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March/April 2016

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[1] Based on number of worldwide purchase transactions and number of credit cards in circulation as of Dec. 31, 2014.

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contents

The Official Publication of the Electronic Transactions Association Vol. 21 | No. 2

features

14 New Rules of Acquiring

By Ed McKinley

Instead of presenting themselves solely as salespeople, modern acquirers are now trusted consultants, tech experts, and solutions providers. We look into this seeming paradigm shift and how the profession has become invaluable to their merchant clients.

20 Can't We Be Friends?

By Josephine Rossi

For better or worse, fintech businesses are disrupting legacy financial services and institutions. And while some incumbents have turned to in-house product development or acquisitions to keep pace, industry data and dialog from some fintech startups say joint partnerships offer more mutual benefits.

26 *Transaction Trends* Exclusive CE Series: Capital Needs

By Ed McKinley

Although technology in alternative finance business has come a long way in predicting credit risk, nothing will replace the need for human intervention. Here's what ISOs need to know. (ETA CPPs: After you read the article, take the online quiz to earn two CE credits!)

departments

4 @ETA Announcements and ideas from ETA's CEO Jason Oxman

6 Intelligence Vital facts and stats from the electronic payments world

12 Politics & Policy Timely political, economic, and advocacy updates affecting your business

32 Comments Why EMV implementation is an on-going journey

34 Ad Index

36 People Adyen's president for North America, Kamran Zaki, talks cross-border payments.

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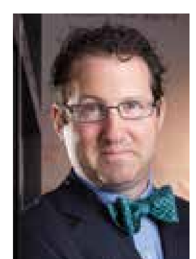
Welcome to the TRANSACTions Community!

Welcome to TRANSACT 16: Powered by ETA! This week, thousands of your colleagues are here to do business, explore the latest innovations in technology, and learn about new opportunities in commerce. This is your community and we are all here with one common goal: to make electronic transactions seamless, convenient, and rewarding for merchants and their customers.



ETA is more than the owner and producer of TRANSACT—we are the nonprofit trade association of the payments industry. Our mission is to grow your business, and every dollar invested in TRANSACT is re-invested by ETA in our growing our industry.

Worldwide, ETA represents more than 500 of the largest and most successful ISOs, acquirers, processors, and financial institutions, as well as the largest mobile network operators, technology companies, equipment manufacturers, security providers, and apps companies. Year round, ETA provides you with opportunities to advance yourself through education, networking, and advocacy. TRANSACT is your annual opportunity to expand your payments business and connect with your current and future customers and partners. Don't just take our word for it—hear it from industry-leading keynote speakers from Square, PayPal, First Data, Verifone, and Discover.

The TRANSACT show floor is the marketplace for innovation. Everyone in payments is here to do business—to sign deals, to partner, to invest. From established payments titans to startups working on the next game-changing technology, everything you need to succeed is here.

And the excitement goes beyond the show floor. Make sure to check out the *Payments Pitch-off* where startups compete for the $25,000 E-Pay Innovation Award, sponsored by Intuit. Contestants will demonstrate their innovative new electronic payments technology product or service to the payments industry's most important players.

We are grateful to our exhibitors, our sponsors, and our attendees for their support of this amazing event. As the only nonprofit trade association for the payments technology industry, ETA is invested in your business.

Jason Oxman
Chief Executive Officer
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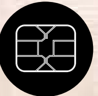
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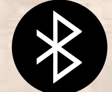
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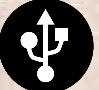

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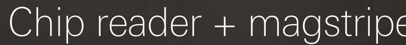

Survey Reveals 2016 Payments Preferences

An ETA and Morning Consult survey of 1,973 registered voters found that mobile payments and chip cards are gaining ground. Highlights from the survey reveal telling information about the payments activity of today's consumers:

• **Half have received their EMV credit/debit cards and are worried about security.** Fifty-two percent of voters say they have received their credit or debit cards embedded with Europay, MasterCard, and Visa (EMV)-compliant technology, but 39 percent say they have not. Of all voters, eight in 10 say they are concerned about the security of their financial information, but only one third believe their data will be more secure with their new chip card. Overall, 61 percent are concerned about fraudulent charges made to their cards, while 32 percent say they are not concerned. Consequently, 58 percent of voters say they do not mind waiting at longer checkout lines that may be caused by the added security benefits of the EMV chip cards, while 13 percent say they prefer regular magnetic-stripe cards, even if they are less secure.

• **Voters are using mobile technology to make payments, but using "tap and pay" less frequently.** Fifty percent of voters say they have used a mobile device, such as a tablet or smartphone, to make a purchase in the past year. Roughly 72 percent of respondents ages 18-44 have used a mobile device to make a payment. However, only one in 10 voters have used tap and pay mobile wallets in the past year. Voters also are aware that mobile wallets such as Apple Pay and Android Pay utilize near-field communication security. Forty-three percent say they are aware that it is the same technology used in EMV credit/debit cards.

• **Consumers question mobile devices' security and ease of use.** When asked for possible reasons why voters do not use tap and pay, most voters choose "data security" (39%) as a concern. Voters also say that using a credit or debit card is easier (35%), and that swiping a credit or debit card is easier (27%).

• **Consumers seek convenience.** If two stores offer a similar price on a product or service, the most important factors when deciding which store to shop at, according to consumers, are convenience (50%), personal information security (28%), and brand loyalty (13%).

• **Security factors into payment choice.** Thirty-one percent say the security of the payment method is the most important factor when deciding how to pay for a purchase.

• **One quarter have been breached.** Twenty-five percent of voters have been affected by a data breach at a store or retailer in the past year.

The survey was conducted via online interviews that took place between Jan. 21 and Jan. 24, 2016, and the data were weighted to approximate a target sample of registered voters based on age, race/ethnicity, gender, educational attainment, region, annual household income, home ownership status, and marital status.

Fast Fact

Forty-three percent of security decision makers are **most concerned with customer data theft** as an outcome of a cyberattack or data breach, followed by intellectual property theft (22%).

Source: "2016 Security Pressures Report," Trustwave

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Global Research Shows Growth in Social Payments

Social media companies continue to build a presence in the international e-commerce space, according to Juniper Research. Findings from the firm's latest research, published in "Digital Payment Strategies: Online, Mobile, & Contactless, 2016-2020," point to the introduction of "buy" buttons by several leading companies, including Facebook, Pinterest, and Instagram. These buttons allow users to make purchases directly from the companies' mobile apps in a seamless and quick transaction.

Juniper predicts that digital e-commerce on social media activity will increasingly extend into the person-to-person (P2P) payments space, following the example of WeChat in China. WeChat saw more than 32 billion "red envelope" monetary gifts sent in a six-day period in February.

"Facebook has already rolled out a P2P service linked to its Messenger service in the United States, and we would expect additional deployments in other core markets over the next year or so," says the report.

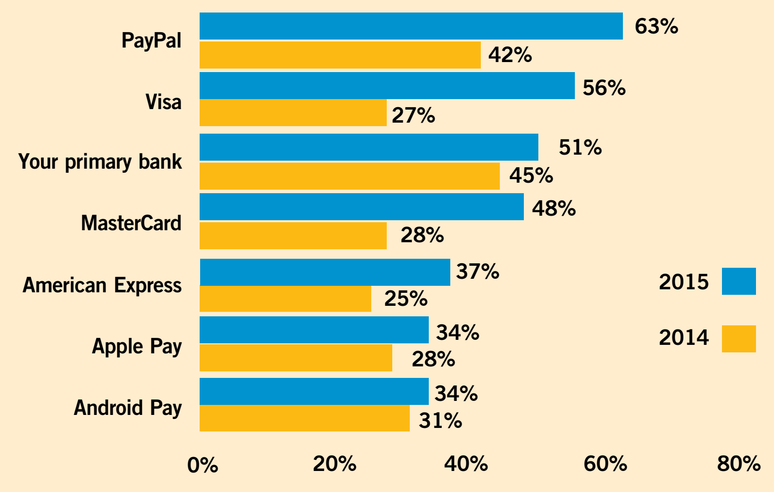
Looking at digital payments on a larger scale, Juniper predicts the annual transaction value of online, mobile, and contactless payments to reach $3.6 trillion this year, a 20 percent increase from $3 trillion in 2015. The recent surge in contactless payments is expected to continue, fueled by further scaling up of infrastructure rollout and increased card payment limits in key markets.

The study also finds that while cards will account for 90 percent of contactless payments over the next five years, the deployment of near-field communications payments by Apple, Samsung, and similar companies will increase consumer awareness and usage of smartphones to fulfill transactions.

Mobile wallet adoption is forecasted to continue to accelerate in developing markets, with nearly 20 countries across Asia and Sub-Saharan Africa now having more mobile money accounts than bank accounts. The research explains that as wallet users reached critical mass in these markets, service providers introduced more sophisticated payment services, such as loans and micro-insurance, thereby hastening the drive toward financial inclusivity for the unbanked.

Infographic

Consumers Rank Likelihood of Adoption By Mobile Wallet Provider

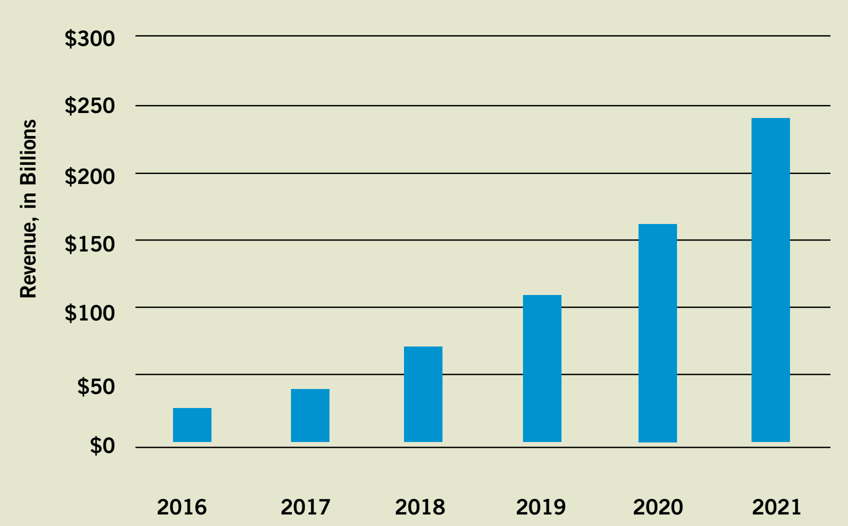


Percent of all smartphone and tablet owners

Source: "What's In Your Mobile Wallet? 2016," Javelin

Infographic

Global Mobile NFC Revenue: 2016-2021



Source: "Mobile NFC Payment Forecast Update: 2004-2021," Strategy Analytics

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'New Account Fraud' On the Rise in United States

A new study from Javelin has found that fraud at physical storefronts has evolved, with fewer criminals committing counterfeit card fraud and more fraudsters relying on new account fraud. "New account fraud" is commonly defined as fraud that occurs within the first 90 days that an account is open; often, accounts are opened with the sole intent to commit fraud.

The authors of the "2016 Identity Fraud: Fraud Hits an Inflection Point" report found that new account fraud rose last year as the United States transitioned to the Europay, MasterCard, and Visa (EMV) standard. This movement resulted in a 113 percent increase in new account fraud, which now comprises 20 percent of all fraud losses. "As EMV becomes more ubiquitous, fraud at physical storefronts becomes very different, driving a movement from counterfeit card fraud to new account fraud," say the report authors. "With growing online retail volume comes greater opportunity for criminals, pushing fraud to card-not-present channels."

In addition, the researchers found a significant amount of stolen U.S. card data is being used outside of the country: Eighteen percent of the 2015 identity fraud instances using U.S. credit cards, or $2.4 billion, was conducted outside of the United States. There was an average of $1,585 spent per incident.

The report also noted that the number of identity fraud victims in 2015 was at its second highest level in six years, although the amount stolen was at its lowest point in that same timeframe. Overall, there were 13.1 million identity fraud victims in 2015, totaling approximately $15 billion.

Moves & Mergers

Blackhawk Network announced that Anil D. Aggarwal has been appointed to its board of directors and Nominating and Corporate Governance Committee. Aggarwal has more than 15 years of experience in the payments industry and is currently a venture partner at Oak HC/FT and the CEO and chairman of Shoptalk. He also was the founder Money20/20 and served as the head of business development, payments, and wallet at Google.

In addition, Blackhawk also announced the acquisition of extrameasures, a prepaid consumer promotions and incentives company. The company reports that the acquisition will broaden the reach of its incentive and engagement business.

Cayan has named Chris Menard as CFO. He will oversee the organization's finance and accounting functions, in addition to human resources and corporate development. Prior to joining Cayan, Menard served as executive vice president and CFO for both Bit9 and Brightcove. He also has held multiple senior-level administrative positions, including CFO, at Phase Forward.

Ingenico Group has named Suzan Denoncourt as managing director for Ingenico Group Canada, responsible for all aspects of Canada's operations. An 11-year veteran of the company, she succeeds David Chaudhari, who held the position since 2011. She previously led all sales and business development for Ingenico Group Canada.

JetPay Corporation has signed a merger agreement with CollectorSolutions Inc. (CSI), a Pensacola, Florida-based debit and credit card processing company. JetPay reports that CSI is expected to add about $700 million of annual credit and debit card processing volume and approximately $4.5 billion of annual e-check processing volume to JetPay. On a combined basis, the company says it will serve more than 15,300 U.S. merchants.

Kount Inc. reports Linda Fayne Levinson has joined its board of directors. Levinson serves as chair of the board of Hertz and as a director at Ingram Micro, Jacobs Engineering Group, NCR, and Western Union. Earlier in her career, she was a partner at McKinsey & Company, Wings Partners, and GRP Partners, and she was an executive at American Express Travel Related Services Co.

Mitek's board of directors has elected CEO James B. DeBello as chairman. The appointment follows the retirement and resignation of John M. Thornton, who served Mitek for 30 years. DeBello has served as a director since November 1994 and as Mitek's president and CEO since May 2003.

Mitek also appointed Bruce Hansen as lead independent director of the board with increased responsibility. In his new role, Hansen will serve as liaison between the chairman and the independent directors, among other responsibilities.

Trustwave has appointed Michael Petitti to senior vice president of global alliances. Petitti will be responsible for global alliance partnerships and payment services programs, payment card industry relationships, and compliance and payment services strategy.

Over the past 13 years, Petitti has led various teams at Trustwave. He has served as executive director of the Asia-Pacific region, and he was the company's chief marketing officer. Petitti also served on the board of advisors and the board of directors of the Merchant Risk Council.

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Persuading the Policymakers

Blockchain technology, money transmitters, and the fintech industry are among the hot topics being addressed by ETA's advocacy efforts

By Scott Talbott

As the presidential race heats up, the second session of the 114th Congress is practically over. Congress will have a brief window in September, and then again in late November and December, to advance any legislative agenda, but the number of legislative days is rapidly running out. However, regulators and state legislatures remain active as they try and grapple with the modern payments world.

ETA is the leading organization advocating for the payments community. At a time of unprecedented change in the payments industry, ETA's government relations efforts are enormously important to our industry. Federal, state, and international policymakers have a huge impact on how we do business—and this influence is only growing stronger. Let's take a closer look at the work ETA is doing on behalf of the payments industry.

Legislative Activity

ETA has had a voice in educating policymakers on a number of important payments-related issues:

• **Blockchain.** ETA was invited to testify on blockchain technology before the Commerce, Manufacturing, and Trade Subcommittee of the House Energy and Commerce Committee. A representative from Circle delivered the testimony on behalf of ETA. A representative of Coinbase, another ETA member, also testified. The testimony focused on the benefits and challenges of using blockchain technology.

• **Cybersecurity.** ETA strongly supported the creation of a uniform national standard for breach notification. While five bills have been introduced to create a national standard, none have reached the desk of President Barack Obama. ETA will continue to press for passage, using direct lobbying and grassroots advocacy.

• **Operation Choke Point.** The House passed a bill to prevent the Department of Justice and federal regulators from pursuing Operation Choke Point. ETA supported this bill and is working with the Senate to get a companion bill introduced.

• **Fintech.** A package of bills designed to ease regulatory burdens for the fintech industry is being prepared in the House. The package is expected to focus on granting a federal license to nonbank lenders, allowing the use of

alternative information for underwriting, and restricting the effect of disparate impact.

• **Patent Reform.** ETA will continue working with a coalition of trades to push for patent reform in 2016.

• **Trans Pacific Partnership.** ETA is supportive of the Trans Pacific Partnership and the carve-out for electronic payments services from the requirement for local data storage. Passage of the secret 12-country, multilateral trade pact faces an uphill climb in the United States and abroad.

Regulatory Outlook

ETA is continuing its efforts to influence regulatory agendas in many areas:

• **Online Small Business Lenders.** ETA launched a major initiative to help educate policymakers about the economic benefits of online small business lenders. Looking to differentiate ourselves from consumer lenders, ETA has filed comments with the U.S. Treasury, fielded a survey, and conducted many educational initiatives.

• **Money Transmitters.** ETA has been educating state regulators who are focused on the intersection of money transmitter laws and the modern payments system. In particular, ETA is very focused on Pennsylvania and Washington. In Washington, ETA formally challenged the Department of Financial Institutions' Division of Consumer Services' interpretation of the money transmitter law. That challenge is pending.

In addition, the New York Department of Financial Services has issued a proposed rulemaking in which it proposes

to require banks and money transmitters to include prescriptive criteria in their anti-money-laundering programs and impose personal liability on chief compliance officers. ETA filed comments opposing the department's proposal.

• **Big Data.** Given that many ETA members utilize Big Data to fight fraud, help underwrite loans, and engage in other business purposes, ETA has formed a new working group to help promote the beneficial uses of Big Data.

State Legislatures

ETA has been busy working with state legislators on several important issues. In particular, there has been a great deal of activity in Washington State, where ETA continues its efforts to oppose the state's Department of Revenue proposed treatment of the merchant discount as taxable revenue to acquirers and/or processors. ETA filed an objection to an effort by the state's Department of Financial Services to treat payment processors as money transmitters.

Be a Payments Advocate

ETA encourages all members to get involved in ETA's advocacy efforts. It is vital for payments industry leaders to actively engage the legislators and regulators that oversee the payments industry. There are many opportunities to take part in these efforts:

• Sign up to participate in one of ETA's many councils by visiting http://www.electran.org/about/call-for-2016-committees-councils.

• Find out how to get started in ETA's grassroots efforts by visiting http://voiceofpayments.org.

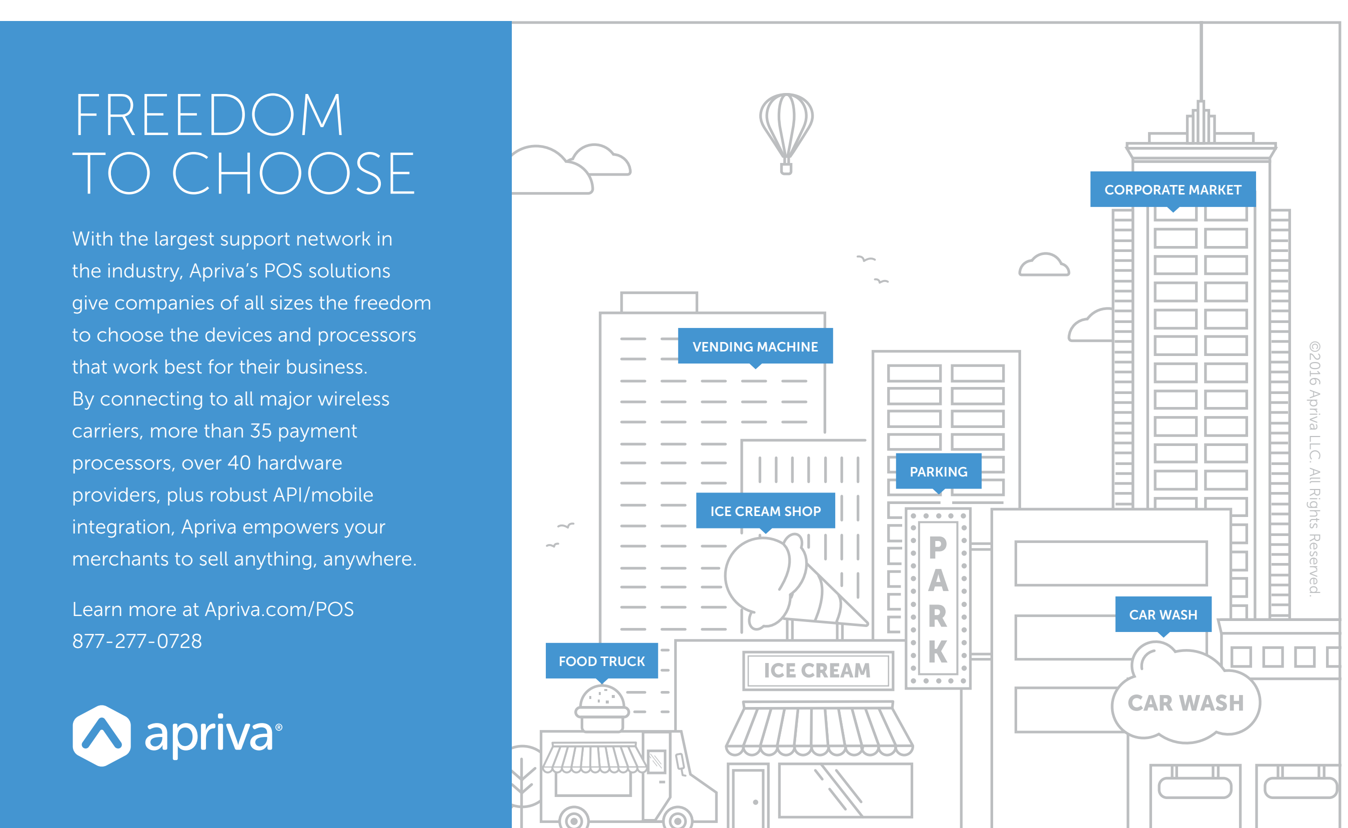
• Learn more about ETAPAC, the ETA Political Action Committee, which is an important tool to help advance the industry's policy goals in Washington D.C. Visit http://www.electran.org/ETAPAC.

• Take part in ETA's Policy Day on June 2 in Washington, D.C., which will focus on money transmitters. Three panels will concentrate on the various aspects of federal and state regulation of money transmitting.

• Discover what will be covered during the first meeting of the ETA Lawyer's Committee. The meeting will take place in Washington D.C., on June 3, and will feature guest speakers from Congress as well as federal and state regulators. Discussions will focus on legal issues facing ETA members, such as e-discovery, Operation Choke Point, and data security.

Everyone in the payments industry should explore the many ways ETA is advocating on their behalf—and find out how to pitch in and share their talents. ***TT***

Scott Talbott is senior vice president of government affairs for ETA. Reach him at stalbott@electran.org or 800/695.5509.



New Rules of Acquiring

By Ed McKinley

How ISOs are surviving and thriving in the world of modern payments

Does anyone remember the thud of the morning paper landing on the porch? The sound of the chimes that rang when it was time to put more coins in a pay phone? The click-clack of those charming metal charge-a-plates at the local department store? For better or worse, everything changes—even in the payments business.

A decade ago, ISO reps pounded the pavement in search of shopkeepers who didn't accept credit cards. Trudging door to door, they sold or leased the payment terminals they kept stashed in the trunk of their cars. But as the market became saturated, their business model turned woefully inadequate. Now, those terminals are as current as black-and-white TVs or desktop computers. The industry has changed so much that today's ISOs and agents have undergone what might seem like a paradigm shift. Instead of presenting themselves solely as salespeople, modern acquirers position themselves as consultants and solutions providers. They form partnerships with tech experts, develop proprietary software, and do whatever else it takes to make themselves irreplaceable to the merchants they serve, says Donna Embry, chief payments advisor at Payment Alliance International, a Louisville, Kentucky-based super ISO. "It's no longer a matter of walking in and selling a box," she says. "You have to be a jack-of-all-trades or align yourself with someone who is."

The evolution has been so profound for a Boston-based company that it changed its name to Cayan to reflect its new status as a tech company. It abandoned its previous moniker, Merchant Warehouse, because it suggested supplying terminals, says Henry Helgeson, ETA CPP, the firm's co-founder and CEO. Over the years, the technological advances at the company have included MerchantWARE TransPort, which encrypts transactions, and BINSmart, which prevents transaction downgrades. The company's tech progress has culminated in its Genius Platform, which Helgeson claims will handle all present and future payment transactions. Along the way, the company's tech staff has grown to 120 employees.

While today's ISOs and sales agents still promote terminals and transaction services, the most successful ones concentrate on marketing "higher-value" products and services, according to industry experts. That includes integrated software and hardware that help merchants run their businesses more efficiently and more profitably by tracking sales; restocking inventory; overseeing accounting; tending to payroll; coping with taxes; and ensuring compliance with laws, regulations, and guidelines.

One of the biggest changes in the business has come as players became "product centric," observes Rick Oglesby, a Phoenix-based partner and head of product consulting and market research for Double Diamond Group LLC. "They used to have a one-size-fits-all product and one-size-fits-all marketing strategy," he says. "Now, it's about [targeting merchants that have a real need] for your product or being able to match a

> "[MODERN ACQUIRERS] FORM PARTNERSHIPS WITH TECH EXPERTS, DEVELOP PROPRIETARY SOFTWARE, AND DO WHATEVER ELSE IT TAKES TO MAKE THEMSELVES IRREPLACEABLE TO THE MERCHANTS THEY SERVE."
>
> —DONNA EMBRY, PAYMENT ALLIANCE INTERNATIONAL

Bonus Audio Content: Reading this at TRANSACT 16? Don't miss "Disruptive Forces in the Payments Industry" Thursday, April 21 at 10:30 AM in South Pacific CD. Or, log in and listen after the conference at http://bit.ly/1OZo3eR.

ETA CPP: The Value of the Knowledgeable Payments Professional

Eric Bostic, ETA CPP

Heather Petersen, ETA CPP

Henry Helgeson, ETA CPP

Four years ago, Eric Bostic was still feeling the first rush of excitement from earning the ETA Certified Payments Professional (ETA CPP) credential, and he couldn't help but talk up the certification when pitching his company's transaction services to an important potential customer, the CEO of a large nationwide daycare chain. When the CEO visited the ETA site to learn more about about the certification, she was so impressed that she went back to her board and argued in favor of awarding the contract to Bostic's Charlotte, North Carolina-based ISO. "I won that business based on the fact that I was certified and the other people competing weren't," Bostic explains. Now, that customer accounts for more than half of the transactions his company handles.

The ETA CPP has become an integral part of the way some ISOs present themselves to the public. For example, National Merchants Association, an ISO with headquarters in Temecula, California, uses the credential as part of a sales strategy that's consultative and education-based, according to CEO Heather Petersen. "All of our [employees] who have the ETA CPP wear their [lapel pins], and often they're asked about it by a merchant," she says. "They carry a flier that explains why [merchants] should work with an ETA CPP."

Besides its outward-facing advantages, the credential can strengthen internal operations, notes Henry Helgeson, CEO of Cayan, a Boston-based acquirer and tech company. Promoting the designation inside the company shows that management is investing in its employees and is willing to help them set their career goals, he says. "It has become a badge for everyone who has [earned] it," Helgeson says of the certification.

Although the ETA CPP provides a competitive advantage, Petersen would like to see many more salespeople earn the certification. She envisions a day sometime soon when the nation's ISOs and agents will capitalize on the credential to raise the industry's standards of professionalism and speak to the public with a single, unified voice. That time is drawing close enough, she says, that ETA is beginning to publicize the credential to merchants. The association postponed its big ETA CPP push among merchants until now because it wanted to make sure it had minted enough ETA CPPs to meet the demand anticipated among merchants as they learn about the credential. More than 1,100 industry practitioners have earned the designation, she says.

Petersen, Helgeson, and Bostic were among the first to pass the ETA CPP exam and earn the credential. "I hate taking tests, and I hadn't taken a test since college," Bostic says, noting that working in the industry every day does help prepare candidates for the examination. Still, it pays to study the ETA materials when prepping for the exam, cautions Petersen. She recommends that candidates study the available study aids because the test covers information that she considers vital to excelling in merchant services. Helgeson is so passionate in his support of the credential that he wanted to be the first to receive it. He's not certain he achieved that aim, but taking the initial test in the Eastern Time Zone at least placed him in the first group, he says.

In Petersen's view, virtually everyone in the profession should earn the credential—not just those who meet with the public. The test covers six domains that define the knowledge a payments industry practitioner must have in order to do his or her job competently, she maintains. "Just as a salesperson needs to understand risk, a risk person needs to understand sales," she says. "To effectively calculate risk, you need to know how it was sold." Petersen requires all of her employees to obtain the credential within one year of the time they become eligible.

Petersen also rewards her independent reps who have earned the ETA CPP by adding 5 percent to their residuals. Bostic encourages his independent sales agents to get the credential, and six of them have now attained it. "The ones who are serious about making this a career have taken the exam, and they have passed," he says.

ISOs of all sizes should embrace the ETA CPP, Petersen, Bostic, and Helgeson agree. Bostic's nine-year-old company, Bostic & Associates LLC, employs three full-time employees and works with 24 independent sales reps. He considers 75 percent of the salespeople active because they send in two or three deals a month, while his best submit 10 to 15 deals monthly. His 2,300 accounts produce about $80 million in transactions annually, he says.

Petersen founded National Merchants Association 12 years ago, and she has added 30 employees this year, for a total of 80. The business has been expanding drastically through organic growth, and she's negotiating to buy some portfolios and some complete ISOs. Petersen's 3,500 merchants had nearly $900 million in transaction volume last year.

Cayan, which Helgeson co-founded in 1998, employs 450. Some 102 of its Boston-based workers have attained the certification, and the ETA CPP in the company's Belfast, Northern Ireland, office may be the first person to have earned the designation while working abroad, Helgeson says. The company handles $14.5 billion in transaction volume annually, he notes.

Size aside, skill and integrity always count in payments, Bostic, Petersen, and Helgeson agree. Pursuing the ETA CPP strengthens both of those qualities—and having the credential demonstrates that to merchants. There's no better testimonial to that than the decision of the daycare center to sign on with Bostic's ISO, he says, noting that "they wanted their business in the hands of someone who's certified."

merchant to a broad spectrum of products that you have on the shelf."

ISOs and agents have also had to become smarter about how they present their products, Embry maintains. They may make little or nothing from the transaction processing services they sell, she says, but they can compensate with higher margins from products such as merchant cash advances and small-business loans. Embry also explains that the industry has made gift cards, loyalty schemes, reward points, coupons, and special offers part of the regular product mix: The consumer data garnered through those programs has also helped merchants understand their customers and gain insight into how their businesses work. As retailers have branched out into online and mobile commerce, ISOs and agents have been there for them with technology that eases the transition to an omnichannel presence.

Some of today's ISOs operate their own payment gateways for online or POS transactions, Oglesby says, adding that such functions have become part of a trend among ISOs to take over functions formerly associated only with processors. "If you own any piece of the value chain, you can create differentiation," he maintains. "You can customize to any set of needs." Aiding merchants with those duties, products, and services builds relationships and fights attrition, says Mark Dunn, president of Field Guide Enterprises, a Hartland, Wisconsin-based payments consulting company. "The more touch points you have with a merchant, the more services you're providing—and the [more] valued those services are, the less of a commodity your service is going to be," he maintains.

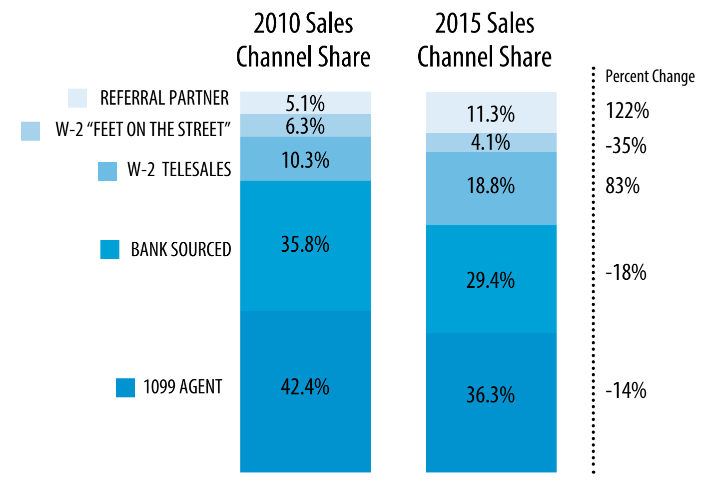
Cyclical Complexities

While the industry has shaken off large parts of its past, history still has a way of repeating itself. The difference is that events now recur in more complicated ways than before, Embry says. For example, ISOs and agents are once again laboring to replace or upgrade terminals to ready them for chip cards that are compliant with the Europay, MasterCard, and Visa (EMV) standard. "It's back to the future," she observes. But now the terminals have become part of complex integrated systems. The industry has to contend with a web of certifications to coax all of the equipment to work together, says Embry.

Meanwhile, ISOs and agents are benefitting from a technological revolution. According to Embry, tablets and laptops have replaced paper and fax machines, easing the way new merchants are brought into their portfolios. Days or weeks of waiting for approval and setup have morphed into minutes and hours.

Many of the industry players who got their start in the old days have remained current by changing with the times, says Dunn. "I've seen a number of ISOs that have been around 15 to 20 years that have really stepped up their game and are competing on many different levels with a lot of new companies," he says. "They're improving their processes." That includes offering better products, such as POS systems integrated with business activities; providing additional processing functions, such as gateways; and becoming consultative, by learning the tech side of the industry, he notes. Making those changes, he adds, has required a large financial commitment that's been beyond the means of smaller players.

Change In Sales Channel Merchant Share 2010-2015



Source: Acquiring Industry Metrics database of 3.3 million merchants, The Strawhecker Group

At the same time, some less familiar faces are appearing in the crowd. The new players range from landlords to software developers, often known as independent software vendors (ISVs). Despite the differences in their backgrounds, many of the newcomers got their start in the business by providing referrals to ISOs or agents. Then, some came to realize that they could offer transaction services on their own and create a steady second source of income. ISVs that have decided against becoming payment companies, possibly because of the mounting complexity of handling EMV and mobile payments, have chosen to form partnerships with ISOs.

Shifting Salesforce Needs

Concern about technology aside, ISOs are coping with changes in the way they sell their products and services to merchants. Many are relying more on leads provided by referral strategies, according to The Strawhecker Group's reporting from its Acquiring Industry Metrics database of 3.3 million merchants. Bank-focused channels and the

traditional 1099 sales force have declined over the past five years, while W-2-based telesales business development is becoming increasingly more important to ISOs.

Regardless of whether the process proceeds over the phone or face-to-face, selling remains a vital part of the business strategy and continues to present some of the biggest challenges. "It's become harder to get inside salespeople or sales agents than it was 10 years ago. Much harder," says Dunn. That includes the increasingly difficult task of finding sales managers capable of putting together a sales team and managing it. According to Dunn, many new salespeople can't even finish a training period: "They voluntarily leave after two weeks or two days."

Sales techniques that succeeded in the past don't always work today, according to Dunn and other experts. Basing a pitch on low rates can perpetuate a "race to the bottom," he warns, adding that ISOs that lack any higher-value services wind up struggling to find an effective sales message.

Characteristics of 'High-Multiple' Acquirers

Characteristics of Modern Acquirers
- Differentiated technology that provides competitive advantage
- Sustainable strategy and/or defendable market niche
- Sustainable sales channel

+

Strong Portfolio Performance
- Solid sales growth
- Low account attrition
- Consistent net revenue margin
- Low losses
- Good profitability

=

Higher Value

Source: The Strawhecker Group

> "IF YOU OWN ANY PIECE OF THE VALUE CHAIN, YOU CAN CREATE DIFFERENTIATION."
>
> —RICK OGLESBY, DOUBLE DIAMOND GROUP

Even if ISOs build a solid team and a workable approach, they may struggle to craft a compensation plan that rewards and motivates. Employees have become skeptical of plans that rely heavily on commissions, so finding the right balance of base pay and incentives has become vital for ISOs, Dunn says. He also asserts that salespeople have become less entrepreneurial. In his view, today's young sales reps seem less likely than their predecessors to abide the delayed gratification that comes with learning the business and gradually building up their residuals.

Meanwhile, some of the industry's new entrants simply skip the human approach to sales. Square, for example, enables merchants to set up their own transaction accounts online. Although connecting merchants directly to the card brands without the need for traditional processors, ISOs, and sales agents is undeniably disruptive, those entities still have a role. Moreover, eliminating the ISO channel works only for the smallest of merchants. As businesses grow in size and complexity they depend more on the personal attention ISOs can provide, which often includes round-the-clock customer service and individualized consultation for merchants struggling to comply with standards and regulations, for example.

New Rules, Old Friends

Indeed, consultative ISOs can still aid merchants who face increasing complications. "The days of the corner retail store where the guy has a little Casio cash register and TRANZ 380 next to it are gone," Dunn says. "There aren't many businesses being put together that way. Virtually none." But some ISOs may become unrecognizable. Many have already redefined themselves as processors or tech companies, Embry notes. "Look at EVO, Vantiv, and TransFirst—all of those started as pure sales organizations and then evolved," she says.

Still, nothing can replace the relationships ISOs and agents forge with their customers, Oglesby maintains. "You hear about 'the last mile effect,'" he says. "That means getting to the actual merchant. If you're processing millions and millions of transactions, you still need help extending that platform out to the merchants." ***TT***

Ed McKinley is a contributing writer for Transaction Trends. *Reach him at edmckinley773@yahoo.com.*

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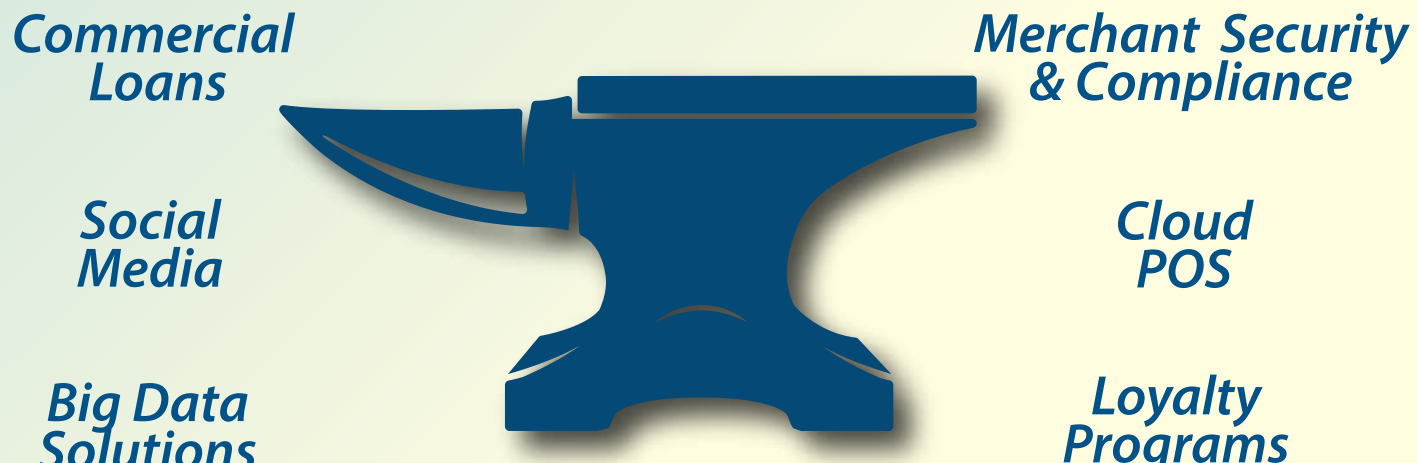

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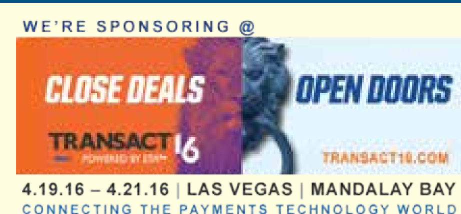

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Can't We Be Friends?

By Josephine Rossi

Moving past the semantics of disruption, **fintech startups** eye joint partnerships

JPMorgan CEO Jamie Dimon's now famous proclamation, "Silicon Valley is coming," has become a reality. And while Dimon's statement to shareholders may not be quite as dire of a message as Paul Revere folklore, it does acknowledge an inevitable truth: Fintech is reshaping financial services.

Take, for example, the more than 2,400 payment startups registered on funding site Angel List as of mid-March, and their average valuation: $4.1 million. Or, consider how fintech funding has exploded in the past 10 years. Last year, investors shelled out $19 billion, up from $12 billion in 2014 and $1.8 billion in 2010, according to CitiGroup.

What's fueling the growth? Several new studies have examined the rise of fintech companies and what they bring to the financial services table. One of the most recent is PwC's "Global FinTech Survey 2016," which shows responses from 544 leaders in various segments of the financial services industry —including "payments institutions"—across 46 countries. The study finds that fintech startups' inherently customer-centric solutions are the main reason for their ascent. PwC analysts further predict that as the financial services consumer profile continues to skew more heavily toward Generation X and digital-native Millennials over the next 10 years, demand for speed and convenience will only accelerate adoption of fintech solutions.

Getting to Know Fintech

Consumer focus is only one variable in the fintech power equation. Startups in the payments space say they can innovate selectively and specifically because they have a different business culture—one that focuses more on quality hiring and agility and less on shareholders and perfection.

"Culture is a broad topic, and unfortunately, one I think people try to describe in writing when, in fact, it is cre-

ated by actions, not words," says Chip Kahn, founder and CEO of Boomtown, a startup specializing in business support services. "We have a small group of incredibly bright, committed people who seek to do the right thing. So in that respect, culture is created first and foremost by hiring decisions."

Trusting that employees have good intentions also helps CardFlight CEO Derek Webster foster a culture that inspires the necessary ingenuity to earn ETA's 2014 Technology Innovation Award. "You definitely have to take some calculated risks," he says. "A large company is much more defensively minded, and [employees] aim to avoid having a mistake blamed on them, whereas we encourage more of a creative culture. Obviously, you have to have the right amount of rigor—we are moving hundreds of millions of dollars of other people's money electronically [but] we will try a lot of things."

Another variable fintech companies, particularly smaller firms and startups, can control is a dynamic product process. Many employ "agile" methodology for iterative development with sprints on a weekly, biweekly, or monthly basis. "One of the big challenges when you think about people who have annual release cycles is that you work on an initiative that is so big that you get behind schedule and you end up having to cut the scope of the work that you're doing," says Webster. "It becomes a crazy and chaotic experience, and sacrifices and cuts are made that you never would have contemplated a year before."

By shortening the development cycle and processes, businesses feel much less pressure to create the perfect product the first time. Proponents say this creates litheness for reacting to surprises and assessing whether steps are absolutely necessary.

"For example, our October 1 EMV certification [for the company's suite of mobile solutions] was a multimonth effort, but we broke it down into pieces," Webster explains. "The big difference is that rather than creating a Gantt chart with 200 processes upfront, six months in advance, and those 200 steps are sacred, this is more nimble because along the way we are knocking out five or so steps at a time without saying that those other 195 steps are preordained."

The process, by function, creates operational transparency across departments. And because they are venture-backed, startups also don't have to answer to shareholders, which further seals the deal for a collaborative work environment. That's where their notorious open floor plans come into play. Feedback can be had in real-time, without scheduling meetings, further supporting the effort. "We do have an open floor plan," says Webster. "But an open floor plan of bouncing balls and free lunches doesn't make it all happen. It is correlated, but it's not causal."

All of this differentiation between agile fintechs and incumbent businesses and institutions goes a long way in explaining the "disruptor" moniker industry experts have given startups in the space. In fact, the vast majority (83%) of "traditional" financial institutions say part of their business could be lost to standalone fintech companies; more specifically, fund-transfer and payments institution respondents fear losing up to 28 percent of their market share, according to the PwC study.

"WE ARE FOCUSED MORE ON OUR OWN SUCCESS THEN WE ARE ON DISRUPTING OR PUTTING SOMEONE ELSE OUT OF BUSINESS."

—DEREK WEBSTER, CARDFLIGHT

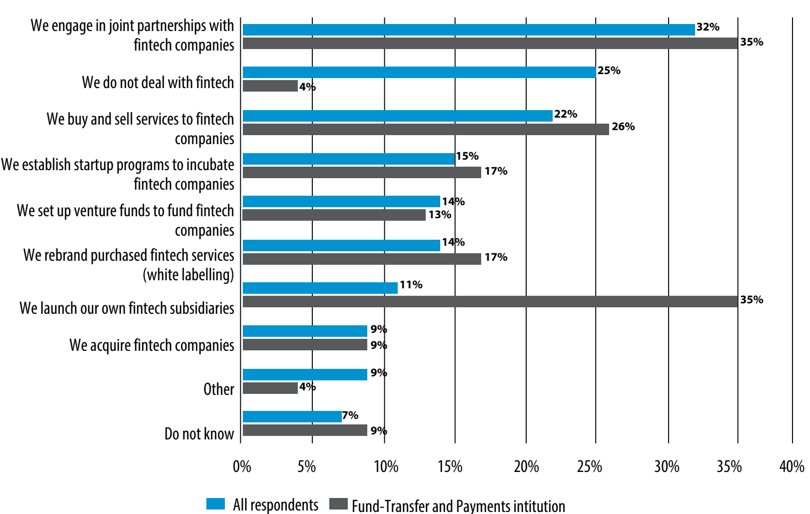
Despite their infamous label, all startups may not be out for legacy blood. Kahn says he sees Boomtown as an "enabler" to the payments industry, not a disruptor. "We help merchant service providers accelerate sales, increase activation rates, drive achievement, and retain valuable customers," he says. "And we do it all in support of our partners' core payments businesses. We're an ingredient in their success."

Webster agrees: "We are not trying to put Visa out of business, and we are not trying to put First Data out of business," he says. "We think there is a role for us in the ecosystem that exists. We are focused more on our own success then we are on disrupting or putting someone else out of business."

Cory Capoccia is president of Womply, a six-year-old startup that uses Big Data to help merchants better understand business performance—a solution that earned the company ETA's 2015 Technology Innovation Award. Capoccia says that while he does consider the firm to be disruptive, the team is "responsible" about it. "Disruption

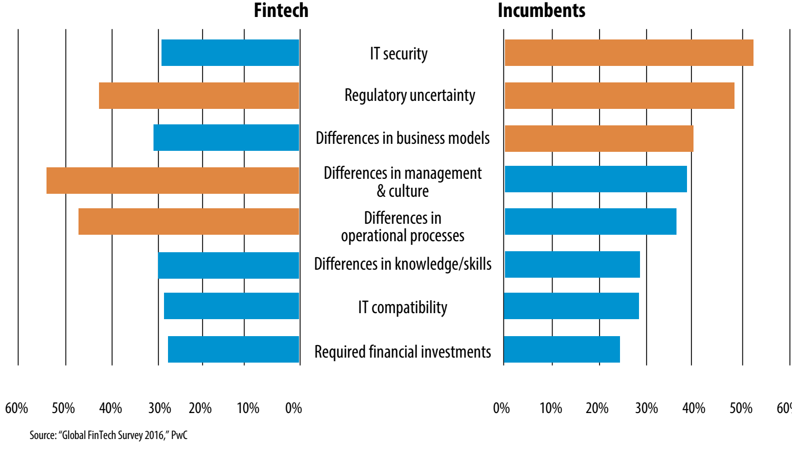
Bonus Audio Content: Reading this at TRANSACT 16? Don't miss "The Fintech Race: How Financial Services Companies Can Compete With Silicon Valley," April 19 at 10:00 AM in South Pacific AB. Or, log in and listen after the conference at http://bit.ly/1RKY9Mw.

How are you currently dealing with fintech companies?



Source: "Global FinTech Survey 2016," PwC
Note: Data filtered via the report's interactive data explorer tool

What challenge did/do you face in dealing with fintech/traditional financial companies?



Source: "Global FinTech Survey 2016," PwC

in and of itself can be very disastrous [if you are] not being respectful of the guardrails that you need to operate in," he explains. "What's in the best interest of all of those involved? Are we making sure that we are not making short-term decisions?"

To Inspire or Get Acquired?

Given the changing climate, analysts advise incumbents to develop a strategy for keeping pace with the challenges and opportunities brought on by fintech. Will it be an acquisition, in-house development, or a joint partnership?

"Acquisition was the traditional route, but seems to have fallen out of fashion," according to "Accelerating Change: London FinTech 2015–2016," a PwC subreport based on the global fintech study and other proprietary data. Highlights from the report say that many companies found the value of the acquisition evaporated when the startup was brought "within the corporate entity."

Sometimes, the default can be a big corporation buying a smaller company and right away facing bureaucracy and conflicting motivations—without a lot of experience navigating those waters, says Ben Brown, a San Francisco-based senior consultant with First Annapolis Consulting. "Then, what you often see is the acquisition underperforming" once the transition takes place.

Among his myriad duties, Brown advises on strategy development regarding fintech and provides M&A advisory services in the payments space. He advises incumbent clients to develop a clear view of their strategy and conduct a gap assessment ahead of time—before they start identifying acquisition targets. He also highly recommends businesses pay attention to culture. "Do the two organizations have the same culture—or at least ones that could be merged over time? If you have a 'move fast and break things' startup and a compliance- and stability-minded acquirer, that could be a recipe for trouble in some cases," says Brown. He cites the First Data Corp.-Clover acquisition as one positive example. "First Data let Clover stay with its own management team in place in Palo Alto [California] and the team functions essentially as a separate company, with First Data acting as a distribution channel. I give them credit for that."

Still, Womply is "definitely not" looking to be acquired, says Capoccia, who notes that the business "is much more valuable as an independently run organization. We work with a lot of different partners, and if someone strategic were to acquire us, I don't think that is something they would respond well to."

But when compared to in-house product development, M&A activity can have upsides. For example, a $1 billion acquisition means executive management is fully committed, as opposed to a budget increase to hire a few project managers and developers to build a product in-house. "That's something you can easily cancel if the winds change in a different direction," says Brown.

Purely Partners

Beyond the customer-centric experience, fintech also offers incumbent financial services more business efficiency, differentiation, and improved customer retention, according to the PwC study. Seventy-four percent of fund-transfer and payment institutions consider additional revenues to be a prime opportunity from fintech businesses.

This describes Womply's partnership value proposition, according to Capoccia's explanation of the company's roughly 30 partnerships with ISOs, acquirers, and processors. "We want to be thought of as an extension of their overall operations," he says. "The ultimate goal is to help individual merchants on Main Street have the same level of sophistication and capabilities as tier 1 national retailers. [We create] conversations between the payments profes-

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sionals and their merchants on how they can better run their business, protect their reputation, and understand their customers and their competition."

Womply's payments partners decrease attrition rates while adding incremental revenue, says Capoccia. "I do have enough empirical evidence to show that partnerships actually add material value to the point that when we look at our public clients' earnings calls, they mention how strategic our products are as a fit for them. I know that I am biased, but I also know that it works, and we have been proven year over year, many times out."

Another benefit of a partnership, compared to building a solution in-house, is speed. "[Startups] can be outside the corporate culture, so it can be much easier to dabble in an area that you are not sure you want to commit to," says Brown.

And while some relationships may appear to be the Davids making nice with the Goliaths, joint partnerships aren't one-sided. PwC analysts say that scale is "one of the most obvious barriers for startups looking to enter the payments market." CardFlight, for example, leans on its larger incumbent partners for their sales and distribution channels. "We partner with dozens of companies to go to market," says Webster. "Those companies have different sales teams and market strategies, but many of their merchants need a good mobile solution and that is something we white label or co-brand with our partners."

For incumbent payments businesses debating a partnership or self-development, Webster cautions against shortsightedness. "You need to be thinking about six, 12, 18 months out," he says. "If you pick the best company today and that company does nothing to improve, you are going to end up with something that is far from being best-in-class very quickly. It's not about building at this one point in time; it's about knowing you are prepared to maintain it."

"I think it just comes down to people who are willing to commit to a relationship and really see it as a partnership," says Capoccia. "We definitely see people who say, 'Oh we want to partner with you,' but when it comes down to the agreement and we get to know the rest of their team, we recognize that they really are looking for more of a vendor relationship. I think that is a disservice to everyone.

"There is a temptation in this industry for someone to say, 'No, we need to own the merchant relationship, we need to build everything in-house,'" Capoccia continues. "The people who say that have not delivered anything that has helped them be competitive. Instead, they are now losing their merchants to competitors who are either more forward thinking in solution development, or they are losing them to tech companies like Square who are building new products and capabilities and delivering them to the merchants. So, I think it is having a new mindset that together through a partnership, they can really deliver incremental value to their merchants and still remain very competitive."***TT***

Josephine Rossi is editor of Transaction Trends. *Reach her at jrossi@contentcommunicators.com.*

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Capital Needs

By Ed McKinley

How the **human touch** still makes an impact in the technology-driven business of alternative financing

Advances in technology are taking some of the risk out of the alternative small-business finance industry. According to some, it's simply a matter of asking computer algorithms to calculate a recommendation on whether an applicant deserves a merchant cash advance or qualifies for an unsecured business loan. The process is quick: The machines crunch numbers more efficiently and accurately than any human ever could. However, many of the industry's brokers and funders maintain that nothing will ever alleviate the need for humans in underwriting.

The alternative funding industry started up at the beginning of the 21st century—thus it remains a neophyte in the financial world, especially in comparison with the 3,000-year history of traditional banks. The fledgling alt finance companies found a niche by extending credit to merchants in deals that banks found too small, insufficiently profitable, and too much trouble to underwrite. Alt funding began by offering merchant cash advances, an arrangement in which a funder provides a merchant with a lump sum of cash that's paid back by splitting the revenues from credit card receipts. In the last few years, the industry also has begun offering small-business loans with scheduled payments debited directly from merchants' bank accounts, often on a daily basis.

Despite its youth, alt finance has come a long way in the quest to predict who will remain solvent and thus represent a sound credit risk. Early entrants to the field—some of them from the world of finance and others from the payments industry—often experimented with cash they took from their own pockets or funds they borrowed from an elderly aunt or other family member, says Andrea Petro, executive vice president and division manager of lender finance for Wells Fargo Capital Finance, a company that makes commercial loans to alternative funders. "It was a small, entrepreneurial effort," Petro says of those early days. "A number of these companies started with maybe $100,000. They would make 10 [merchant

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cash advances] of $10,000 and collect them in 90 days. That's how they started building their knowledge of the types of risk that were reasonable to take on."

The industry's pioneers quickly increased their understanding of underwriting because of the nature of the business, Petro says. The short duration of the advances, often 90 days, enabled them to test four underwriting hypotheses in just a year. In comparison, in the auto loan business, she explains, it can take five years to find out what's working and what's not. Funders using their own capital enjoyed the latitude to tinker with their offerings, Petro says. They could, for example, extend the target term to four months instead of three, which enabled them to find out how the change might influence their losses, she says.

Growing Pains

But industries mature, and, after a few years' time, the alt finance business began looking more professional. Companies hired statisticians and mathematicians with postgraduate degrees, job experience in related fields, and a knowledge of how to test data, Petro says. Once those pros were in position, the next step came when alt funders began securing loans from institutional lenders, Petro explains. The fact that they qualified for that capital attests to their growing maturity in underwriting, she says. Still, that prowess couldn't shield most of the industry from the ravages of the Great Recession, according to Joel Magerman, CEO of Bryant Park Capital, which makes loans to funders. "I wouldn't t be surprised if 80 percent of them went out of business, and their credit losses more than doubled," he says. "They went up to 18 or even 20 percent credit losses in those days."

Bonus Audio Content: Reading this at TRANSACT 16? Don't miss "The Evolution of Alternative Finance," April 20 at 10:30 AM in Islander H. Or, log in and listen after the conference at http://bit.ly/1mWtVt8.

The survivors, however, emerged stronger and wiser, says Jared Weitz, CEO of United Capital Source LLC, a New York-based funder. The companies that were still standing also found themselves well-positioned to take advantage of a number of favorable factors that converged as the financial crisis was easing, he says.

First, when real estate lost its glow, wealthy investors directed some of their capital into the alternative finance busi-

ness. Funders that weathered the financial meltdown began lowering the fees they charged for capital, lengthening the average repayment period, and catering to more credit-worthy merchants. In the meantime, the Dodd-Frank Financial Regulatory Reform Bill and Basel III, which the recession had spawned, had the unintended effect of keeping banks out of the market by barring them from endeavors where they're inexperienced. Meanwhile, the Small Business Finance Association, known at the time as the North American Merchant Advance Association, succeeded in polishing the industry's image, making the case in the media that the high risk of merchant cash advances justifies high fees. At the same time, unsecured loans became more widespread, providing the industry with a product for customers who didn't take in much revenue on cards. And finally, funders began automating their underwriting with computer algorithms.

With the computerization of underwriting, the data that funders had been collecting for years took on added meaning. "Big Data and alternative data sets came of age after the Great Recession," says David O'Connell, a senior analyst on Aite Group's Wholesale Banking Team. "They had been around before but became a little more democratically available." Besides digesting FICO scores, Dun & Bradstreet reports, and credit card receipts, computers can examine the viability of an applicant's product, test the health of its distribution channels, and scrutinize its management profiles, O'Connell says. The computer, he explains, holds the promise of analyzing broadly defined business conditions to determine what's really going on with a particular merchant. O'Connell offers up this example: Funders were able to discern whether a skateboard shop is having a cash flow problem because the sport has slipped into decline or because its popularity is increasing so quickly that

Personal Investment Worth the Risk: A Case Study

The proprietors of a few ISOs like merchant cash advances and small-business loans so much that they've reached into their own pockets for capital to make deals. "We started by funding the little ones—a couple thousand here, a couple thousand there," recalls Hiram Hernandez Sr., the CEO of First Capital Payments, a Rochester, New York-based ISO. His company began offering the service in 2005, deducting payments from merchants' bank accounts by automated clearing house (ACH).

By 2010, Hernandez had negotiated the revenue split with his processor, First Data Corp. Now, the automatic mechanism is in place for First Capital to collect an agreed-upon portion of a merchant's card receipts. The change enabled the ISO to begin pursuing the advances business in earnest. All told, the ISO has extended credit to more than 100 customers and has placed more than $5 million in funding in the last two years alone. But the profit his company makes from advances and loans isn't the only benefit; Hernandez has turned the practice into a public relations bonanza that brings in business and boosts the company's image. An ad in the local Chamber of Commerce e-newsletter touts the company has reinvested $5 million in the community, he says, and the publication's readership includes the small-business owners who might need advances.

In addition, Hernandez uses the split mechanism to encourage his customers to save their money. His customers can assign a portion of their card receipts—typically 10 percent of their card volume—to an escrow account. It's their money to use as they like, but many save it to catch up on back taxes, rent, or mortgage payments. He charges no fees for the service—another opportunity to burnish his company's image.

Because he provides the capital himself, Hernandez has the discretion to finance merchants that the alternative funding industry would probably reject. He provides an example of one merchant in Florida who needed $150,000 before he started his business and another $50,000 once the doors opened. The applicant didn't look great on paper, but he had a successful cousin that Hernandez had done business with in Rochester. Hernandez decided to make the advance, and the situation is turning out well.

When other ISOs or agents promote advances for First Capital, they can offer the funding at any rate and receive 8 percent of the total as a commission, Hernandez notes. Funders typically charge as much as $1,420 for a $1,000 advance, but he collects an average of $1,380, he says.

Underwriting has presented challenges, but Hernandez and his people have learned to evaluate credit scores and to check Universal Commercial Codes to find out if applicants already have outstanding advances. Paying an IT company to create a system that tracks the loans and advances proved costly but necessary, he says. ETA strongly recommends using the second edition of its "Guidelines on Merchant and ISO Underwriting and Risk Monitoring," which includes specifics and guidance to address underwriting and review for the alt lending space.

The **Alt Finance** Game Is Only as Good as Its Players

Members of the alternative finance industry urge ISOs to do their homework before choosing a partner to provide merchant cash advances and small-business loans, which are two parts of the overall alt finance business. They advise ISOs to look for players who have established reputations for honesty, efficiency, longevity, and transparency and warn against those with past examples of greed, insolvency, and betrayal. Tapping into the heart and soul of the alt finance community couldn't be easier: Most funders are enthusiasts for their chosen profession, and they openly lavish praise and air grievances on industry blogs, publications, and websites such as deBanked and DailyFunder.

Other tips for getting started include the following:

- **Avoid** funders who engage in the dubious practice known in the alt finance industry as "stacking," cautions Jared Weitz, CEO of United Capital Source LLC, a New York-based funder. Stacking refers to providing two or more advances to a merchant at the same time. It can eat up too much of the merchant's revenue and put his business in jeopardy. If the merchant shutters his or her store, the ISO loses the transaction services account and the residuals it pays.

- **Take a pass** on funders with high default rates, says David Goldin, CEO of Capify, another funder with offices in New York. Funders who have trouble collecting on their loans and advances might go out of business and thus tarnish an ISO's relationship with a merchant who was using the defunct company's services. Even if the funder stays afloat, a high default rate means it's putting merchants at risk—something ISOs don't want to happen.

- **Beware** funders who charge the same rates for a credit vehicle of short duration as they do for one with a longer payback period, Goldin says. A product that's out of balance can strain a merchant's cash flow unnecessarily, he notes.

- **Exercise caution** with funders who double as merchant services providers, notes an industry veteran who asks to remain anonymous. Those companies have been known to steal transaction accounts from unwary ISOs that thought they'd found a partner but were actually doing business with a swindler.

- **Consider** seeking a funder who's cautious about providing too much information in Uniform Commercial Code filings, advises another funder who will go nameless. Some funders "reverse engineer" company names in the filings so that competitors can't get easy access to their customers and steal them away, he says.

- **Do business** with a funder who offers a wide variety of products, says Stephen Sheinbaum, founder of Bizfi, a funding provider with headquarters in New York. His platform offers his company's six credit-based offerings and also is integrated with the technology of 15 other funders that include Kabbage, Lending Club, OnDeck, Credibly, and Capify, he says. The products include Small Business Administration loans, equipment finance loans, traditional factor deals, line of bank and non-bank credit, and proprietary medical programs, he says.

- **Look** to form a lasting relationship with funders, Sheinbaum counsels. "Many times sales offices get too hung up on how much money they're going to make on the first deal, and they don't look at the totality of the relationship with the funding company," he maintains. Many merchants take a second or even third advance, he notes.

- **Bear in mind** that funders specialize, notes Isaac Stern, CEO of Fundry, Yellowstone Capital and Green Capital. "We fund the higher risk deals," he says. Most companies provide funding for deals with A, B, and C ratings while he takes on C, D, and F paper. His customers won't get as much funding or as sweet a deal as a merchant who's been in business for 20 years and has an 800 credit rating, but they might have nowhere else to turn, he says.

Any ISO taking on a new client should practice a high level of due diligence, and similar underwriting efforts are industry standard when on-boarding any new merchant, say ETA's industry affairs and government relations experts.

With the right funder, everybody wins, says Goldin. "We're here to help the customer, not hurt them. If they've had a bad experience before, they should keep looking. Just like in merchant acquiring, there are good players and bad players."

suppliers can't replenish the store's inventory in a timely fashion.

A merchant's managers merit special scrutiny, and, in O'Connell's estimation, computers can help there, too. "What do they say online, and what is said about them online?" he asks. "Do the principles of the company look more or less likely to walk away when it becomes difficult to pay back the loans?"

Close examination reveals that merchants fall into three categories, O'Connell maintains. Some live up to their shining image online and might even qualify for bank loans. Others look risky at first glance and carry the burden of lousy credit scores but have fallen into undeserved financial straights and actually merit funding. They're good candidates for credit from the alternative finance industry. Members of the third group don't just appear unworthy of funding—they truly don't deserve it. They can go to payday lenders for capital, he suggests.

Combining common sense with a little legwork can help funders move up to a more reliable clientele, counsels Stephen Sheinbaum, founder of Bizfi, a New York-based funder. For example, he would turn a skeptical eye toward a floor coverings store located in a ZIP code with unusually depressed real estate prices, he says.

The Human Side

Although funders can buy underwriting software off the shelf, many serious players—including CAN Capital—prefer to write their own versions in-house, according to O'Connell. "Development of your own risk software is the primary source of competitive advantage," he says of the market. Funders also want their programming to reflect their unique way of approaching the business, notes Isaac Stern, CEO of Fundry, Yellowstone Capital and Green Capital. "Everybody wants to have their own proprietary algorithm with X amount of data points and various different ways of doing it," he says. ETA strongly recommends consulting the second edition of its "Guidelines on Merchant and ISO Underwriting and Risk Monitoring," which includes specifics to address underwriting and review for the alt lending space.

Regardless of who actually writes the underwriting program, employees with training and experience should remain part of the process, many funders agree. "I believe you need an actual human being to make the underwriting decision," says Stern. A computer can't phone the landlord and find out if an applicant has fallen behind in the rent; an algorithm can't gauge a merchant's forthrightness, says Stern. "A real live person should make the up or down decision."

But a person can't do it all, either. Humans and their machines, together, appear likely to sustain an upward spiral in alternative finance, says Bizfi's Sheinbaum. He envisions an industry that will become increasingly smarter by leveraging technology. That will improve the customer experience, and profits will rise. Reinvestment can then refine the technology, and the cycle begins again. Thanks partly to that technological support and partly to a burgeoning supply of capital, Weitz of United Capital Source envisions a bright future. "Large companies and traditional banks are taking a bigger interest in the industry," he says. "We're pretty well-positioned to continue to grow." ***TT***

Ed McKinley is a contributing writer for Transaction Trends. *Reach him at edmckinley773@yahoo.com.*

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EMV Accelerates in the Right Direction

But the quest for payment security and convenience happens one step at a time

By Jennifer Miles

Here in the United States, we're conditioned to judge success or failure in an instant. It will come as no surprise then that some seemed bewildered that everyone wasn't using Europay, MasterCard, and Visa (EMV) technology immediately after the October 2015 liability shift went into effect. However, implementation around the world has shown us that adoption doesn't magically happen overnight. Even so, we're actually making progress at a relatively rapid rate.

Gradual Adoption

Many in the industry focused so much energy on preparing for the EMV liability shift that you could practically feel that energy level deflate once the October 1 deadline passed. As Brian Hamilton, Visa's senior director of risk products and business intelligence, recently noted, based on what has happened in the 80-plus countries that adopted EMV before the United States, it typically takes two years to get to 50 percent adoption and six years to get to 90 percent adoption.

According to Visa's analysis, 43 percent of its credit cards representing 72 percent of purchase volume, and 21 percent of debit cards representing 45 percent of purchase volume, now have chips, says Hamilton. That's an indication that card issuers did a good job of focusing on high-value, high-volume card holders who spend a lot at larger retailers that have implemented EMV.

Technology Availability

Undoubtedly, many have seen EMV-capable terminals installed even in large multi-lane retail locations that are not yet accepting this new form of payment. A big reason for that is timing: Because of the liability shift's close proximity to the holiday shopping season, many retailers with installed EMV-capable terminals simply didn't want to add another level of complexity to their infrastructure during the peak season, and/or didn't want to risk seasonal employees creating confusion with EMV card-carrying consumers.

Another major factor in the delay is the backlog of EMV certifications required for integrated POS systems in use at many large retailers. This is largely why many are moving to implement semi-integrated payment architectures, which remove payment processing from their infrastructure and route card transactions directly from the terminal to the processor.

EMV Misperceptions

Because the payments process is complex, retailers and payment industry participants need to understand what EMV actually accomplishes. EMV doesn't prevent data breaches; EMV doesn't protect card data, per se; EMV doesn't prevent malware from being installed on POS systems. And, let's not forget that EMV is not yet applicable to card-not-present environments, which means that purchases made online and over the phone are still vulnerable to counterfeit card fraud.

EMV is designed to prevent use of counterfeit cards and to prevent the misuse of lost or stolen cards. Because authorization data changes dynamically, counterfeit cards are easily detected and declined in

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card-present environments, while stolen and lost cards can be quickly blocked from payment network authorization.

EMV is one component of what should be a layered security system, albeit a very important one. It needs to be part of a payment architecture that includes encryption and tokenization to ensure that cardholder data is not usable by fraudsters.

Moving Forward

The payments industry is moving in the right direction, even if it sometimes seems that it's moving at a maddening pace. It takes time to fully implement payment security and educate store clerks and consumers, for instance, on the chip card insertion process. We'll no doubt experience consumer complaints about longer authorization times (even though they're only slightly longer than typical card swipes). But before too long, we're going to be hearing complaints about why consumers can insert their chip card at one store but have to swipe it at another.

Nonetheless, the EMV journey has finally begun in the United States. As consumers become more accustomed to EMV—and become more aware and concerned about the relatively weak security of magnetic stripe cards—they'll begin to apply pressure on merchants to achieve consistency.

A Bright Future Ahead

Fortunately, as EMV acceptance becomes more widespread, retailers will begin to get more value out of the new technologies they put in place to prepare for the liability shift. Many of the EMV rollouts updated merchants' payment infrastructure with new capabilities they can use to reinvent the in-store experience. For example, the majority of EMV-enabled terminals facing consumers today can also accept near-field communication (NFC) and mobile wallets. If fact, it's not uncommon to see merchants that are not yet accepting EMV already accepting Apple Pay.

Many devices also feature digital multimedia screens, and a growing number are being supported on the back-end with managed services that—in addition to removing payment complexity and management from retailers' scope—give them an efficient means of providing more value to consumers at the point of sale. That value is delivered by way of digital offers, coupons, and loyalty incentives presented to consumers through the terminals during checkout.

In other cases, consumers receive added value in the form of shorter checkout lines and a more personable shopping experience. Customers also appreciate the convenience of being able to pay for purchases in the aisle—or anywhere in the store—via new mobile POS terminals that transform retailers' smartphones and tablets into EMV and NFC-enabled payment devices.

Regardless, there is much to look forward to as the EMV journey progresses. This will open the door to more innovation that will pay off in many ways beyond EMV for years to come. ***TT***

Jennifer Miles is president of Verifone, North America, and a member of the ETA's board of directors.

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Kamran Zaki

Adyen's president for North America, Kamran Zaki, joined the acquirer, processor, and tech company in 2014. He came from Netflix, where he had served as the head of global payments, and before that he led PayPal payments teams in Europe, North America, and emerging markets. He spoke to *Transaction Trends* about the company and working in cross-border transactions.

Tell us about the company, growth, and differentiation.

Adyen has 4,500 customers, including seven of the 10 largest Internet companies in the United States. A sampling of our customers include Facebook, Uber, Airbnb, Netflix, Spotify, Dropbox, Evernote, Booking.com, Yelp, Vodafone, Superdry, Mango, Crocs, O'Neill, SoundCloud, KLM, and JustFab.

We're headquartered in Amsterdam and San Francisco, but we have a total of 12 offices on five continents. We process payments in more than 200 countries. Last year, we doubled both our volume of transactions processed and revenue, to $50 billion and $350 million, respectively. This is the second consecutive year we have doubled revenue, and we have been profitable since 2011. We are still early in our journey, and, as we grow awareness around the world, we have a tremendous amount of growth ahead of us.

By building our own rails from scratch to power payments across online, mobile, and in-store, we've really established a position that will be incredibly difficult to replicate.

How many of your employees work in tech, sales, and support?

We have over 330 employees worldwide. They are located across our offices in San Francisco, Boston, Amsterdam, London, Stockholm, Paris, Madrid, Berlin, Sao Paolo, Singapore, Sydney, and Shanghai. We don't break out exact figures across our various functions, but we have a sizeable development and technical group, in line with other Internet/tech companies.

Can you explain how Adyen handles cross-border transactions?

Absolutely. Most payment platforms are essentially running on payment rails that are over two decades old. Those systems are fragmented and antiquated, and, when a merchant wants to expand to new countries or regions, it will need several different partners and integrations. Adyen allows our customers to operate a seamless, consistent experience across different countries with one single integration.

Although we don't disclose the exact percentage of cross-border transactions, the majority of our clients work with us in multiple regions. Our payment rails allow us to offer customers the ability to easily connect their payments across the world. For instance, we enable our customers to accept 250 payment methods across 187 currencies.

What barriers hinder cross-border transactions?

One major issue is all of the different payment methods that exist in the world. Credit cards, while ubiquitous in the United States, aren't as popular around the world. For instance, in Germany direct debit rules and credit cards account for less than 25 percent of the transactions. In China, Alipay, an ewallet, is the most popular payment method, and international credit cards account for less than 1 percent of transactions.

Being able to connect digital and in-store payments is also a problem that many of our customers face. And this is an even larger problem when you look at trying to do transactions across different countries. We have an omnichannel solution that can connect online and offline payments.

What is the Mobile Payments Index?

The world is becoming mobile in almost every way possible. Because we process such a massive volume of transactions, we have a unique view into mobile payments, and this is a topic that our customers are eager to learn more about. The Mobile Payments Index is our chance to share some of this information and track key trends on a quarterly basis.

Since starting the Mobile Payments Index in June 2013, we've seen tablets overtake mobile phones for online purchases, and Asia has very quickly emerged as a mobile commerce powerhouse. Both trends, while not entirely unexpected, have shown us that the industry is constantly changing and adapting to new payment methods and new technology.

What challenges does the payments industry face?

The largest challenge the industry is facing today is delivering a true omnichannel solution that can connect online, mobile, and in-store payments under a single platform. What may seem like a relatively simple task, such as buying online and picking up in-store, is actually tremendously difficult for most retailers because they usually cannot run in-store and online payments on the same platform. We designed our omnichannel and point-of-sale product so that retailers could have a single platform for all their payment needs, and we're seeing the industry embrace it. ***TT***

—*Ed McKinley*

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