	4.08%
Q4'22	2.55%
Q1'23	3.84%
Q2'23	1.18%
Aug'23 T3M	0.98%

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

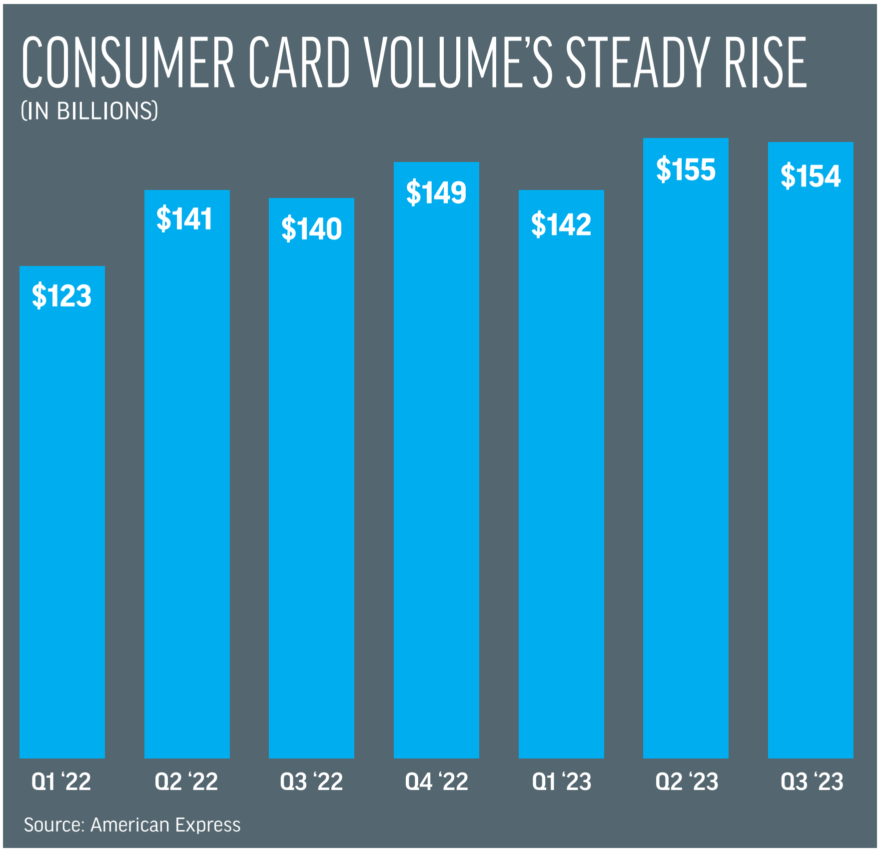
AMEX PUTS ITS PANDEMIC EXPOSURE FIRMLY IN THE PAST

Card companies with a heavy exposure to travel and entertainment spending took a beating during the pandemic, but that's ancient history now so far as American Express Co. is concerned.

The T&E giant last month reported its sixth consecutive quarter of record revenue, backed by strong cardholder spending and new cardholders added. "There are many ways for us to grow revenue," AmEx chief executive Steve Squeri told equity analysts on a conference call to discuss the company's September-quarter performance. "Cardmember spending remains strong."

Indeed, AmEx has added new cardholders at a steady clip of around 3 million per quarter since at least the start of 2022. "New card acquisitions is a major driver [of revenue growth], not raising fees," Squeri said. This comes on top of spending by "tenured cardmembers we know well," added Christoph Le Caillec, who took over the chief financial officer role this summer on the retirement of longtime CFO Jeffrey Campbell.

The continuing growth in cards helped drive revenue to more than $15 billion for the quarter. But the discount fees AmEx collects from merchants remain the company's biggest source of revenue, accounting for 55% of the total. This fee generated $8.4 billion in the third quarter, a 7% increase year-over-year.



Still, the pebble in AmEx's shoe could be spending at small and medium-size businesses, which grew a modest 2%. "This is the second quarter in a row [the category] has been low growth," Squeri conceded, adding merchants that have been with AmEx for some time are lagging. "We haven't seen as much momentum from an organic perspective," he said.

On the other side of the spectrum, restaurants have recovered swiftly from the beating they took during the pandemic, with billed business growing 13% year-over-year. Here, AmEx offers a reservation-booking app called Rezy, which it acquired in 2019. "Restaurants continue to be one of our largest and fastest-growing segments," Squeri said, pointing to a record level of reservations on its app in the quarter.

AmEx is confident enough now, Squeri told the analysts, that it plans to increase its marketing spend to $5.5 billion in 2024, a move that will start promptly. "We look at cards acquired and we still see tremendous opportunity. You will see a higher level of marketing spend in the next quarter," he said.

In the September quarter, AmEx posted $15.4 billion in revenue, a 13% rise over the same quarter last year. Net interest income, the second largest portion of the total after merchant fees, rose fully 33% to $3.4 billion.

—John Stewart

WITH CBDCS, BE VERY CAREFUL INDEED

BY
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DIGITAL-MONEY TECHNOLOGY is irresistible, and its impact is going to be much more profound than we can imagine. Money—an entity of transactable value formed by faith, not by per se value— may be seen as the mother of all inventions. It allows inventors to invent rather than get bogged down growing their own food and tailoring their own clothes.

By upgrading money into cyberspace, we are re-inventing it. We are opening the door for yet unimagined social impact. For that reason, this prospect should be treated with caution and with care.

To switch the basis of a national currency to a digital framework is a very big step, with unforeseen consequences. Yet, just about every central bank in the world is at some stage of development of a digital national coin. Remarkably, the cryptographic constructs being considered are not only narrow but also vulnerable to quantum computers and artificial intelligence.

Digital currency vanishes if its cryptographic foundation is breached. Such a catastrophe has no parallel in pre-digital money. The prevailing cryptographic building blocks don't come with any proof that they are good for the purpose they serve. The rationale for their deployment is that no one published a breach procedure. And why would they? We are dangerously impressed with our technology, and we ignore the history of surprise catastrophes: both nature and our adversaries are smarter than we expect them to be.

But there's more than security. We should be alert to the range of capabilities and the scope of limitations. A national digital money framework, once set in place, will be hard to modify, let alone replace. A Central Bank Digital Currency is a complex system with lots of moving pieces. Mistakes in its construction will reflect on the national economy and on international disposition.

It is, therefore, advisable to gain experience through a series of small steps. This can be done by switching from a plan to build a CBDC to a plan to build a CBDC Platform, a regulatory framework into which private and commercial entities can be fitted, allowing each to offer private digital money backed by the national currency as it stands today. Banks and other entities with regulatory compliance will compete on a range of digital-money solutions, and let the marketplace sort things out.

All the amazing capabilities we've already identified for digital money can be implemented through private digital coins backed by the national currency. Security, convenience, versatility, universality—all these can be practiced and field-tested in a competitive climate.

The idea of a CBDC platform is to write a comprehensive body of terms, requirements, and qualifications for commercial digital tokens backed by the national currency, and add to them and modify them as experience accumulates. In parallel, central banks will build a national monitoring capability, compliance-enforcement capability, and lessons-learned activities, to manage commercial offerings, unleash the creativity of the public sector, and allow a winning protocol to bubble up.

Governments have come to realize that a national digital coin will give authorities unprecedented power over the citizenry, exposing their wealth and tracking all payments in and out of every wallet. Taxation will take place automatically and accurately. But more alluring will be the government power to financially choke every individual or firm, since government computers will be the custodian of our money. Governments are thrilled by this level of control. They are going about it despite the specter of a ticking cryptographic catastrophe.

Even if a central bank insists on CBDC, why not first test-run it through private enterprise trading with digital claim checks for national money? DT

A SUPREME REPRIEVE FOR THE CFPB?

BY BEN JACKSON

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AFTER LAST MONTH, the Consumer Financial Protection Bureau's future seems more secure.

On Oct. 3, the Supreme Court heard oral arguments in Consumer Financial Protection Bureau v. Community Financial Services Association of America. The CFSA originally sued the CFPB over its payday-lending rule in 2018.

As previously reported in Digital Transactions, in October 2022 the Federal Court of Appeals for the Fifth Circuit held the CFPB's funding mechanism is unconstitutional because its money comes from the Federal Reserve rather than Congressional appropriations. The CFPB appealed the Fifth Circuit's decision to the Supreme Court.

Many in the payments industry expected the funding question could lead to the Supreme Court's either ruling the Bureau is unconstitutional or at least requiring its funding to come from direct appropriations. The latter outcome was viewed as a way of making the Bureau more accountable or to reduce its power by reducing its budget.

The oral arguments have tempered the industry's expectations.

"I had one opinion going in, and another coming out," said Brian Tate, the president and chief executive of the Innovative Payments Association.

Tate, who attended the oral arguments, said the questions from the justices about the focus of the CFSA's argument made him think the case could go either way.

According to the transcripts, the CFSA's argument rested on the concept of "separating the sword from the purse," meaning that the powers of the executive branch are tempered by Congress's control of funding.

The Justices appeared to want a clear test for determining whether any funding mechanism was constitutional or not, as evidenced by Justice Clarence Thomas's question: "Mr. Francisco [Noel J. Francisco, the CFSA's lawyer], just briefly, I'd like you to complete this sentence. Funding of the CFPB is … violates the Appropriations clause because?"

Francisco's answer: "Because Congress has not determined the amount that this agency should be spending. Instead, it has delegated to the director the authority to pick his own appropriation, subject only to an upper limit that's…so high it's rarely meaningful," This did not completely satisfy the justices.

Both conservative and liberal justices pushed back on these arguments. Justice Brett Kavanaugh pointed out that Congress has the power to change the CFPB's funding through future legislation. Justice Ketanji Brown Jackson said it appeared Congress had exercised its power of the purse by deciding how the CFPB is funded. She agreed with Kavanagh that it could change the funding if it saw the need.

This column can't cover the entirety of the hearing. But the transcripts are worth reading for anyone interested in the outcome of this case. The Court will base its decision on the briefs as well as the oral arguments, so it might still be persuaded that the CFPB's funding is unconstitutional and send its funding back to Congress.

The justices did question Solicitor General Elizabeth Prelogar about whether the CFPB's funding negates "the exacting control" that Congress has, and whether it was too aggressive to read the appropriations clause of the Constitution to say Congress can fund agencies in a manner that gives away its power.

So, while predicting the final decision is tough, I think it's safe to say we will not see the CFPB abolished by the Court. The Court may decide the Fifth Circuit made a mistake when it said the Bureau's funding is unconstitutional and overturn the decision without any further changes. Or the Court may tell Congress it needs to revisit the CFPB's funding, but let the current regulations stand.

This suggests that, barring a big surprise, financial companies should plan on complying with the current rules going forward. DT

WHAT'S AN ACQUIRER TO DO?

Agents that sell card acceptance aren't powerless when merchants gripe about the cost.

BY **PETER LUCAS**

MERCHANT DISCONTENT OVER card-acceptance fees is nothing new, but every few years the din rises several octaves, just as it has in 2023. While merchants, card issuers, the card networks, and politicians argue over whether acceptance costs are fair, guess who's caught in the middle? Merchant acquirers.

An integral part of card payments, acquirers often find themselves performing a difficult balancing act when it comes to card-acceptance fees. Sure, acquirers levy a fee on merchants for settling card transactions, but their fees are a small portion of overall acceptance costs, the bulk of which is composed of interchange costs.

Since interchange is set by Visa and Mastercard, acquirers have little power to reduce merchants' acceptance costs. That does not mean acquirers aren't mindful of acceptance costs or are not taking steps to reduce those costs. Or at the very least, make those costs more predictable.

"Everyone in the payment ecosystem believes there should be acceptance costs. The question is, what should those costs be?" says Greg Cohen, chief executive at Fortis Payment Systems. "Acquirers are middlemen, but they can proactively work with merchants to reduce acceptance costs."

Many acquirers are doing just that, payments experts say. Tactics include waiving hardware costs, supporting dual pricing for cash and credit purchases, offering bundled rates, and helping merchants qualify more transactions for a lower rate by sending more information about the transaction to the issuer to let it know the transaction is low risk.

Bundled rates aren't necessarily cheaper for merchants. But they do provide certainty for small merchants about the acceptance fees charged for each card transaction and simplify a merchant's monthly statement from its acquirer.

"There is value to small merchants in bundled pricing, and several acquirers, such as Stripe, NAB


Gray

Gray “There is value to small merchants in bundled pricing.”

[North American Bancard], and Square are or have moved to it,” says Cliff Gray, a senior associate for the consultancy TSG, formerly The Strawhecker Group.

“Bundled pricing doesn’t necessarily provide cost savings,” Gray continues, “but it does simplify the acquirer’s monthly statement for the merchant and gives them certainty over acceptance costs, since they know every transaction will be charged the same rate.”

While bundled pricing makes sense for small merchants, it does not for merchants with high card volumes. “Any merchant with large volume is going to negotiate to get the best acceptance fees possible [because it’s in their best interest],” Gray says.

‘A POINT OF FRICTION’

Keeping abreast of the challenges merchants face and their needs in payment acceptance is important for acquirers and can help reduce merchants’ dissatisfaction over acceptance fees. Paysafe Ltd., which specializes in online and mobile transactions, regularly seeks feedback from its customers through customer-satisfaction surveys.

“In the event of acceptance fees being a point of friction, we leverage our merchant-support team to educate our customers on how to lower their total cost of acceptance through industry education,” says Nathaniel Short, senior vice president of Global SMB (small and medium-size businesses) for Paysafe. “In some cases, we will evaluate the interchange categories with the merchant and ensure we are utilizing the correct ones on their transactions.”

One way that Paysafe helps merchants lower their total costs of acceptance is ensuring that the address-verification system or 3D Card is enabled for card-not-present transactions to prevent fraud or chargebacks.

3D cards require customers to complete an additional verification step with the card issuer when paying. Typically, cardholders are directed to an authentication page on the card issuer’s Web site, where they enter a password or a code sent to their mobile phone.

Waiving hardware costs can also help reduce a merchant’s acceptance cost, but that strategy has limitations. Offering a free terminal reduces a merchants’ upfront cost to accept cards, but does not lower acceptance fees.

“Free hardware is a one-time fee reduction that does not reduce the day-to-day pain of acceptance costs,” says Gray. “Plus, hardware costs have pretty much been normalized, so the magnitude of the savings is not necessarily that great.”

Supporting dual pricing for cash and credit purchases is another strategy acquirers are using to help merchants ease the pain of acceptance costs. Dual pricing allows merchants to show consumers a cash price and credit price for their purchase. Typically, the cash price is lower, which serves as an incentive for the consumer to pay with cash.

The drawback is that dual pricing can be complicated to implement. It may not make sense for some merchants. “We are seeing more dual pricing in the market, and it works great for gas stations, but that’s because gas stations have only one SKU. Dual pricing is not as easy to implement for merchants with thousands of SKUs,” says Cohen.

“What acquirers should be educating merchants about is the base rate as opposed to the headline costs. Acquirers all deal with the same base costs,” he adds.

The key to getting merchants to understand the foundation for their acceptance costs is for acquirers to present their base rate in as transparent a manner as possible, Cohen adds.

VALUE AT CHECKOUT

While dual pricing can help lower a merchant’s total acceptance costs, some payment experts argue acquirers should avoid supporting it. “Dual pricing is a gimmick,” says Todd Ablowitz, co-founder and co-chief executive for payments facilitator Infinicept. “Acquirers should focus on service and bringing in the right products and value-added services. If a merchant perceives value in the services the acquirer is offering, the merchant will pay for it.”

Fraud-detection and -prevention tools are value-added services frequently offered by acquirers. The value to merchants is two-fold. First, merchants can use them to mitigate financial losses from selling goods for which they will not receive payment. Second, the tools reduce chargebacks, which can increase a merchant's interchange rate if they exceed a certain threshold.

Stripe Inc., which offers bundled pricing, touts value-added services as a way for merchants to increase revenues, which can help offset card acceptance.

"Payments is a domain with significant opportunities for optimization, and thus technical craft really matters," says Tom Holman, head of payment acceptance for Stripe. "[Just as] a superior computer chip makes a smart phone faster, superior payments technology means more legitimate payments succeed, while fraud is kept in check."

Stripe offers tools that aim to improve and speed up checkout and boost conversion rates. In September, Stripe unveiled a series of enhancements aimed at improving checkout for merchants. The new features—which include one-click checkouts and a no-code A/B testing tool for businesses to evaluate how different payment methods perform—rely on pre-built user interfaces, which allow merchants to quickly deploy the new features, since they don't have to develop the code themselves, Stripe says.


Ablowitz

Ablowitz: "Dual pricing is a gimmick."

A key feature within the enhancements is a so-called Payment Element that uses algorithms trained on billions of data points to present consumers with what it determines to be the most relevant payment methods from more than 40 options.

For example, the Payment Element could suggest to French consumers shopping in Japan that they might pay with Cartes Bancaires, while suggesting local payment options to Japanese consumers.

"While a majority of organizations still view payments as a cost center, others are beginning to see it as an engine to grow revenue," Holman says. "These companies are seeing pretty heady ROI. For instance, we've seen companies deploy no-code A/B testing to increase average order value by 36%."

Stripe research has also shown that merchants migrating to its enhanced checkout apps increased users' revenue by an average of 10.5%, Holman adds.

"There's a lot of value add possible at checkout, and there's a ton more when it comes to authorizing those successful checkout sessions," Holman says. "Any business knows there's a lot of legitimate transactions that get declined as suspected fraud."

One drawback to pitching value-added services is that merchants often have to pay an additional fee for them. "There's a cost to value-added services," says Gray. "Fraud-detection tools help a merchant save money by reducing fraud losses, but are they really a value-added service or [a standard feature] acquirers should be offering?" says Gray.

'LESS FRICTIONAL'

Other techniques acquirers can use to help alleviate merchants' cost concerns include surcharging, a practice in which the merchant passes acceptance costs along to the consumers.

Under Visa and Mastercard rules, retailers are required to register the surcharge with the payment network. Next, they must display a notice of the surcharge at the point of sale — both in-store and online. The consumer's receipt must also indicate a surcharge was added to the bill.

The drawback to surcharging for merchants is that it can turn off consumers by making them feel as though they are being penalized for paying with a credit or debit card, payments experts say.

Acquirers that support surcharging or dual pricing also need to make sure those solutions are compliant with industry regulations and educate merchants about those pricing models, adds Paysafe's Short.

Alternative payment methods, such as digital wallets, buy now, pay later, and cryptocurrency are a way to lower a merchant's card-acceptance costs as those options cost less to accept than a credit or debit card. "Depending on the fees associated with these alternative methods, some merchants may find them less frictional compared to traditional card payments," says Holman.

While alternative payment options can help lower a merchant's acceptance costs, they do not necessarily generate enough volume to matter. "Unlike cards, most alternative payments are not revenue positive," says Gray.

'A LINGERING QUESTION'

Given the competitiveness of the merchant-acquiring market, one of the most effective ways acquirers can ease merchants' concerns over acceptance costs is to provide multiple pricing models. Complete transparency about costs also helps.

Paysafe, for example, offers multiple pricing models to ease merchants' concerns. "We have interchange plus, tiered, bundled pricing, cash discount … flat rate, and many more options for our merchants," says Short. "We have a very transparent approach to acceptance costs and placing merchants in the right pricing model to suit their business."

Paysafe's goal, Short adds, is to offer pricing models that provide sellers with a service that doesn't become, as he says, "cost inhibitive."

Regardless of what strategies acquirers employ, the controversy surrounding acceptance fees will never go away. "There is value in card acceptance to merchants, but what is an appropriate cost is a lingering question," says Cohen. "No matter what the cost, there is always going to be a camp that says it is too much." DT

Cohen

Cohen: "What acquirers should be educating merchants about is the base rate as opposed to the headline costs."

SUPER APPS: THE NEW FRONTIER—AND THE RISKS INVOLVED

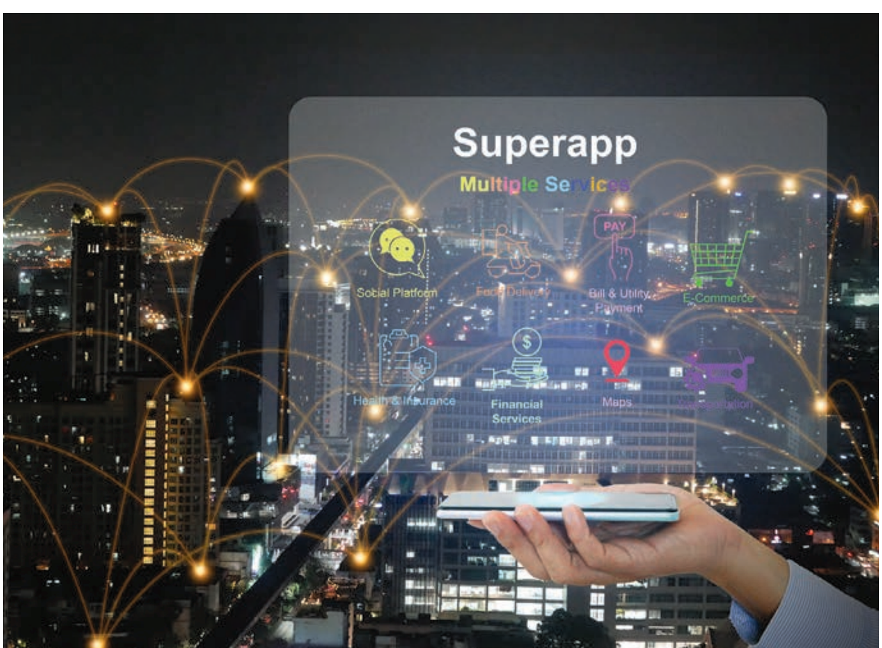
These apps are becoming more popular and encompassing more and more sensitive data—which is exactly why they're attracting cyberthieves.

BY **MAYA SHABI**

Maya Shabi is payments and risk specialist at EverC.

IN TODAY'S HIGHLY competitive market, brands are tasked with providing a seamless, integrated, and convenient user-app experience to attract users. With the limited space on smart phone home screens, companies have started consolidating apps under one corporate umbrella to create a one-stop-shop for users, giving rise to super apps.

Instead of one application with a single or very few capabilities, super apps provide multiple services in one place. They even play host to numerous mini-apps, creating a platform that lets consumers carry out a suite of activities in one place.



Super apps aren't new to the digital age. The first company to successfully implement the concept was WeChat, a Chinese instant-messaging, social-media, and mobile-payment app developed by Tencent. Initially designed for messaging, WeChat expanded into a massive e-commerce platform boasting 1.3 billion active monthly users.

The demand for an all-encompassing platform has grown in regions where smart phones lack the capability to host multiple separate apps. Despite the demand for super apps, their adoption has been slow in the United States and Europe due to strict regulations surrounding data privacy and security.

As smart-phone penetration moves toward saturation, many American tech companies have attempted to increase the stickiness of their offerings by adding features. Now, it's more competitive than ever to develop a successful super app as U.S. tech giants engage in a game of survival of the fittest to gain dominance.

CONSUMER PROTECTION

Regulators are concerned that super

app companies will be able to gather an extensive amount of personal and sensitive user information, data that could potentially be abused for commercial and advertising purposes, or worse. For these very reasons, consumer-protection laws remain at the forefront in places like the European Union to restrict sharing, selling, and leveraging user data for corporate gain.

Officials in the U.S. have taken similar steps in recent years. For instance, the Federal Trade Commission (FTC) has put companies developing health apps "on notice" out of concern that consumers' sensitive information could be used or shared with advertisers or other third parties.

Failure to obtain consumers' express affirmative consent to use sensitive data for marketing purposes violates U.S. law. In March, the FTC ordered telehealth app BetterHelp Inc to pay $7.8 million to consumers because it revealed sensitive data to third parties, like Facebook and Snapchat, after ensuring user privacy.

Of course, concerns over user data and privacy with super apps extend beyond advertising. Expanded access for app developers to user data, especially if they span across industries, can also present national-security risks.

PAYMENTS FRAUD

As an application expands across industries, including new application programming interface endpoints, pages, and users, it creates a larger attack surface for cybercriminals to infiltrate. The sheer complexity of super apps makes it easier for bad actors to locate security oversights and harder for administrators to monitor potential attacks. This becomes especially risky as super apps are expected to disrupt the banking sector over the coming years.

Super apps already capitalize on open-banking capabilities to offer a range of payments and financial services. The increased integration of banking presents fraudsters with even more opportunities to access the financial system. Developers are now rushing to make new offerings and mobile features available on the market, often at the expense of comprehensive security protocols, as they grapple with the challenge of reducing time to market while trying to balance speed and security. The lack of consistent compliance standards for developers raises questions about where the liability rests, particularly when it comes to security, putting the burden on banks to ensure their customers' data and transactions remain protected.

As users and merchants partner with super-app platforms, they are subject to an increased level of risk. For example, if there is a data breach and consumers are using several different apps, they only need to worry about a criminal accessing their information from one or two places. Should a breach take place on a super app, criminals would gain access to a wide range of consumer data stored across the platform's ecosystem.

Furthermore, vulnerabilities in identity-verification procedures could become a substantial risk, as cybercriminals frequently use credential stuffing or account takeovers (especially from bots) to abuse user data. Criminals also target super apps by setting up fake accounts with stolen or falsified information, often creating multiple accounts at once.

Payment fraud also occurs on super apps. Cybercriminals will use stolen card details, likely obtained through data breaches or phishing scams, to make a purchase. The real card owner will file a chargeback, and the merchant foots the bill (on top of losing inventory).

Given the risks associated with super apps and the frequency with which they handle financial data, payment providers must


Shabi

Shabi: "It's more competitive than ever to develop a successful super app as U.S. tech giants engage in a game of survival of the fittest to gain dominance."

continuously review standard underwriting protocols to prevent fraudulent actors from abusing the technology. This is in addition to current security measures typically implemented by developers, including code obfuscation, advanced encryption, and runtime application self-protection (RASP).

THE FUTURE

Creating a digital fingerprint for each device in a super app's ecosystem would allow for the effective detection of risky activity and confirmation of user identity. However, this becomes complex when credentials are shared across multiple services. This creates serious implications for user data privacy and can be potentially exploited by bad actors.

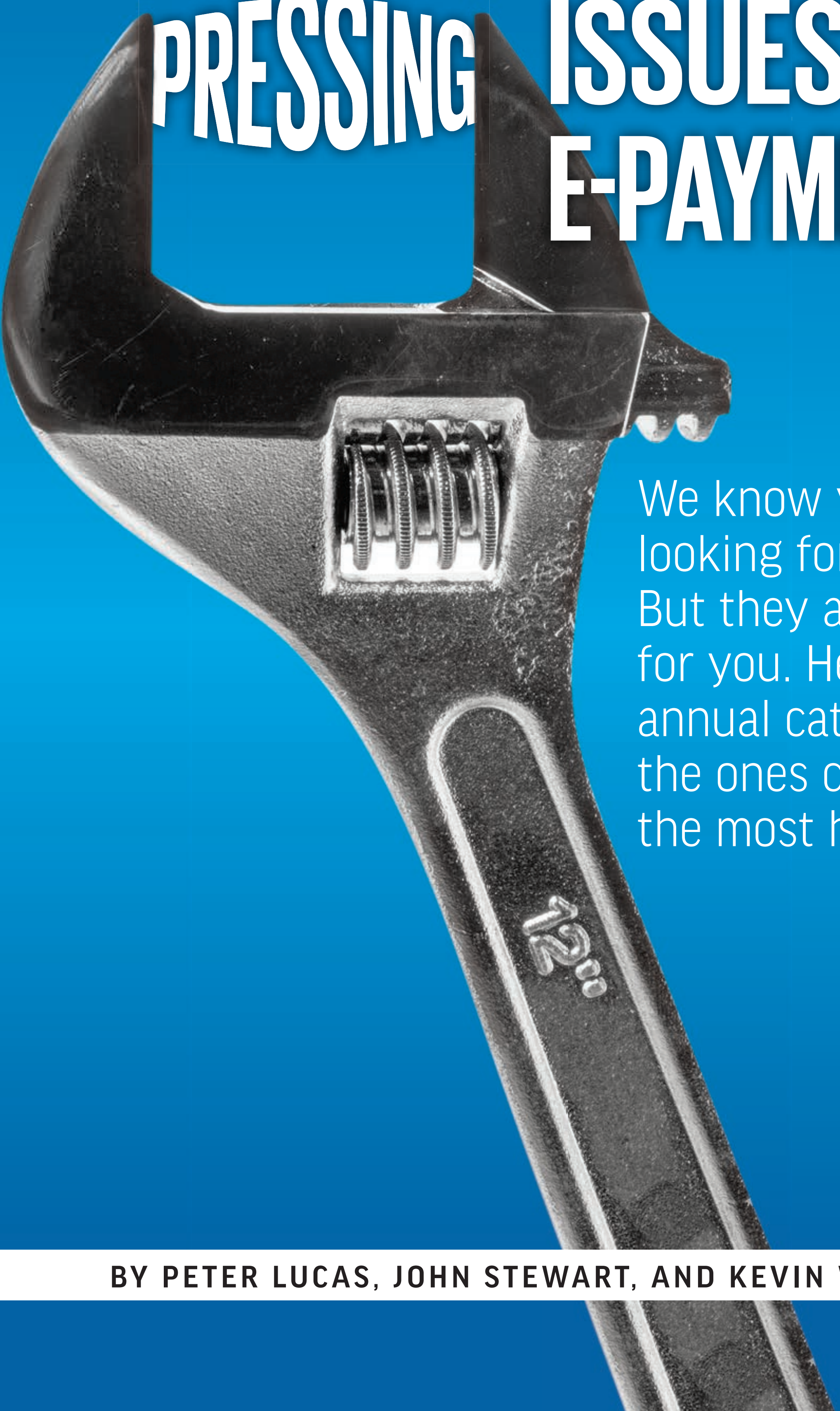
Looking to the future, major players across verticals will partner with super-app tech companies seeking to consolidate their services to a single access point. This will include participants in the payments ecosystem because financial services are a major component of most app offerings, especially since they drive app revenues.

Awareness of these risks must play a crucial role in considering partnerships with super-app developers. Particular focus should be given to maintaining tight customer-verification protocols and continuous monitoring for malicious activity.

It is the responsibility of every partner involved to ensure that they are armed with the proper detection and protection mechanisms to prevent insidious actors from exploiting users, merchants, financial institutions, and the global financial network. DT

17TH ANNUAL

THE 10 MOST PRESSING ISSUES IN E-PAYMENTS



We know you're not looking for problems. But they are looking for you. Here's our annual catalog of the ones causing the most headaches.

BY PETER LUCAS, JOHN STEWART, AND KEVIN WOODWARD

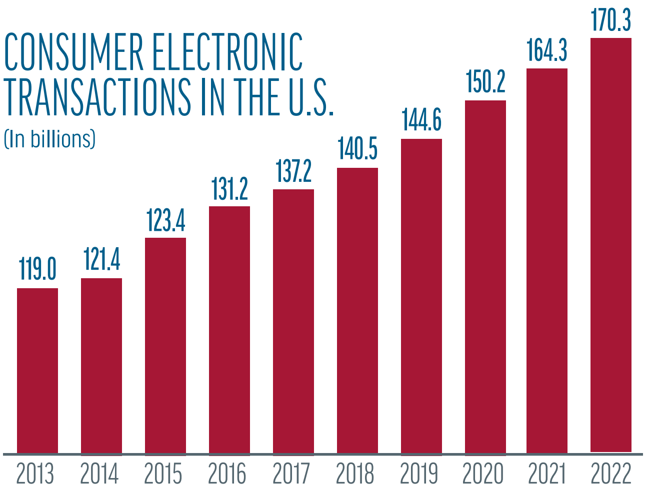
IF ADVERSITY BREEDS STRENGTH, as the old saying goes, then payments professionals may have plenty of opportunity to develop their strategic and tactical biceps. The industry no sooner recovered from all the ill effects of the pandemic than it found itself enmeshed in a slew of other issues, some old and familiar but some others quite surprisingly fresh.

Herewith our annual catalog of the problems we think are most alarming for payments professionals right now, ranked in order of their impact—or potential impact—on the industry. "Impact," of course, can be a matter of degree. Some of the matters ranked below, however, may be no less pressing for being still more or less in their larval stage.

So, what do we mean by "pressing"? The term refers to the sense of urgency the issue arouses in those it affects, not so much to the size of the market that must deal with it. Some issues, on the other hand, are pressing for a substantial segment of the industry. Take our number-one issue, the Credit Card Competition Act. The bill proposes to control merchants' acceptance costs by requiring a wider choice of networks that can carry transactions. That means merchants, networks, and banks are all affected—no small constituency.

The ranking was done by our staff editors, who cover this industry day by day. You may agree or disagree. Either way, let us know what you think the big issues in payments are, and we'll take up the matter with our 18th annual ranking next year. You can reach me at john@digitaltransactions.net.

CONSUMER ELECTRONIC TRANSACTIONS IN THE U.S.
(In billions)



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

1 The CCCA's Long Shadow

The Credit Card Competition Act, which was reintroduced in the Senate earlier this year, has been generating a lot of buzz lately, yet many unanswered questions remain concerning the bill's potential impact on the card industry.

The bill, whose lead sponsors are Senators Dick Durbin (D-Ill.) and Roger Marshal (R-Kan.), would require all banks with $100 billion or more in assets, essentially the largest card issuers that control more than 90% of the credit card market, to offer acquirers a choice of two unrelated networks for routing. If one network is Visa, for example, the other can't be Mastercard.

Key questions concerning the bill include which networks would serve as alternatives to Visa and Mastercard, how likely are issuers to support networks that may significantly lower their pricing structure as alternatives to Visa and Mastercard, and what kind of teeth the CCCA would the law have?

While the debit networks such as Pulse and Shazam, are considered good bets to be low-cost alternatives to Visa and Mastercard should the CCCA pass, they remain mum about their plans. Plus, the debit networks' history as low cost-alternatives is likely to prompt card issuers to support networks with fee structures similar to Visa and Mastercard, such American Express and Discover. It also remains to be seen how effectively regulators would be able to enforce the CCCA, as debit routing rules haven't always worked so well, payment experts say.

Co-sponsor Marshall has publicly stated there is a commitment among supporters to vote on the bill in the Senate this year. Meanwhile, proponents of the bill cite growing bipartisan support as reason to be optimistic the bill will become law.

2 The Fed and Real Time Payments

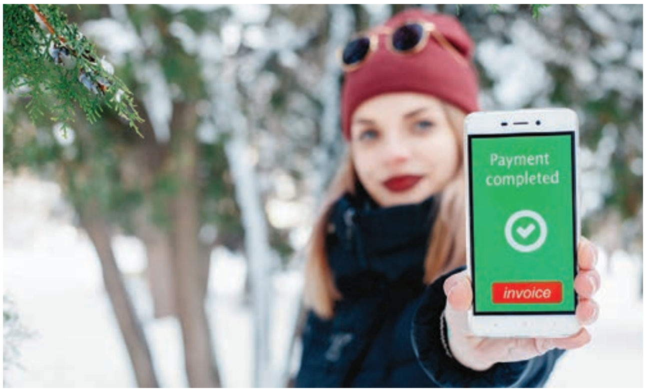
A much-ballyhooed newcomer to real-time payments, FedNow, is spurring more interest in instant payments despite its chief competitor, The Clearing House Payments Co. LLC's Real Time Payments network, entering its sixth year of operations.

With FedNow and RTP vying for attention, what's next? The hope is that with two players educating merchants about real-time payments and selling similar capabilities, the number of banks and credit unions offering it will grow. To do that, however, RTP will have to enjoy continued success and FedNow will need to convince financial institutions it has a viable and valued service.

FedNow already has found some traction, having grown from 35 financial institutions at its July launch to 108 as of early October. "For instant payments to be successful in the United States, the networks need to have as many participants as possible," Scott Anchin, a vice president at the Independent Community Bankers of America, a Washington, D.C.-based trade group, told *Digital Transactions* in October.

Getting more FedNow users involves getting the word out and educating financial institutions, especially smaller ones that may not have explored real-time payments options before. "The key concern on everyone's mind is time—how long will it take to get to ubiquity or at least significant volume," Miriam Sheril, head of product at Form3, a London-based payments provider, said in October.

Front and center for many FIs will be use cases. Examples include disbursement of urgent funds, bill payment, and money movement, such as for real-estate transactions. First, though, is getting a good portion of the approximately 9,000 U.S. banks and credit unions to enroll in one or both real-time payment options.



3 The Chargeback Challenge

Illegitimate chargebacks, known as friendly fraud, remain a nettlesome problem for merchants. A Chargebacks 911 survey of 300 merchants in May revealed respondents saw a 19% increase in illegitimate chargebacks compared to the same period a year ago.

Help may be on the way. Visa Inc. announced in September changes to its dispute rules and processes to give merchants more ways to show a disputed charge is valid and authorized, such as increasing merchants' ability to provide more accurate data around a disputed transaction. The rule changes could potentially save small businesses globally $1 billion in chargeback costs over the next five years.

"The change we've made to our dispute process is an important part of our strategy for fighting all types of fraud on the Visa network," Paul Fabara, Visa's chief risk officer said in a statement. "The dramatic rise in first-party fraud rates necessitated this change."

The merchant community welcomed the changes. Kaseedee Pilarz, owner of PilatesBKLYN, a Brooklyn-based fitness studio, said the impact of friendly fraud can be devastating for her businesses. "I have been in tough situations where legitimate membership charges have been disputed. If I lose the dispute, not only do I lose the membership fee, I also get a penalty," Pilarz said in a statement. "That can be the difference between making payroll or not. This change will help ensure I have a fair shot during those disputes."

The Merchant Risk Council also supported the changes, noting that small businesses are significantly more at risk for friendly fraud. MRC chief executive Julie Fergerson added that Visa's rule changes signify "historic progress" in combatting friendly fraud.

4 Slow Checkouts Are Killers

With an average e-commerce conversion rate ranging from 2.5% to 3%, according to Shopify Inc., online retailers look to the checkout flow to capture more sales and not impede purchases. As e-commerce sales picked up during the pandemic, especially among those who had not shopped online before and among those using their smart phones more often, the impetus for a better checkout experience ballooned.

The goal has been to increase the conversion rate—the percentage of Web visitors who purchase from an online store—and thereby boost revenue. Among the approaches many retailers and e-commerce platform providers have taken is to reduce surprises and provide customer choice in payment method. The goal is to eliminate as many disruptions as possible in the checkout process.

One tactic along these lines is implementation of accelerated checkouts. Think Apple Pay, Google Pay, or PayPal, where not only is the payment information stored but shipping details, too. Accelerated checkout is a trend now, but will gain broader use, Alex Hoffman, senior vice president of payments at BigCommerce Pty. Ltd., says. A one-page checkout is closely tied to accelerated checkout use.

How effective might this be? In a BigCommerce conversion report released in July, a test group of sites that offered both PayPal and Apple Pay had a conversion rate of 61.9%. Offering these advanced payment methods gives consumers choice without impeding their intent to purchase.

Paze, the upcoming digital wallet from Early Warning Services LLC, is another accelerated checkout example. Though Hoffman had no announcement regarding Paze and BigCommerce, he called it the equivalent of Zelle for e-commerce. Early Warning also created Zelle, the person-to-person payment service.

5 Abandoned Carts Are Everywhere

From too many steps in the checkout process and unexpected fees to a lack of personalization, there are numerous reasons for consumers to abandon their e-commerce shopping carts.

The average cart abandonment rate is 70%, according to user-experience research firm The Baymard Institute. Key reasons why cart abandonment is so high include higher than expected shipping fees and taxes (47%), ecommerce merchants wanting new customers to open an account (25%), a long or complicated checkout process (18%), not being able to see or calculate the total cost of the order upfront (17%), and not enough payment options (11%), according to Baymard.

Reducing friction at checkout can increase conversion rates by 35%, which translates to about $260 billion in purchases e-commerce merchants in the United States and Europe might otherwise lose, Baymard says.

One way e-commerce merchants can improve checkout is by offering more payments and customizing those options for the consumer. Stripe Inc., for example, recently introduced a so-called Payment Element that uses algorithms trained on billions of data points to present consumers with what it determines to be the most relevant payment methods from more than 40 options.

For example, a French consumer shopping in Japan can be shown Cartes Bancaires, a payment option native to France, while local payment options are suggested to Japanese consumers. Stripe offers merchants access to more than 100 payment methods.

Offering digital wallets, such as Apple Pay, Google Wallet, and PayPal, can also increase conversion rates by allowing customers to shop online without surrendering their credit card information, and offering Buy Now Pay Later, according to e-commerce platform provider BigCommerce.

6 Fraud's Ugly Permanence Online

Since the Covid pandemic, which pushed consumers to shop online at unprecedented levels, online fraud has become a larger problem and shows no signs of slowing down.

Online merchants accounted for 58% of all fraud and breach investigations, according to Visa Inc.'s Fall 2023 Biannual Threats Report. In comparison, brick-and-mortar merchant fraud made up 20% of fraud and breach investigations, while ransomware/[other] fraud schemes made up 7%.

Since the pandemic, the scams cybercriminals run on consumers—and merchants—have gotten more sophisticated. One consumer scam is directing consumers to favored merchant Web sites that appear to be legitimate, according to the Visa report. In reality, these sites are masterfully created counterfeits that capture consumers' order and payment credentials, but do not deliver the goods.

Another favored attack strategy is cybercriminals targeting known vulnerabilities in an e-commerce merchant's platform. One known vulnerability allows cybercrooks to create new customer accounts on an e-commerce merchant's site, then inject the data fields at checkout with digital skimming code during order placement. Once the order is approved and an email confirmation sent, criminals can release backdoor commands that can give them remote access to the merchant's e-commerce platform.

Once inside a merchant's platform, cybercriminals can try to obtain any information they want, be it a consumer's personal or payment credentials or a merchant's payment credentials, according to Visa.

Cyber criminals are also employing so-called bust-out schemes, which occur when a cybercrook establishes a legitimate merchant account and processes a small number of legitimate payments to establish credibility, then submits numerous fraudulent transactions and vanishes after obtaining payment, the Visa report says.

7 The Reguators Strike Back

With the possible exception of the Consumer Financial Protection Bureau, the nonbank payments industry until recently hadn't been much of a focus for Washington's regulators. 2023 may go down in the industry's history as the year that changed—or certainly began to change.

Consider just some of the actions Uncle Sam's various agencies took this year. Start with, of all places, the Securities and Exchange Commission. With digital currency gaining, well, currency in the payments business, the SEC decided to take a closer look at two of the industry's biggest players.

Take the Binance crypto exchange. The SEC this spring filed 13 civil complaints against the Cayman Islands-based conglomerate and linked entities, alleging among other things that it operates unregistered exchanges. Binance responded that the suit was "baseless." The company had earlier announced it would stop activity in dollar transactions and move to being a crypto-only exchange.

Then, without missing a beat, the SEC sued the U.S.-based cryptocurrency exchange Coinbase, this time alleging the company operates as an unregistered broker. Coinbase vowed to fight the suit, which came after the agency had vowed to force crypto companies to abide by federal securities rules.

The litany of regulation doesn't end there. The Federal Trade Commission in March issued a proposed rule that would require sellers to offer a "click to cancel" button that customers could use to more easily stop subscriptions and recurring payments. And, in April, the FTC accused chargeback-resolution provider Chargebacks911 of allegedly using multiple techniques to prevent consumers from winning chargeback disputes, accusations the company denied.

But no agency was more active in payments than the CFPB. Among other notable actions, the regulator in September released a report raising questions about the part restrictions imposed by big technology firms like Apple Inc. and Alphabet Inc's Google subsidiary may play in hampering innovation, consumer choice, and the growth of open and decentralized banking and payments in the U.S.

And, in June, it fined payments provider ACI Worldwide Inc. $25 million for erroneously debiting from nearly 500,000 homeowners a total of $2.3 billion in mortgage payments through the automated clearing house network in 2021.

8 The Hard Edge of SoftPOS

More merchants are adopting technology that lets them process card transactions on an ordinary mobile phone equipped with nothing more than the software necessary to run the payment—no dongles necessary. And the technology lets merchants save on acceptance costs since the payment is a card-present rather than card-not-present transaction.

But while softPOS may cut acceptance costs for merchants while spawning new opportunities for acquirers, its emergence is creating some complications, as well, some experts caution. Much of this lies in its complexity, said Bohdan Myroniw, sales director for the Americas at Preludd Payment Services, a France-based terminal company, during an August panel discussion on softPOS at MPC23, a payments-industry conference.

"There's no magic—it's just as complex" as installing traditional terminals, said Myroniw. Indeed, "complex" was a term that occurred several times during the discussion with respect to the adoption of mobile payments on commercial off-the-shelf devices (MPOC, for short), offsetting some of the virtues of the move to softPOS. "MPOC is card-present and fully secure, but complex," acknowledged Thad Peterson, a senior analyst at Datos Insights who moderated the panel.

9 Super Apps – Myth or Reality?

For years, banks and nonbanks alike have sought the magic formula for creating not just a popular financial app, but one that can handle a wide array of financial—and even some non-financial—tasks. It's called a super app, and it's wildly popular in part of Asia, particularly in China. Indeed, in China, it's said you could manage your entire life with a super app.

But in the U.S. market, financial apps have stuck pretty closely to payments, a vital function but maybe not one that the average consumer finds compelling enough to use regularly. There's plenty of competition on that phone for the user's attention, after all.

Even so, there have been efforts by U.S. companies to introduce a super app in the true sense. One of the earliest entrants was PayPal, which a few years ago launched what it explicitly called a super app that featured a raft of shopping and payments features. Not much is heard of it now.

But for all their obscurity in the 50 states, super apps in one form or another remain an ambition for at least some payments networks. There are few more compelling opportunities, after all, than capturing the constant attention of hordes of phone-bearing consumers.

The key is finding the right formula, and this is where the payments industry has struggled. Some observers are hopeful the upcoming Paze wallet from the major banks that back Early Warning Services LLC may find success and lay a foundation for an eventual super app. Set for introduction early next year, the wallet will give users the ability to make online purchases from a wide variety of merchants. Early Warning expects issuers representing 150 million cards to be participating ultimately in Paze.

10 The In-Car Payments Quandary

A few years ago, some carmakers championed the idea of paying for gas, coffee, and donuts from the dashboard. While wallets were developed and tests completed, the idea of a car as a payment vehicle—payment device?—stalled out.

But now, in 2023, new implementations are available and they're beyond testing. In use is Mercedes pay+, an in-car payment app that uses tokenization to virtually turn the car into a secure token. Available only in Germany for now, the service uses a fingerprint sensor in the dash to enable payment authorization. Fuel-payment and parking-payment capabilities are available now.

By contrast, Hyundai Pay, announced in September, is available in the United States in the 2024 Kona, a small crossover. To access Hyundai Pay, car owners download the MyHyundai mobile app and activate the Bluelink subscription agreement. Bluelink is Hyundai's connected-car app, which buyers receive free for three years. Bluelink enables Hyundai owners to remotely start their vehicle, lock and unlock its doors, locate it in a parking lot, run a full vehicle diagnostic check, and map routes to a destination.

Hyundai owners will be able to access Hyundai Pay through the Bluelink app. Card data stored within the Hyundai Pay wallet is tokenized.

It's not just automobile manufacturers developing in-car payments. Car IQ Inc., which creates payment platforms for vehicles, is working with Visa Inc. to enable acceptance of its Car IQ wallet across the Visa network. Even Apple Inc.'s CarPlay service can be used to order and pay for pizza and food using the stored payment method in the user's merchant account. P97 Networks also is working with Visa to deploy its token technology to reduce friction for in-car payments.

Now the question is, are these developments enough to add horsepower to the long-stalled efforts to turn automobiles into rolling payment devices? DT

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CAN YOU AFFORD TO KEEP YOUR BACK OFFICE?

Patches and updates won't cut it in an increasingly competitive payments industry. Time to install modern computing power.

BY **KATE KNUDSEN**

Kate Knudsen is senior program director at BHMI.

WHILE SOME FINANCIAL institutions try to hang on to their legacy systems, the costs to manage, maintain, and repair these systems are rising. Many now spend more every year on patches, updates, and integrations to keep pace while still falling behind the competition and missing out on new growth opportunities.

The question is no longer whether companies can afford to replace their back-office system. It's whether they can afford to hold onto their legacy systems. A modern payments platform offers continuous long-term benefits in the form of cost reduction, increased efficiency, and greater agility to compete and adopt the latest payment methods. Organizations that modernize can start accruing operational benefits and reducing long-term costs.

While financial-services organizations strive to improve the customer experience with advanced applications and real-time payments, many still run their back office with outdated software. There's a common perception that updating a back-office system is time-consuming and expensive.

Some organizations have concerns about the migration process or lack a qualified team to help with the transition. Others worry that a full "rip and replace" of their entire banking core or back-office system will have a widespread impact on their channels and operations. And some also need help finding internal funding for upgrades as they still carry technical debt from their legacy systems. According to McKinsey, the cost of technology debt can run between 15% and 60% of every dollar spent on IT.

Many companies are also tied to these systems through decades of connection with people and technology, making it hard to break habits and escape the mindset of "what has worked." And when contemplating an upgrade, internal departments can have competing priorities, while the enormous task creates some uncertainty about where to begin.

As a result, many feel that upgrading legacy systems is easier said than done. These perceived pushbacks lead some organizations to continually kick the can down the road and hang onto antiquated systems far longer than they should.

'FRANKENSTEIN' SYSTEMS

While these organizations attempt to stretch their legacy systems and make them work, maintenance, fixes, and integration expenditures are continually rising. One study by IDC Financial Insights found such costs are rising nearly 8% annually, and global financial institutions are projected to spend $57 billion on outdated payment systems by 2028.

Since legacy back-office software applications are older than current technology, it can be difficult to find ongoing support and technology resources to maintain these applications. "As underlying operating environments modernize, the supporting infrastructure for legacy systems can begin to age out," said Peter Tapling, managing director at PTap Advisory.

Back-office legacy systems also have many indirect costs that don't always appear on the balance sheet. For example, many are slow and inefficient. Poor user interface designs can impede the customer experience and hamper the ability of employees to do their jobs effectively. Many of these systems are also prone to operational errors, which can lead to downtime and a poor customer experience.

As the U.S. economy rapidly adopts real-time payments in the next few years, these legacy systems will seem even more burdensome. Most were designed to support card-based transactions, which process every few hours or every few days. By contrast, modern real-time payments must happen in seconds, with 24/7 demands.

Some financial institutions try continual updates with add-ons and patches, but end up with siloed and unintegrated "Frankenstein" systems that cannot support message formats like ISO 20022.

Even as organizations may be operationally comfortable with their legacy systems, it's becoming more difficult to find the talent to operate, manage, and repair them. According to Deloitte, COBOL programmers and employees with deep knowledge of other legacy systems are aging out of the workforce, while younger programmers are being educated in modern platforms.

This lack of talent, combined with poorly documented systems and unattended known vulnerabilities, also poses security risks which could lead to significant financial liabilities in the event of a data breach.

Finally, because legacy systems cannot be scaled or quickly adapted to market changes, they also carry massive opportunity costs. This often puts companies years behind in adopting the latest payment methods or in capitalizing on innovative trends.

Knudsen

Knudsen: Legacy systems often put companies "years behind in adopting the latest payment methods or in capitalizing on innovative trends."

THE REAL QUESTION

Continually upgrading out of date back-office systems is a costly, time-consuming, and impractical way to evolve in today's rapidly changing ecosystem. The real question may not be the cost of upgrading the back office but the cost of not upgrading it. While a back-office upgrade does take time and money, it's an investment that yields ongoing, long-term payoffs.

"Payments providers need to have modern platforms in place to keep up with the pace of change and disruption in the payment industry. This enables providers to respond to market demands more quickly with competitive solutions while reducing risk," said Patricia Partelow, managing director of financial services consulting at EY.

One of the first ways a modern back office saves money is through increased efficiency. Eliminating manual processes often reduces the demand for labor, enabling employees to focus on more high-value tasks.

An updated payment system also helps organizations eliminate operational bottlenecks. The centralized transaction repository and a continuous processing architecture enable organizations to use one system for traditional and real-time payment methods. Managing all payments in one place with a configurable rules engine, security infrastructure, and a multi-tenant browser-based user interface reduces labor and software costs.

Upgrading a legacy system can also help organizations respond faster by easily supporting new regulations and payment types without the high costs and delays of code changes and configuration adjustments.

And because a new system is scalable, financial institutions can keep adding new payment methods with unlimited volume. Robust analytics capabilities also offer opportunities to improve the customer experience and loyalty with new products and services.

Hanging on to a legacy back-office system is like hanging on to a long-outdated version of Windows. While patches and updates may serve as temporary fixes, they are neither a long-term solution nor a viable

means to compete in the financial-services sector.

As costs and missed opportunities mount, organizations should realize they can reap long-term benefits and cost savings by modernizing their back-office environments. DT

THE RISING TIDE IN DIGITAL GIFT CARDS

Here's how smart providers will ride the wave by pleasing customers.

BY JEROME MYERS

Jerome Myers is chief product officer at Prepaid2Cash

THE GIFT CARD industry has significantly transformed over the past decade. With our modern world becoming more and more digital, brands must find ways to adopt the changing technology while keeping customer experience and protection at the center of what they do.

It all started with the paper gift certificate. From there, gift cards evolved to magnetic stripe cards, emailable cards, and now digital gift cards, with contactless redemption options, on the smartphone platform.

The rise of e-commerce and mobile commerce has made gift cards more accessible, enabling users to purchase them from anywhere and use them online or in-store. QR codes, readable at the point-of-sale device, make it easier for customers to pay with their cards without having to keep a stack of them in their wallet. These simple digital advancements will be instrumental in helping merchants create a more personalized gifting and gift card experience.

Indeed, there is a great opportunity for merchants to promote and differentiate themselves in the emerging digital gift card space. This new world, for those who solve their customers' problems, offers tremendous opportunities to build customer relationships, kindle trust, and generate revenue and recognition.

Despite the digitization of gift cards, consumers still have a greater affinity for physical cards. In the physical world, the experience of giving and getting gift cards is built-in. There is the card, the greeting card that goes with it, and the presentation of putting it in a stocking at Christmas or with a birthday cake. In the digital world, there isn't much of that—a problem worthy of solving.

PAIN POINTS

Some pain points are self-inflicted, by merchants and by gift card platform providers. For instance, merchants that have not updated their point-of-sale devices to accept contactless or to read QR codes or 2D barcodes make it difficult to redeem a digital gift card.

With digital gift cards, many merchants have been slow to offer consumer advantages, such as the ease of showing the balance. How difficult is it for a merchant to instruct the gift card platform to make balances available to digital gift card apps? Anything less is shortsighted.

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SECURING MERCHANTS IN AN INFLATED ECONOMY

Strategies to Boost Sales and Safeguard Your ISO Business

By Matt Nern, Managing Partner, SignaPay

Investors received unsettling news recently as U.S. consumer prices for September surpassed expectations, hinting at persistent inflation and sparking debates on another potential interest rate hike by the Federal Reserve in November.

The evolving pricing landscape in the past couple of years is reshaping how consumers and merchants conduct business, influencing the merchant services industry in various ways:

Escalating Credit Card Processing Fees: The rate increase in April 2022 delivered a harsh blow to many merchants, exacerbating the impact of inflation on businesses across various industries. In August, Visa and Mastercard were reportedly preparing to raise credit card fees again starting this month.

Shifting Spending Patterns: As prices continue to rise, 95 percent of consumers are willing to alter their spending habits, with 41 percent planning to transition to digital payments exclusively. This shift leaves merchants with a larger share of their profits going toward interchange fees.

Rising Operating Costs: Costs for essentials from food to energy, to office supplies, and business services have risen by 3.7 percent over the last 12 months, directly affecting merchants' profitability if they are hesitant to raise prices.

Elevated Business Loan Costs: In times of rapid inflation, the Federal Reserve can adjust the federal funds rate, impacting the cost of borrowing for commercial banks. This, in turn, affects the cost of borrowing for merchants.

WHAT YOU NEED TO BE DOING NOW

Dual Pricing: Offset interchange and other fees by providing a choice between cash and card payments. A slight price difference between the two options covers the merchant's processing costs while allowing consumers to save at checkout. Over time this will add up to thousands in extra revenue for your clients.

Target Market Shift: Focus on enterprise businesses with more stability and higher revenue potential, as they weather cost increases better. Consider companies with recurring annual or monthly service fees, such as property management, subscription services, or membership fees. Additionally, target recession-resistant sectors like medical services, child care, auto repair, or home repair.

Product Awareness Drive: Maintain a diversified product portfolio to meet all merchant needs, and continually communicate with merchants about your other products and services. Ensure your staff is well-versed in emerging technologies. For every new product introduced, build a target market from your existing client base, establishing yourself as a trusted advisor in the merchant's eyes.

Network Leverage: Convert loyal customers into growth tools by asking for referrals or forming referral partnerships. Incentivize them to spread the word, as merchants trust fellow merchants. Referrals are typically the easiest sales to secure with minimal time and financial investment.

Optimize Efficiency with an Experienced Processing Partner: Devote 100% of your time to building your clientele by partnering with a processing provider that supports you comprehensively. A reliable partner automates processes for faster sales and onboarding, provides insights on the latest technology tools and trends, and efficiently manages your customer base from both service and technology perspectives, minimizing wait times. When evaluating potential partners, inquire about their channel support, review their past performance, and ensure your business philosophies align.

Adaptability to market changes is the key to ensuring a steady revenue stream and continued growth for your ISO office. It's time to assess your office's health and ensure you have the right partner to navigate the rapidly evolving technical and market landscape.

A particularly intriguing problem, easily solved by merchants, is the risk inherent in the secondary gift card market. Here, consumers can buy at a discount from sellers who do not want their gift cards. Fraud in this market can be quite high because, after the sale, the seller and the buyer both have the gift card account number. The seller can still use it to make purchases.

This results in a high-risk situation. Buyers who are defrauded may associate the bad experience with the brand. The simple solution is for merchants to allow gift card platforms to rip and replace account numbers, so the buyer receives a new account number and the original number is rendered invalid.

There are many legitimate reasons why a gift card recipient may want to trade or sell gift cards on the open market. Some recipients live outside the company's geographic area. Some may not shop at a particular store or eat at that restaurant. Refusing to support gift card holders with basic and readily available technology reflects poorly on merchants.

A primary incentive for merchants to disallow rip-and-replace technology is the breakage companies receive for unused gift cards. Breakage can be a windfall for merchants and is very measurable. What is not as measurable is the frustration consumers experience with the merchant when the recipient cannot use the gift card or safely sell it.

Relief for consumers from these pain points requires merchant participation. The good news is that brands that embrace these trends can create a more personalized and engaging customer experience. The ability to safely swap out their gift cards across brands gives power back to consumers. It allows them to customize their experiences, showing that merchants value their customers' preferences.

Even then, the merchant is the winner. It allowed its card to be put in the hands of a new or existing customer who wants it. And it gained the appreciation of those who, for their own personal reasons, just needed to sell or trade their cards.

A MODERN EXPERIENCE

High-quality mobile apps are being created that will provide an easy way for merchants to delight their customers by giving them the flexibility they desire. Customers want the ability to upload, manage, and keep track of their gift cards and balances in one place. This added convenience helps to incentivize further spending with the brand.

Making gift cards available within up-and-coming, high-quality mobile apps can make it easier for customers to purchase and access the cards any time. Merchants must not only embrace digital gift cards but also embrace everything digital has to offer, including the display of balances and safe and easy gift card management. Support of third-party gift card exchanges and point-of-sale technology makes paying with digital gift cards simple. It puts the customer first, providing information and flexibility customers crave.

Many emerging trends in gift cards are derived from consumers' increased need for ease of use, flexibility, and customization. To generate the loyalty and participation brands desire from gift cards, they must embrace solutions that will offer a more modern experience. One that provides protection and empowers customers to use gifted funds in a way that suits their needs.

The rising digital tide has the power to float all merchant boats. But merchants who are tightly moored to the past may very well be sunk by the enormous digital swell that is beginning to crest. DT

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