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A Failure To Differentiate

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It’s a fact of life that puts Subway sandwich shops at a distinct disadvantage. The 48-year-old chain has more than 37,000 locations worldwide, but it doesn’t have drive-up windows.

And as a consequence of not having a window, a Subway restaurant’s business can plummet 40% when it rains.

But technology can address that type of shortfall, according to Jed Rice, senior vice president of business development at Wellesley, Mass.-based Paydiant Mobile Systems.

Merchants that find themselves in meteorological predicaments can combine data from multiple sources to award customers more points for purchases made during inclement weather, Rice told attendees at the recent Northeast Acquirers Association 2014 Winter Seminar and Outing.

It’s the clever type of money-making data crunching that ISOs and agents should offer merchants, according to just about everybody who spoke into a microphone at the show, which was held, as usual, at Mount Snow, Vt.

The NEA speakers seemed to agree that acquirers that push technology set themselves apart from competitors and thus avoid the trap of selling solely on price.

Just offering the usual technology, however, is apparently beginning to fall short of what’s needed. A survey of ISOs indicates the vast majority are now promoting the basic value-added offerings, including prepaid cards, gift cards and loyalty programs. Most are even offering e-commerce gateways and mobile POS.

For more on the struggle to differentiate, see the article that begins on page 36 of this issue.

And for more on the show, check out the interview that begins on page 50 with Jacques Breton, who’s vice president of ISO sales at My Clear Reports and serves as NEA treasurer.

Breton describes the beginnings of the organization and explains why it makes perfect sense to hold the winter regional show in the same remote location each year. ISO
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What do you think will be the most surprising development in the acquiring industry this year?

I think the most surprising development in the acquiring industry this year will be a dramatic shift from card-present to card-not-present transactions. This shift will be driven by three primary factors. First, there’s the continued growth of internet transactions, which has risen steadily over the past decade and shows no sign of abating. The second factor will be mobile wallets, which will finally start to show some real traction this year. The third factor will be security.

As merchants look at the unintended consequences of the current card processing model, they will naturally look for ways to mitigate their risk and liability. The three factors mentioned above all point in the same direction—move transactions away from physical cards and into the cloud where new, innovative and more secure methods of handling payment can be developed which are not limited by the card-based form factor.

There are two parts to this question. The first is specific to acquiring. In that arena I am convinced there will be more than one surprising acquisition in 2014. I suspect this for two reasons. First, there is capital available that has been sitting on the sidelines for several years. Second, many buyers are looking for fast ways to ramp up revenue. Acquisitions often seem to top the list of ways to do that.

The second part is about the payments industry in general. I believe 2014 will (unfortunately) surprise many of us due to increasing data breaches. The sophistication of the crooks continues to rise and will hit areas outside of standard retail. We already saw this with breaches at Living Social, Evernote and Adobe, as well as retailers Target and Michaels. Mobile devices will likely be hit hard as most users lack even basic security precautions and protection on them.

An increasing number of processors, financial institutions and super ISOs will race to develop their own proprietary online merchant dashboards.

Merchant dashboards link technologies like big data, smartphones, cloud-based solutions, biometrics, geolocation and social network-based networks. We already see this convergence imbedded into many POS tablet solutions. It provides merchants’ online access from PCs, tablets or smartphones.

Merchants view their customers’ buying preferences, and likes and dislikes, to craft a targeted marketing offer they text or email to the customer. The dashboard also provides real-time data analytics, and it reports when and where the merchant needs it so he or she can use it to build a deeper customer connection, improve customer service, and increase customer traffic and loyalty.
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Independent ATM operators will soon have to upgrade, replace or abandon their newly outmoded machines.

A perfect storm of problems that’s making the nation’s fleet of cash machines obsolete includes the upcoming EMV liability shift, the decision to abandon a key Windows operating system, and issues raised by the Americans with Disabilities Act and the Payment Card Industry data security standards.

But adversity’s nothing new for America’s independent ATM deployers.

“The independent operators...should get medals for making a living in this business after all this time,” says Rob Evans, director of industry marketing for ATM manufacturer Nautilus Hysung America.

For years, the independent ATM market alternated between the status quo and crises, he notes.

“If we go back to the last decade, we had Y2K, and then back to stasis. We had triple DES migration. Stasis. Then it was ADA upgrades. Stasis,” Evans says. “Now we’re looking at EMV and the double whammy of being able to support chip cards along with, oh, by the way, if you are on a Windows XP platform, you might want to get off of that because Microsoft is discontinuing the operating system.”

But many industry leaders maintain that change could bring opportunities.
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Survival in the coming years will largely depend on finding competitive advantages and creative revenue opportunities.

When upgrading, deployers should consider what’s required, what’s a good idea and what can wait.

A Window Is Closing On An Operating System

April of 2014 will mark the end of an era for Windows XP—the operating system at the heart of many of America’s ATMs. That’s because Microsoft will stop supporting the operating system, meaning it will issue no new security patches.

Any ATMs remaining on an XP platform will become juicy targets for hackers targeting the newly vulnerable machines, says David Tente, executive director of the U.S. Chapter of the ATM Industry Association.

“My guess is that a lot of ISOs won’t have the transition done on all their machines before support is terminated,” Tente says.

The cost and difficulty of upgrading a machine to a newer operating system varies widely depending on what’s “under the hood.” Newer machines with more RAM and better processors may simply need a software update. Older machines may require significant hardware upgrades.

“The worst case you would run into is the processor may not be able to handle the new OS,” Evans says. “And in some cases, the price of the upgrade may rival the cost of the machine.”

Assuming all continues according to published schedules, independent ATM operators should be well-engaged in their plans to upgrade their machines to support the chip-based EMV protocol.

That’s because published schedules show that in 2015, ATMs should be capable of accepting EMV cards, and in less than three years, acquirers will assume the liability if fraudulent magnetic stripe cards are used in a transaction when a chip-enabled card was available.

Upgrades to help ATMs comply with the EuroPay MasterCard Visa protocol include new chip-enabled readers, new security modules that support EMV requirements and software updates to help process the transactions.

Each of those upgrades comes with a cost but does not bring in additional revenue, Tente says.

“For independent operators, the business case for an upgrade is pretty sketchy. It is a big burden, cost-wise,”
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he says. “There is not an opportunity to make money on this. In the end, the only ones benefitting financially are the card issuers, because they are the ones that are getting the fraud reduction.”

Still, upgrading to the new standard is not only required by the new guidelines, it’s going to get expensive if ATM operators hold out too long, says Dean Stewart, senior director for core product management at North Canton, Ohio-based ATM manufacturer Diebold.

While fraud liability will sting if a criminal rips off a machine that didn’t comply with the standard, the real motivation to switch will come when processors begin to decline transactions initiated with outmoded mag stripe technology.

“At some point, a lot of the networks will stop accepting mag stripe when chip is available,” Stewart says “That means a loss of transactions, and for an ATM operator, that is loss of revenue. Fraud happens, but loss of revenue is real.”

Ghost Of The Past: PCI And ADA
Two old upgrade requirements that haunt independent ATM operators are the Americans with Disabilities Act and the Payment Card Industry data security standards, the latter commonly referred to as PCI.

The deadline for ATMs to comply with ADA-mandated accessibility rules has passed, but that doesn’t mean that every machine out there complies.

“Some independents have lagged behind banks in terms of their ADA requirements,” Tente says. “In the past, a lot of the networks will stop accepting mag stripe when chip is available,” Stewart says. “That means a loss of transactions, and for an ATM operator, that is loss of revenue. Fraud happens, but loss of revenue is real.”

Independent (ATM) operators should get medals for making a living in this business.”

– Rob Evans, Nautilus Hyosung

The federal mandate says that every machine deployed must have a Braille-enabled keypad and instructions, as well as voice guidance. ATM operators who have lagged behind on the compliance mandate are now facing lawsuits, which is prompting many operators to update their fleets in a hurry.

“ADA lawsuits don’t have the big punitive damages, but they do include lawyer’s costs, and some law firms are keeping busy chasing down plaintiffs,” Tente says.

As far as PCI goes, the biggest offender is the PIN pad, though some legacy machines may also have some hidden problems, such as back-end components that store entire card numbers, and those need upgrades.

Any machine purchased, installed or moved after 2014 must be upgraded so the PIN pad devices are tamper-resistant and incorporate Encrypting PIN Pad Version 7 standards. For most modern machines, that merely means swapping out the module. However some older machines may take a bit more to upgrade.

But either way, the operators will have to take on the cost of a service call or face compliance issues.

Evaluate ATMs While Upgrading
Industry observers say that this fresh round of technological upgrades may also be a convenient time to conduct an analysis of each machine to evaluate return on investment and perform a cost-benefit analysis of potential upgrades.

Todd Nuttall, CEO of Mesa, Ariz.-based Better ATM Services Inc., says the question of whether to upgrade a machine will have to be done on a case-
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by-case basis.

“You have some machines that are in the back of the bar, and they don’t have much capacity to be upgraded, and the operators are going to have to make a real tough choice whether it makes more sense to upgrade that machine or just replace it outright,” Nuttall says.

There is no rule of thumb as to when a machine is worth upgrading, versus replacing, Evans says.

“There is a whole range of rationalization for every piece of your fleet,” he says. “You have to ask yourself, ‘Do I really want to put $600 or $700 into that machine?’”

Evans says it is important to analyze when it stops being worth it and establish a numerical cutoff point.

“You might just say ‘this is nuts, why would I do this if it costs the same as the machine?’” Evans says.

For most modern ATMs, it isn’t a question of whether an upgrade is technically possible, but rather whether that investment makes sense, Tente says.

“In most cases, and from talking to our membership, those machines that can be upgraded will be upgraded, but there is a significant number that just can’t be upgraded,” Tente says. “It might be that they can’t handle some component, and rather than going through the expense of taking out half the electronics, it just makes more sense to replace the whole machine.”

Between the ADA, PCI, Windows and EMV requirements that are all looming, coordinating one big strategic overhaul might make the most financial sense, Evans says.

“As long as you are thinking about upgrades anyway, you might as well knock it all out at once,” he says. “Efficiency is the name of the game for ISOs. Do it strategically so you don’t have to go out there repeatedly.”

Nuttall says that the wisest operators will not just lump all their upgrades into one service call, but they will also be looking at each machine to see what else might be added to the machine to make it more usable.

“What we are seeing is the independents facing those upgrades are also seeing this as an opportunity to look at other value adds at the same time,” Nuttall says. “Everyone is looking at the utility – but what we should be asking is what more can we do?”

Nuttall says he could see ATMs becoming points of contact for many other entities beyond just financial institutions.

“ATMs could become the touch point for any number of businesses,” Nuttall says. “For example, you just bought something on Amazon, and need to pay for it, you could do that at an ATM.”

He says that any number of entities doing business online could use ATMs as their real-world cashiers.

### DEPLOYERS CAN TAKE THEIR PICK OF SPLASHY NEW ATM FEATURES

**INNOVATION IS COMING TO ATMS, giving independent deployers their choice of features that bring phones and mobile devices into the world of cash machines.**

“One of my favorite ideas that is coming into play is on staging transactions,” says Dean Stewart, senior director for core product management at ATM manufacturer Diebold.

One of the ways to communicate that staged transaction to the machine is through a QR code that consumers hold up to a camera or reader on the machine.

Rob Evans, director of industry marketing for ATM manufacturer Nautilus Hyosung America says QR codes could be used the other way around, too.

For example, the machine could generate a QR code on the screen that the user could scan with a mobile device’s camera to create a paperless receipt.

ATMs could also dispense things other than cash.

Better ATM Services, for example, is working to equip ATMs to work like a vending machine as much as a cash machine.

“In the past, people saw the ATM as an extension of a bank—as a place to get your cash,” said Todd Nuttall, CEO of Better ATM Services Inc. “But now there is a network all over where people are going to work and are doing their shopping.”

He said that the distribution network and ubiquity of the ATM means that operators should view them as more than just cash dispensers.

“If you were to open a new vending machine business, you would wish you had the locations that ATMs already have,” Nuttall said. “Operators need to be looking at their locations and at their equipment and asking themselves ‘what is the latent capacity built right in there?’”

Nuttall said that by simply swapping out a simple internal component or two and adding a little software, nearly any ATM could be retrofitted to dispense gift cards, stamps, transit cards, or nearly anything that can fit through the slot.

“You can be giving cash and noncash media—the mechanism is the same,” he said. “ATMs have such a terrific distribution model that is just underutilized.”

One thing Stewart said that has been sold successfully through ATMs in other countries is SIM chips for mobile phones.

“Alternate media have been successful niches,” he noted.

— Michael Guisti
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“It becomes a brick and mortar for non brick and mortar entities,” Nuttall says.

Costs and benefits
But often, expanding a machine’s capacity means dollar signs for the operators.

“The more ‘whiz bang’ you get with your features, you have to start asking how do you make it economical for ISOs to own and operate their machines,” Evans pointed out.

Evans says that there is a natural limit to what technology investments ISOs can do while still staying profitable.

“Independent operators are constantly asking themselves, ‘how much can I throw at it and still meet thresholds of profitability within the confines of interchange and surcharge support of the business model,” Evans says.

Stewart said that the trick to getting widespread adoption would be for the electronic components to come down in price but keep their functionality.

“It is so hard to tell how technology will effect the price of a machine,” Stewart says. “I wouldn’t imagine that these things will add significant expense in the long term — I mean look at the auto industry.”

Stewart pointed out that features, such as dynamic stability control or antilock breaks initially start out as expensive add-ons.

“But then it comes down in cost, and it becomes easier for everyone to include into their machines,” Stewart says.

Evans says that the other factor to consider is how much revenue those upgrades promise to bring with them. He pointed out that while the industry isn’t likely to find one solution that solves all their problems, a bunch of smaller ones might just do the trick.

“At this point, ISOs aren’t out there looking for a silver bullet, but they might just be hoping for silver buckshot,” Evans says. ISO

<table>
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<tr>
<th>Tech Trouble Looming For Indy ATM Dealers</th>
<th>Required upgrades</th>
<th>Deadlines</th>
<th>Reason</th>
<th>Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>EMV compatibility</td>
<td>April 2015</td>
<td>The card brands say machines should be able to accept chip cards by this date. Liability shifts for fraud will kick in a few years later.</td>
<td>At minimum, machines will need new card readers, new security modules and software to support the new cards. Additional processor, memory or other hardware upgrades may also be required.</td>
<td></td>
</tr>
<tr>
<td>PCI-Compliant Key Pad</td>
<td>2014</td>
<td>Any machine purchased, moved or upgraded this year must be modified to include a tamper resistant Encrypting PIN Pad Version 7 device.</td>
<td>Newer machines will just need the keypad swapped out and a software patch. Older ones may need additional hardware upgrades to accommodate the new device.</td>
<td></td>
</tr>
<tr>
<td>ADA compliance</td>
<td>Already Past</td>
<td>Even though the deadline for complying with ADA has already passed, many independent and some bank-owned ATMs still need to be brought up to standards.</td>
<td>All ATMs must include Braille keypads and instructions, along with voice guidance.</td>
<td></td>
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</tbody>
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<tbody>
<tr>
<td>Windows XP</td>
<td>April 2014</td>
<td>Microsoft is ending support for this legacy operating system, opening up any remaining XP machines to security breaches.</td>
<td>Depending upon the hardware, an upgrade could range from a simple patch to a complete processor, memory and hardware upgrade.</td>
</tr>
</tbody>
</table>
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What’s the best way to describe the relationship between ISOs and new entrants to the payments business? You could call it complicated.

In the past few years, the payments industry has experienced a flood of new players—from consumer-facing giants like PayPal and Google to Silicon Valley startups.

The influx has left ISOs wondering whether the new entrants regard them as competitors or potential allies. In fact, established payments companies identify the risk of displacement as their main concern about new entrants and emerging payment technology, according to the 2013 survey “New Entrants in Payments: The incumbent perspective,” by the Electronic Transactions Association and Goldman Sachs.

Meanwhile, some new entrants may regard ISOs as dinosaurs on the verge of extinction. But others are starting to understand some of the advantages ISOs bring to the business, says Steve Eazell, president of the Western States Acquirers Association and vice president of sales and marketing for Secure Payment Systems Inc., a San Diego-based merchant services provider. “We have the relationships,” Ezell says of himself and other ISOs. “We have the distribution network. We have the players on the street. Without us, they’re not going to be able to go to the next level.”

That’s why ISOs seem to set aside their concerns about displacement, according to another ETA-Goldman Sachs survey. Like automakers coming onto the transportation scene a century ago, new entrants in the payments industry are looking to innovate—but without having to reinvent the wheel.

New technology can seem impressive until someone has to distribute it to merchants. Some startups are finding that if they want to keep growing among merchants they can’t reach directly, they have to embrace ISOs as distribution partners, says Linda Perry, an independent consultant and friend of the ISOs.
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former head of acquirer and processor relations for Visa Inc.

With new entrants aspiring to grow steadily through merchant outreach, it’s inevitable that at some point they’re going to need a bigger distribution channel, Perry says.

“ISOs and the acquiring industry have a good reputation for growth,” she says. “We know how to get in and sign up people for payments. That’s what we do.”

Payments analyst Gil Luria of Wedbush Securities contends that many newcomers consider ISOs potential partners instead of direct competitors. “They want to move very fast. And to move fast, they would much rather go through the existing infrastructure as much as they possibly can,” Luria says.

With their forays into payments, PayPal Inc. and Google are trying to create technological innovation that provides added value for retailers, and they want it to happen quickly.

Those companies don’t want to start from scratch by building merchant relationships, but they will if they have no other alternative, Luria says.

“If acquirers don’t want to cooperate with them—which some would rather not—they’ll find a way to get around them,” Luria says of the possibility that tech companies shunned by ISOs will find their own way to market.

With its now ubiquitous white dongle, Square seems firmly planted in the competitor category, while Google Wallet is positioned as a potential ally to ISOs, Luria says. But PayPal has taken more of what Luria calls a “co-opetition” approach.

Last spring, PayPal made some in the acquiring community nervous when it announced a deal with Discover Financial Services to accept payments at brick-and-mortar stores that accept Discover. PayPal then signaled it wants to work with acquirers on the new venture. To enable the in-store system at more locations, PayPal contracted with
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50 acquirers just after the launch. Among those acquirers was EVO Merchant Services of Melville, N.Y. “PayPal realizes that it’s best to work with processors rather than try to challenge them,” says Jeff Rosenblatt, EVO’s president.

Rosenblatt believes EVO and other ISOs should form partnerships with some of the new payments entrants. EVO has been in talks to create other alliances with Isis, the mobile wallet venture of AT&T, Verizon Wireless and T-Mobile and mobile payments company LevelUp, he says.

Luria also sees opportunities for incumbent payments companies to work with Isis, which might need ISOs, acquirers and retailers to buy NFC terminals. He also expects ISOs could work on the acceptance of Google Wallet, in some capacity.

Industry experts question the long-term viability of some of the new entrants—especially the startups—that are competing with traditional payments companies. Some wonder whether Square in particular can sustain itself financially because it works mostly with smaller merchants. Without the kind of distribution channel that ISOs can provide, a company like Square might have trouble growing beyond the micromerchant market.

“There’s an arrogance that some don’t want to deal with us. But I think ultimately they’re going to find out that they do,” Eazell says.

Square still isn’t embracing ISOs as an ally, Eazell says. Instead, it relies on social media and their own network of reaching the masses. “I think they’re going to run into a roadblock at some point,” Eazell says, adding that Square won’t be able to reach the volume players by using their current methods. “They’re dealing with small mom and pops. They’re not doing any serious volume yet.”

Perry suspects Square might need to explore other business models. “I don’t think they’re going to be their own ISO forever,” she says. And with Square making noise about an initial public offering in 2014, the company might move even closer to needing that extra distribution.

Old Rivalries With The Card Brands
Technology companies and startups might be inching into ISOs’ space. But perhaps the oldest, most traditional foe to ISOs is the card brands themselves, Perry says. Visa and MasterCard have long competed against ISOs on the merchant acquiring side, stacking their people and resources against the ISO community. Perry recalls that when she was with Visa, she had a big team that faced a tough fight in trying to improve the situation for ISOs.

“I think any of us would say those two big brands are not overly acquirer-friendly,” Perry says.

It’s taken the card brands years to embrace ISOs, and even now they’ll allow ISOs to become part of the system only if a bank sponsors them.

Rosenblatt sees room for cooperation with the card brands, though. The brands spend a tremendous amount of time developing products such as wallet, cloud and mobile offerings that companies like EVO and other processors can use, he says.

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NEW ENTRANTS

Strawhecker Group, an Omaha-based technology company, says Jamie Savant, a partner in the company, creates a new avenue for card acceptance to merchants. Discover is also following the same model after years of relying on its own agents to sell directly.

The same happened overseas with UnionPay Ltd., formerly known as China UnionPay, China’s national electronic-payments network and card brand. In recent years, UnionPay set out to grow its business to add merchants and cardholders both in and outside of China. So to achieve that, the company began working with ISOs to offer UnionPay card acceptance as a merchant service.

“You as China UnionPay can’t go out and independently sign every single merchant,” Perry says.

Opportunities For Cooperation

In the debate over new entrants, Luria sees two sides. On one side, big players such as Square and PayPal compete directly with ISOs through word of mouth and retail sales. On the other side, ISOs can cooperate with players like PayPal and Google—in terms of mobile wallet acceptance and technology integration. The cooperation would benefit everyone involved, and then there would be less incentive to compete with the ISOs.

There’s a huge micromerchant base consisting of merchants that don’t accept credit cards, and new technology players are focused on non-acceptor merchants who are looking for ways to accept payments. So enabling a fitness trainer to accept $50 payments on his mobile device for his workout classes creates a new avenue for card acceptance, says Jamie Savant, a partner in the Strawhecker Group, an Omaha-based payments industry advisory firm.

“If this going to hurt the business? Absolutely not,” he says.

As more card acceptance methods enter the marketplace, ISOs trying to differentiate from competitors will develop partnerships with entities that are new to the business, Savant says.

But as those new payments methods come into play, new entrants and incumbents should consider the rate of merchant adoption, Rosenblatt says. In a lot of areas, there isn’t much penetration because retailers feel comfortable doing what they’ve always done.

“So people are afraid of change. They like their desktop terminals,” Rosenblatt says. EVO is supporting several new technology, including cloud-based products, tablets and digital wallets, but adoption has been slow. “We have not seen a great deal of usage from the merchant or the consumer perspective,” Rosenblatt says.

If there’s one way to guarantee competition, it’s to sit back and let in competitors in the first place, Perry says. ISOs tend to wait for the next product to be thrown at them and should focus instead on setting those trends themselves, she says.

“It’s easy to get stuck in what we do every day and not stop to think: What would make it better?” Perry says.

ISOs should pay attention to what new entrants are doing and think creatively about payments as a business, Perry says. From there, ISOs can decide whether replicate that product, come up with a better idea or form a partnership with the new entrant.

Without question, ISOs should figure out where they can add value in a way that keeps them relevant, says Greg Pesci, president of ProPay, a merchant services company based in Lehi, Utah.

“New entrants can put challenges on older players, but this also creates opportunities,” Pesci says. “And if you’re able to adjust, there are solid opportunities to be had.” ISO
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If there’s one thing in payments that appears unlikely to change for ISOs in 2014, it’s the rapid rate of change itself. Innovation, competition, disruption and adaptation will continue to characterize the payments industry in the months to come, experts predict.

“The pace of change that has evolved in the last few years will remain constant as new technologies drive new solutions,” says Kevin Lambrix, chief operating officer for EVO Payments International, an ISO based in Melville, N.Y.

As long as ISOs are willing to roll with those changes, experts contend, the opportunities will outweigh challenges. That requires proper positioning, the right products and services, and seizing opportunities as they arise.

The fact that merchant acquirers are embracing disruptive innovation underscores the uniqueness of the payments industry, says Jason Oxman, CEO of the Electronic Transactions Association. Whereas other business segments—such as the record industry—have shunned or mishandled innovation, payments companies are forming partnerships with technology companies, while also drawing inspiration from them to launch products and services.

“That speaks very well to the bright future of our industry,” Oxman says.

From his vantage point as head of the ETA, Oxman sees payments becoming more important—and more innovative—than ever before. The industry is embarking on an era of innovation that could change the way consumers and merchants initiate payments transactions, he says.

BY AUTUMN CAFIERO GIUSTI
“I think it’s safe to say we are at an inflection point in payments,” Oxman says. “The level of innovation taking place today is greater than any level in the 50-year history of the credit card industry.”

Meanwhile, competition will continue to drive down margins, and the industry will have to cope with that, says Steve Eazell, president of the Western States Acquirers Association and vice president of sales and marketing for Secure Payment Systems Inc., a San Diego-based merchant services provider. But competition also produces opportunity, and there’s continued optimism for the year ahead.

“We are going to witness some positive aspects of the industry really come to fruition in 2014,” Eazell says. “We’re going to see profit, change and growth.”

**Fierce Competition To Continue**

ISOs are facing a lot more competition than in the past, and it’s from players who previously didn’t participate in merchant acquiring. That’s been ongoing for the past few years, and experts expect it to remain a hallmark of the industry for yet another year.

The extent to which ISOs embrace new technology will dictate how fast the technology progresses, says Gil Luria, payments analyst for Wedbush Securities, a Los Angeles-based financial services firm. Luria believes that in 2014 the focus will remain on how ISOs compete with Square, PayPal and other entrants in the payments industry who don’t have sales forces to acquire merchants but do have good distribution.

Luria points to a PayPal payment acceptance scheme as an example. In April, PayPal launched a deal with Discover Financial Services that enables bricks-and-mortar merchants to accept PayPal payments at the point of sale. Customers can use PayPal anywhere that accepts Discover by keying in a mobile phone number and PIN at the terminal. Through the agreement, PayPal has potential access to as many as
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Shortly after the launch, Discover contracted with 50 merchant acquirers to enable the in-store PayPal system. But not every acquirer was sold on PayPal. First Data made headlines when it publicly announced it would not support PayPal’s in-store payments.

Big acquirers have been reluctant to become involved with the deal, Luria says. “They’re literally going to hold back the progress of technology,” he says, adding that PayPal will continue to find ways around those obstacles.

For as many challenges as new entrants create, opportunities could be plentiful for ISOs willing to adapt. Companies like PayPal would prefer rely on established infrastructure to enable their customers to pay at the point of sale, Luria says.

**Innovation Brings ISOs Business**

Overall, new players in payments are producing innovations that drive more consumers to pay through electronic means, and that’s good news for ISOs, Luria says. The direct competition the new players create, however, remains a different matter. “That is a real risk to ISOs,” Luria says.

The role of direct acquirers will continue to face scrutiny in the coming year, with concerns that players such as Square and PayPal will take market share from established players in the acquiring business. Square is also exploring the possibility of an initial public offering in 2014.

Oxman believes ISOs should work to help new entrants recognize the vital role ISOs play in delivering payment services to merchants, he says. As new technology is deployed, the incumbent payments industry should take steps to remain at the core of merchant services, he says.

There’s renewed optimism in the ETA because some of the technology companies that are new to payments have become members of the trade group. The association now represents all of the mobile network operators—including AT&T, Verizon, Sprint and T-Mobile, as well as technology companies such as Google, Amazon and Microsoft.

“That says to me that these new technology companies are very interested in partnering with and working with payments companies,” Oxman says.

The greatest opportunity for ISOs could lie in deploying new services to merchants, Oxman says. That means offering not only card acceptance, but also mobile payments, loyalty, security, data collection and other ancillary services.

“It’s exciting that all these new services are coming to market, but it’s important that these new services are offered to merchants through the trusted and long-standing valuable relationships that ISOs and agents have with merchants,” he says.

Although EVO’s Lambrix believes ISOs are still positioned well, they should continue to seek ways to deliver the right service to the right merchant. Some competitors offer great products, but they don’t offer customer support to the merchant when a question arises, he says.

By supplying merchants with value-added services and customer support, ISOs can make them more likely to stick around, Lambrix says, adding that companies that are new to the industry are starting to realize that.

“I think they recognize the value ISOs bring to the marketplace in terms of sales and support and are looking for ways to leverage that, and I think there should be opportunities there,” Lambrix says.

**Industry Is Attracting Investors**

The fact that more innovators are entering payments might be a positive economic indicator for ISOs.

Tech companies’ enthusiasm for the industry is signaling that payments is the place to be, says Linda Perry, an industry leader.

**INDUSTRY LEADERS WEIGHT IN ON SOME KEY ISSUES FOR 2014**

**On Big Data:**

“It’s more hype than reality right now.”

— Gil Luria, payments analyst for Wedbush Securities

**On EMV:**

“I don’t think it’s going to be as urgent as the associations want to make it. One of the problems is that consumers just don’t have enough chip cards in their hands to make EMV the urgent issue.”

— Steve Eazell, president of the Western States Acquirers Association and vice president of sales and marketing for Secure Payment Systems Inc.

**On mobile wallets:**

“We’re going to have to work with it for a while to see what takes and what doesn’t. It’s just going to take more maturity in that market to see what’s going to happen.”

— Linda Perry, independent consultant and former head of acquirer and processor relations for Visa Inc.

**On the technology shift:**

“For ISOs and agents, we think that opportunities in technology are going to be very powerful business drivers in 2014.”

— Jason Oxman, CEO of the Electronic Transactions Association

**On new entrants:**

“I think you need to be ready for it. These are smart, good companies with good products and solutions. A lot of these companies have spoken to acquirers about working together.”

— Kevin Lambrix, chief operating officer for EVO Payments International
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independent consultant and former head of acquirer and processor relations for Visa Inc. The economy is improving, investors have more money and they see payments as a good place to put it.

“If someone’s willing to put $20 million into a couple of kids in Silicon Valley who have an idea, it can’t be all bad,” she says.

One of the more sizeable investments took place this past fall, with PayPal’s $800 million acquisition of Braintree Payments Solutions, a Chicago-based startup that processes payments for other startups such as Uber and Airbnb. Perry believes there’s more to come from other big investors.

“We’re going to continue to see payments as a growth space, and a good growth space,” she says.

That’s not to say the economy has completely turned around. Most businesses continue to struggle with weak economic conditions, Eazell says.

Eazell does predict a bright spot in 2014, as the economy will continue to emerge from hard times. And the fact that so many organizations tightened their belts during the recession could start to pay off in the coming year. “It’s created a better marketplace for some of us to be more competitive,” Eazell says. “We’ve cut a lot of fluff out of our organizations, so we’re going to reach some benefits in 2014 because of that.”

Opportunities With Tablets, Mobile

Industry experts expect opportunities and challenges to arise in a few key areas for ISOs and agents in 2014.

Lambrix predicts the biggest shift in payment acceptance will take place with tablet-based systems, which he expects to grow in popularity even more during the next year than in the past 12 months. With technology more available to merchants—whether in the form of a mobile or tablet-based system—merchants will have access to more features than they would get from a terminal that only accepts credit cards, he says.

On the consumer side, the mobile wallet remains a perennial hot-button issue for the payments industry, but everyone is still waiting to see when the technology will take off.

This could be the year when mobile wallets finally become mainstream, and PayPal could promote its mobile wallet in a more substantial way than it has so far, Luria says. At the same time, Google and Apple could make similar progress with their mobile wallets. When two or three of those events converge, mobile payments will become widespread, he says.

In the past year alone, some key players have set the wheels in motion for greater mobile wallet use. Isis, the mobile wallet venture led by AT&T, T-Mobile and Verizon Wireless, was launched nationally in November. Meanwhile, this fall Google overhauled its Google Wallet app, which enables customers to make person-to-person payments and keep all of their loyalty offers in one place. Customers with NFC-enabled Android devices can make contactless payments in stores by tapping their phones at the POS.

Other experts believe the mobile wallet still needs more time to catch on. Oxman says mobile payments won’t replace cards for a long time but will continue to grow and present business opportunities for the industry.

He views Big Data as a lucrative opportunity for the industry. ISOs have begun to capitalize on customer data by helping merchants capture and analyze the customer information produced at point-of-sale transactions.

“Companies that can help make use of that data will be enormously valuable to merchants,” Oxman says.

But concerns are arising about data, too. Perry sees data analysis as revolutionary but intrusive. “I wonder if other consumers will find it the same way,” she says.

EMV Constitutes Major Challenge

Perry cites the transition to EMV chip card acceptance in the U.S. as one of the greatest challenges facing the industry in 2014. The industry is scrambling to come up with an adoption strategy that makes sense both for ISOs and merchants.

Questions center on what kinds of terminals merchants should use, how companies provide technical support and how EMV terminals will work with established payment products.

“There are just a lot of questions around EMV,” Perry says. “If I’m a merchant with 200 terminals, do I put all of them out there at once?”

Some experts believe the EMV transition will continue, although perhaps not as quickly as some might like because of unresolved technical issues. Luria suspects the process will speed up when the October 2015 Visa and MasterCard deadlines are looming.

But EMV opportunities will arise in the coming year as merchants continue to replace terminals with brand new EMV-enabled POS systems. That could mean more revenue for ISOs from equipment sales or leasing.

So the industry can look to continuing change, but that shouldn’t surprise anyone who’s been paying attention.

“I think there are going to be a lot of changes, but those changes have been coming,” Eazell says.

And for players in the industry that hope to succeed in the next 12 months, they might have to be willing to change, too. ISO

“(New entrants) recognize the value ISOs bring to the marketplace in terms of sales and support.”

– Kevin Lambrix, Evo Payments International
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knowing that commoditization is a drag on business, most ISOs are working hard to find a different type of rabbit to pull out of the hat. But most ISOs are still not putting on a show that’s special enough to dazzle merchants.

About 90% of the acquiring industry is struggling to differentiate, according to Rick Oglesby, a senior analyst with the Boston-based consulting firm Aite Group. For evidence, look no further than the results of a recent Aite study that asked nearly 500 small to mid-size retailers to name their merchant acquirer. The most common answer—chosen by a quarter of respondents—was “don’t know.”

“When a customer cannot name his or her service provider, you can be sure that customer does not believe that the service provider stands out in any way,” Oglesby wrote in the report.

Oglesby says the acquiring industry as a whole is struggling to differentiate for several reasons. For starters, while many ISOs are good at selling, they don’t have product-development capabilities. Other ISOs don’t have enough scale to compete effectively. Still others have grown so big they can’t help but operate as generalists, Oglesby notes in an interview with ISO&Agent.

In Aite Group interviews, merchant acquirers report offering the same value-added services as many of their peers. Ninety-five percent provide reporting and analytics services over their websites, 95% offer gift and prepaid cards, 91% offer loyalty programs, 91% offer check processing, and 86% offer encryption and tokenization services. About 77% offer e-commerce gateways, and 68% offer mobile point of sale. But those last two offering are becoming commonplace, Oglesby notes.

Standing Out’s Not Always Hard
While lots of ISOs are trying to differentiate, many seem like “deer caught in headlights,” says Todd Ablowitz, president of Double Diamond Group in Centennial, Colo. They don’t know what to do or how to get started, he says.

That’s where it becomes important to understand how the industry is moving and where they believe they fit in. “Coming up with a plan to differentiate doesn’t have to be hard,” Ablowitz says. “It can be very basic blocking and tackling.”

Ablowitz, who has worked with many merchant acquirers trying to find their way, says ISOs looking to differentiate should take a hard look at their strengths and where they think they can continue to provide the most value to merchants.

“There are lots of ways to do it, but it shouldn’t be done in a vacuum,” he says. “It has to fit what you’re already doing and already good at. Whether it’s through verticals, or technology or anything else, it has to be real and not just surface level or marketing spin. Otherwise it just won’t matter.”

There are ways of differentiating, agrees Oglesby, the Aite consultant. “The answer isn’t to throw your hands up and say I’m in a commoditized market.”

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lem, some ISOs are trying to distinguish themselves by focusing on their software capabilities—developing and market-
ing technology that boosts merchants’ profits and makes their lives easier.

Others ISOs are taking a more consultative approach to selling—trying to help merchants build their business and manage expenses as opposed to merely processing their transactions.

Others are concentrating on one or a few verticals or niche markets, such as doctors, dentists, hotels or micro-
merchants.

Still others are focusing on growth areas such as mobile technology as a way to separate themselves from the pack.

One overarching theme is that compet-
ing on price alone is a thing of the past

“The old way of marching into Mr. Merchant and asking for last month’s statement and bidding on price, is cer-
tainly a dying mode of sales,” says Kurt Strawhecker, managing partner of The Strawhecker Group, a payments industry consulting firm based in Omaha, Neb. “The more you specialize, the less com-
moditized your offering is,” he says.

Boston-based Merchant Warehouse is one of a number of ISOs that has taken pains to stand out from the crowd. Michael Gavin, senior vice president of sales, attributes some of the ISO’s suc-
cess to staying ahead of the market.

“We try to look at what is going to happen, as opposed to what it is happen-
ing,” he says.

It’s why over the years Merchant Warehouse developed three distinct sales channels, as opposed to one, and why its most recent technology platform is designed to support mobile com-
merce in addition to cash, credit, and debit payments from a single device. Transactions are more complicated than they were 10 years ago, and merchants want flexibility, Gavin says.

Jeff Broudy, vice president of sales and marketing at Total Merchant Ser-
vices of Woodland Hills, Calif., agrees. The ISO is pushing services that aren’t
just payments-oriented but also help merchants expand their business.

The ISO is combining two recent acquisitions to further those efforts. In December 2012 it bought Fanninder, a company that focuses on mobile and social loyalty marketing. Total also recently purchased Registroid—a POS application for Android devices that is available for restaurants and retailers.

A number of other ISOs are also introducing data services that help clients grow their respective businesses.

A lot of smaller ISOs haven’t seen the change coming as rapidly as some of the more technologically advanced ISOs have. The [old] model still works for them,” Rawls says.

Today, ISOs should think about what they can do to help merchants drive sales and manage expenses, says Tim Munto, group executive of sales and client relations at TSYS Acquiring Solutions. If ISOs can make these processes more efficient for merchants, they will have a more sustainable model, he says.

“Payments are the foundation around which to build a much stronger, a much deeper value proposition,” Munto contends.

Yet not every ISO can make that work. In fact, the inability to differentiate is prompting some ISOs to explore buyout opportunities. “They realize they aren’t in a position to grow their business going forward,” Munto says.

Those ISOs either don’t have the scale, haven’t developed a differentiation strategy or they don’t have the capacity to invest in new technology.

That market reality has created a buying opportunity for companies like TSYS of Columbus, Ga., that are looking to expand. Last year, for example, TSYS bought NetSpend Holdings Inc., a provider of general-purpose reloadable cards. In 2012, TSYS bought ProPay, a processor that focuses on small and micromerchants.

Other ISOs are also looking to purchase capabilities as a way to differentiate. John V. Priore, president and chief executive of Priority Payment Systems in Alpharetta, Ga., says his company has an active M&A pipeline and a team dedicated to searching for opportunities, particularly with respect to certain types of technology.

“That takes capital and not every small to mid-size ISO will have the capital and the expertise to go out and originate and close an M&A deal,” Priore says.

Focusing On Vertical Markets

Another way ISOs are trying to stand out from the pack is by focusing on a few niche markets. That strategy helps ISOs become experts in a market, thus giving themselves with a convincing sales pitch and better retention rates.

A few years ago International Bancard Corp. in Clawson, Mich., decided to build up three verticals—business-to-business, business-to-government and real-estate payments.

David Lafrate, Bancard chief executive, says he saw more upside to focusing on those areas than to continue to target a broader Main Street merchant base. International Bancard has entered the early stages of its conversion. It has taken several years to develop software and hire and train salespeople. The endeavor has cost the ISO millions of dollars, but Lafrate believes the strategy will give the ISO a better chance to compete.

“It’s a long, hard road,” he says.

Eric Remer, chief executive of PaySimple in Denver, is another ISO taking a slightly different approach to the commoditization problem. The company considers itself primarily a software provider and targets service-related businesses with 20 or fewer employees.

Most of those businesses are still operate in a paper-based world and need more than just a dongle to do business, Remer says. PaySimple provides them with payment acceptance, customer management, smart-marketing tools, billing and invoicing automation, business insights, and mobile payments.

While some ISOs target only a few small-business sectors, PaySimple works with small service-oriented businesses of all kinds, including law firms, accountants, landscapers and day care centers.

Remer says merchants who want industry-specific services may choose another provider, but he sees more benefit to his company in a larger merchant base. Besides selling directly to merchants, PaySimple also private labels its software for larger companies such as ADP.

To be sure, differentiation is a process that never ends. But ISOs will prosper if they adapt to the new realities of the market, industry observers agree.

Merchant Warehouse’s Gavin puts it this way: “ISOs have to be able to think ahead of the market—to be proactive rather than reactive.”

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As the October 2015 EMV deadline draws closer, the retailing and payments industries could find themselves scrambling this year to switch to the standard. But uncertainty remains about just how significant their progress will be. Unanswered questions about debit cards could stall the switch, industry experts say.

“Card issuers don’t want to issue debit cards until regulations are finalized for debit interchange rates and routing, part of the Durbin amendment to the Dodd-Frank Wall Street Reform Act, says Mansour Aaron Karimzadeh, managing director and chief technology officer of SCIL-EMV Academy, a New York-based EMV training and consulting firm.

Card issuers don’t want to issue debit cards until regulations are finalized for debit interchange rates and routing, part of the Durbin amendment to the Dodd-Frank Wall Street Reform Act, says Mansour Aaron Karimzadeh, managing director and chief technology officer of SCIL-EMV Academy, a New York-based EMV training and consulting firm.

Issuers’ hesitation is influencing retailers, he says.

“I have talked to a couple of the very, very big merchants, and they are saying they don’t know what to do, primarily because of Durbin,” Karimzadeh says.

Once issuers act on EMV, merchants will too. Merchants want to accept every type of card and focus on selling their goods and services, he says.

Still, no one knows when regulations will become final, partly because of a court case over the Durbin amendment, says Deborah Spidle, director of EMV solutions at Paragon Application Systems, which makes software-testing systems for financial institutions and is based in Holly Springs, N.C.

Many are confused about how the case affects them, Spidle says. Issuers understand the litigation doesn’t cover credit cards, and many are therefore preparing to issue EMV-equipped credit cards and accept those transactions, she says.

“But the legal case does impact the debit side, so people are holding back and saying, ‘I don’t even want to approach debit until I know what the courts are going to do,’” Spidle says. “Meanwhile, you have these liability shift dates, and a lot of people are very confused because they don’t understand what they’re supposed to do.”

How liability for fraudulent transactions will shift depends on the card brand, but Oct. 1 of 2015 and 2017 are key dates for Visa, and Oct. 1 of 2015, 2016 and 2017 are key dates for MasterCard. American Express has announced Oct. 1, 2015 for its liability shift date. Parties

An Unfocused Transition

Even the retailers and tech companies that want to embrace EMV feel reluctant to pursue it because of unresolved issues.  

BY ELIZABETH WHALEN
that fail to adopt EMV by the relevant deadline could bear the financial consequences of fraudulent transactions.

The Durbin-related concerns that areimpeding progress toward EMV come mainly from the debit networks, says Karimzadeh, but they make other stakeholders nervous, which then prevents them from thinking about what to do if and when Durbin is resolved.

Issuers don’t want to choose an approach to EMV and then later have to modify it to comply with the final regulations, says Todd Freyman, vice president of the Americas for Bell ID, a Dutch-based maker of software that prepares and loads data onto EMV-based cards. In reality, though, the changes necessary for compliance will be minor, he says. The exact form of those changes is yet to be determined but could include issuers making a small software configuration change or even changing nothing about the card-issuance process.

“It’s something that can be handled on the routing side, on the back end at the point of sale at the time of transaction,” he says. “So the idea of holding off on doing this, and making it a fire drill in the end to make these 2015 liability shift deadlines doesn’t make a whole lot of sense to us,” Freyman says.

“The important thing is that the migration is not stopping because of that,” says Randy Vanderhoof, executive director of the Smartcard Alliance and director of the EMV Migration Forum. “It’s still moving forward. Issuers are issuing cards. Merchants are implementing EMV-compatible hardware systems.”

The EMV Migration Forum has formed a group to assess technology that would support debit routing no matter what regulations are ultimately enacted, Vanderhoof notes.

Durbin Issues Aren’t Just Technical
The issues surrounding Durbin are not simply technical, says Spidle.

“We have to find a technical solu-
tation to a business problem that all the business people will be happy with and understand,” she says. “That’s the challenge.”

One issue the industry will resolve this year relates to testing and certifying the applications loaded onto EMV-equipped terminals, Vanderhoof says. Some acquirers have expressed concern about getting all their merchants through the process before the liability shift, he says. In response, members of the EMV Migration Forum are assessing ways to streamline and accelerate testing.

Some argue that the card brands will postpone the liability date, but Vanderhoof sees no indication of that.

Freyman hopes the major brands hold fast to the deadlines, in part because fraud is increasing, but Jae Haas, president of TransNational Bankcard, a merchant services provider based in Rosemont, Ill., views the 2015 date as too early.

“Certainly, if the equipment manufacturers want for that to happen, and the card issuers push cards out, then I can see that coming to fruition,” Haas says. “Otherwise, we have a sneaking sense that it’s probably going to get pushed back again.”

Some Question The EMV Shift
Some may discount the benefits of switching to EMV, says Karimzadeh. Nearly everyone involved will incur near-term costs to upgrade terminals, purchase software or issue new cards. Savings on fraud may not outweigh those costs for perhaps seven years, he says.

The difficulty of calculating some benefits also raises questions about the business case for EMV, Karimzadeh notes.

“There are some fundamental components of the business case that are not easily quantifiable,” he says. “For example, interoperability. A lot of the international travelers who come into the U.S. only have chip cards. Some European countries are going to stop issuing magnetic stripes on the back of the chip cards.”

Those trends, combined with the fact that some European merchants no longer accept magnetic stripe cards, may leave travelers unable to use their cards away from home, but determining how much that costs the industry and retailers is difficult, says Karimzadeh.

Mobile payments, which Karimzadeh ties to EMV, are another difficult-to-quantify element in the EMV equation, but he says that issuers with an EMV infrastructure will find it easier to accept and process mobile payments.

Most merchants will find it difficult to quantify the fraud they’ve never previously had to pay for, says Spidle.

“If you’re a merchant, you’re going to say, ‘I don’t know how much I have not had to absorb before, so I don’t know what it’s going to mean to me. How much fraud am I going to have to pay for that I’ve never had to pay for before?’”

Building a business case that rests on avoiding paying for an unknown amount is challenging, says Spidle.

But it’s clear that merchants and ATM deployers that lag behind their peers in adopting EMV will become targets for fraudsters.

“Criminals are very smart,” Spidle says. “They’re the smartest people in our industry, unfortunately. They will quickly determine which merchants and which ATMs have not been upgraded to support EMV, and that’s where they’re going to do their damage. Those who are the last to migrate to EMV are the ones who are going to suffer the most.”

Some merchants may not find the fraud liability shift a compelling reason to switch to EMV, says Haas. Some of TransNational Bankcard’s clients are in Canada, where the switch to EMV is essentially complete, yet some merchants there still rely on magnetic-stripe technology. These merchants are often small, know their customers relatively well and accept primarily card-present transactions, Haas says. He cites a small gym as one example but says other businesses also fit the mold.

“They kind of disregard this concept of the liability shift,” Haas says. “They know their cardholders. They have good customers. They’re good merchants. They just swipe the cards in a lot of instances. In some cases, if there’s a recurring payment, they swipe the card one time.”

These merchants don’t see the benefits of EMV applying to them, he says.

A Deadline Without A Mandate
Vanderhoof notes that there is no mandate for issuers or merchants to meet the October 2015 fraud liability shift date. Some organizations may decide the risk of delaying the switch to EMV is acceptable and prefer to wait until after the deadline and the potential rush for testing and training resources, he says.

Moreover, Haas remains unconvinced that EMV will be the dominant payments technology for long. He sees thumbprint-based smartphone locks as one indication that some form of biometric authentication could overtake EMV sooner rather than later.

The need for a globally interoperable payments system prevents any one country from lagging too far behind or advancing too far beyond the rest of the world, Vanderhoof says.

“If the U.S. happened to be the first
to move ahead of the rest of the market in terms of new payments innovation, they would have to at least keep up with the current market, which is already EMV-based," Vanderhoof says. “There certainly could be a concurrent change that means doing EMV now and preparing to do EMV plus whatever that next generation of payments options will be.”

A New Experience For Consumers

Whether all merchants adopt EMV or not, consumers should prepare for a different experience than they have now, especially at ATMs, says Owen Wild, global marketing director, security and compliance solutions for NCR Corp. of Duluth, Ga.

“Consumers here are very used to a card environment where the transaction is initiated when you put the card in the ATM and then remove it, just as at a gas pump,” he says. “And in most cases, in the EMV transaction, the card is going to be held in the device for a longer period of time, and I think we need to do some more work as an industry to talk about how the customer experience is going to be impacted by that.”

Many ATMs deployed in the U.S. in the last few years are already capable of handling EMV transactions, Wild says; they are simply not yet activated to run EMV transactions. However, that does not mean the switch to EMV is easy or quick, he says. Still, he’s confident 2014 will be a year of progress.

“Every financial institution is looking at this and clearly understanding the impact and is now much more engaged,” Wild says. “I think everybody now has the right level of focus. It’s just going to be a question of making sure everybody stays committed to a program plan.”

Freyman sees another sign of progress from financial institutions. He says they are increasingly interested in Bell ID’s training courses and have also begun adding in-house EMV-issuing capabilities to the outsourced capacity many relied on for pilot programs.

Haas encourages ISOs to learn about EMV so they can serve as a resource for their merchant clients. He also hopes ISOs keep their merchants’ needs in mind.

“I think ISOs have a responsibility to their merchants to go out and provide this equipment to them at little to no cost,” he says. “I would just hate to see this be another checkbox for the general merchant population to say, ‘Those darn credit card processing companies. We just don’t like them. They’re constantly taking advantage of us.’”

The switch to EMV is ultimately the merchant’s choice, Haas maintains. “And they should be given as much information as possible in order to make the best-educated decision for their store,” he says.

Large merchants should probably get started earlier and may incur greater costs, Haas says.

“But for the small and medium-sized businesses, I think 2014 should very much be a holding pattern,” he says. “They should continue to educate themselves through the first and second quarter for sure. Maybe use the third and fourth quarter to get a clear understanding of what the implications are at their counter; what sort of process flows do they want to consider if these dates are going to seem to hold.”

By the end of 2014, merchants may want to begin assessing whether they need new hardware, he says.

Karimzadeh has found that, while large merchants generally understand EMV, many small and mid-sized merchants do not. He also encourages ISOs to learn about the technology and recommends web seminars as a budget-friendly alternative to seminars that require travel. ISO
A nyone who was bracing for major changes in PCI had a bit of a surprise last November. After all, the Payment Card Industry data security standards council operates on a three-year cycle to establish a new version of its rules, so major changes were inevitable, right? Wrong. Instead, the council released version 3.0 of the standards with the intent of nudging the industry back to the basics of security. It’s chiding merchants for using default passwords and encouraging them to change passwords on a regular basis—all in the spirit of making good security habits part of business culture.

PCI security council general manager Bob Russo uses the catchphrase “business as usual” to describe what the council would like to see these days. For Russo, the new standards stress education, awareness and security as a shared responsibility for each organization. That means the rules have undergone only minor changes.

“As luck would have it, not many tweaks were needed,” Russo says. The latest version includes best practices for complying with PCI and improved testing to validate compliance.

Others agree with Russo’s analysis. “I studied the PCI requirements and didn’t see anything really difficult; it really is getting back to the basics,” says Randal Asay, chief technology officer for security vendor Catbird.

However, the period of simplicity will end soon as anticipated technical advances arrive over the next two years or so, Asay says.

In the meantime, the card industry is discussing ways of manipulating sensitive data in the cloud, experts say. Everyone has a different interpretation of how the cloud works for payments and where security fits in, says Julie Conroy, a fraud prevention and security expert for Boston-based Aite Consulting.

“I think there is the opportunity over the coming years for services like tokenization and end-to-end encryption to reduce the impact of PCI requirements, provided merchants and financial institutions take advantage of these technologies,” Conroy says.

When it comes to security, big business gets it and the little guys don’t, she says. “I was talking with the head of info security for a large health insurance company the other day, and he really didn’t think that the new PCI requirements were a big deal at all,” says Conroy. “He said they were basically just a codification of things that they were already doing as a basic security practice.”

That’s not necessarily the case for smaller organizations. “I think the disconnect comes with the small merchants,” Conroy says. “The reality is that raising awareness there will continue to be a challenge, so as an industry we need to continue to find ways to just get the data off of their systems.”
On a regular basis, Susan Matt, CEO of Thoughtkey Inc., a tax and PCI consulting business, sees small businesses struggle to comply with PCI.

“It’s a constant education process for smaller businesses,” Matt says. “You have to break it down for them to a simple subset of rules, and all of these small businesses are not the same.”

It’s not uncommon for small-business owners to handle PCI compliance in the same way they do their taxes.

“They wait until the last minute and ask for an extension because they are not prepared and don’t understand all of this stuff,” she says.

Most small merchants opened a business “because they wanted to do something they were good at,” and spending time on PCI compliance seems alien to them, Matt says.

“Accepting credit cards is an extension of their business. It is not their business,” she says.

But it’s not as though the PCI establishment is oblivious to the challenges facing small businesses. The emphasis on education and best practices is aimed at smaller companies.

For the more complex tasks, PCI calls for virtualization technology.

The requirements include network diagrams that identify connections between cardholder data and other networks, including wireless networks. In addition, PCI calls for network diagrams that show how cardholder data flows across systems and networks.

Catbird’s Asay likens that requirement to winning at three-card monte, the three-cups-and-a-ball shell game used by con artists. “You must keep your eye on the ball to see where it ends up,” Asay says. “Likewise, you must know where your cardholder data is at

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all times in order to protect it.”

As they plan their attacks, hackers create color-coded schemes of network diagrams to pinpoint where sensitive data is stored, so it makes sense for those defending the data to do the same.

Businesses should also maintain an inventory of system components that are in scope for the PCI data security standards. Keeping track of physical components is hard enough, Asay says, but an automated system is needed to keep track of the “dynamic nature of virtual components.”

Matt says the PCI Council did the right thing by keeping changes to a minimum and giving merchants a year to comply, but encouraging faster compliance.

“So much is going on with mobile and advanced encryption, the PCI Council is doing the best that can be done right now with its requirements,” she says.

But that will change soon, Matt warns. “I would say, easily, eight to 12 months from now will mark the need for another revision and the need to adjust to emerging technologies,” Matt says. “I don’t agree with those who say it could be two years or more because it’s not going to take that long.”

In the meantime, the PCI Council continues to repeat the message that simple improvements provide the best defense. “If we can eradicate default passwords, we would eliminate a lot of fraud,” says Troy Leach, the council’s chief technology officer.

Chris Bucolo, senior manager of security consulting services for ControlScan, shares Leach’s disdain for default passwords.

It’s easy for hackers to gain entry to payments systems because most default passwords are a sequence of numbers as simple as 1-2-3-4-5-6, Bucolo says.

With that password, fraudsters have changed settings on ATMs to trick them into thinking they were stocked with $1 bills instead of $20 bills—as a result, ATMs dispensed 20 times as much cash as they were supposed to for each withdrawal, Bucolo says. ISO
Acquiring’s First Association

All of the regional trade groups grew out of the Northeast Acquiring Association. The NEAA even predated the precursor to the Electronic Transactions Association. **BY ED MCKINLEY**

JACQUES BRETON

As treasurer of the Northeast Acquirers Association, Jacques Breton handles logistics for the regional trade group’s events. That includes everything from managing exhibitors to signing off on the luncheon menus.

In the process of performing those tasks, Breton is helping his fellow NEAA board members turn the trade association’s winter outing at Mount Snow, Vt., into a tradition of the acquiring business.

He and the rest of the board are also working to renew the association’s summer outing, which is scheduled next year for Tarrytown, N.Y.

Breton devotes 80% to 90% of his working hours to his job as vice president of ISO sales at My Clear Reports, and he divides the rest of his work day between the NEAA and his consulting duties at MJM Associates Inc.

But he recently took time out from that busy schedule to sit down and talk with ISO&Agent about the NEAA’s history and what the association means to the industry.

Breton explained how the NEAA show started and how the acquiring industry’s system of four regional associations grew out of his work at General Credit Forms.

He also revealed why the NEAA “isolates” its trade show attendees and vendors in destination resorts like Mount Snow—it’s for their own good, he says.

The interview has been edited for length and clarity.

**ISO&Agent:** *How did you get started in the acquiring business?*

**Breton:** I started in the credit card industry back in January 1970, so I’ve been around for a couple of days. In the early days of the industry, most of the smaller banks did both issuing and acquiring. I had responsibilities for both. I started off as collection manager, and when the vice president of the department resigned, I took his position. I handled a little bit of card issuing but became more and more involved with merchants.

My real involvement with the acquiring industry occurred right around 1979. At that time I was working for the First National Bank of Portsmouth in Portsmouth, N.H., which is now long gone, but some of the footprint is TD Bank. At that point in time the economy was going into a little bit of a downturn. Clearly, the bank I was working for was a true Yankee conservative bank. They instructed me to go around to every merchant that had BankAmericard card applications and pick them up. They felt they did not want to put the bank in the position of having extended too much credit. So I’m 32 years old and I’m saying, “What am I going to do the rest of life?”

I sat down with the chairman of the board and the president of the bank, and I said, “What about the merchant side?” And they said, “We don’t care what you do with the merchant side.”

That’s where I jumped into the acquiring side. The bank pulled in the horns and went from there. As time went on, the First National Bank of Portsmouth became a very strong bank on the merchant side. I don’t know if the bank was aggressive or I was aggressive, but we started attaining multi-location accounts throughout the whole country on a small scale.

**ISO&Agent:** *What else did you accomplish there?*

**Breton:** In the early ’80s we were one of the first banks to do two things. One, we were doing electronic draft capture. Two, we were doing what’s now known as unbundled pricing with separate transaction fees and statement fees. We had to go to unbundled pricing because otherwise we didn’t know how to bill electronic draft capture.

**ISO&Agent:** *How did the NEAA start?*

**Breton:** In ’85, several of us got together. There were eight foursomes playing golf. We had lunch and exchanged notes, and we had dinner and exchanged notes. At the end of the day we had bills
for these meals, and we couldn’t expense it. But if we had a business meeting and brought a whole bunch of people from the industry, we could.

So we decided to start an annual gathering that brought middle management—the office managers and the sales people—to a meeting place to meet their peers, discuss things, exchange notes, etc. The card association meetings of the time were just for top management.

In 1986, the second meeting had, lo and behold, five banks and 50 to 60 golfers. The first meetings were always in the summer, the first two weeks of June in Portsmouth, N.H. That lasted until around ’97 or ’98.

Our first outing was at Wentworth By The Sea Country Club in Portsmouth, N.H. It stayed at Wentworth By The Sea from ’85 through ’97 or ’98. Then we moved the summer event to various locations in New England.

Visa and MasterCard—back then they were BankAmericard and Master Charge—used to have regional meetings for senior management of the banks or key people of the various credit card departments. A number of us had met each other at these various meetings and decided to have a local gathering of our own. It was a bunch of us sitting around saying we need to get together once in a while, talk about what our problems are, exchange notes and network.

**ISO&Agent:** Was the NEAA the first trade association in the acquiring business?

**Breton:** The NEAA is the oldest trade association in our industry. We say we were established in 1985, so we were around before the Bankcard Services Association, which became the Electronic Transactions Association. Our goal was to be an education and network forum, and we want to continue with that.

“The NEAA is the oldest trade association in our industry. We say we were established in 1985.”

**ISO&Agent:** Did the other regional shows grow out of the NEAA?

**Breton:** They did. In 1997-98, I was working for General Credit Forms out of St. Louis, which is owned by the McCormick family. Glen Taylor, the chief operating officer I was reporting to, became aware of what I was doing with the Northeast. He was aware of the number of people I was touching on a regular basis.

He felt there was a tremendous tool to cross-sell, cross-market without a private agenda. Here I am advertising and selling the Northeast, and my byline is General Credit Forms. So I’m getting some branding out there.

General Credit Forms operated in four regions for sales—the northeast, southeast, midwest and the western states. From there, each one of the other shows grew at a different time. The Southeast grew with John McCormick because he was the salesperson handling the southeast. Jim McCormick came on a couple of years later, and he was handling the midwest. Sherry Friedrichsen, subsequent to that, came on and she was handling the western states. The four of us had the four corners of the country covered.

**ISO&Agent:** Why have the four regional shows fared so well?

**Breton:** The Regional’s have created a forum to educate ISOs, small sales offices and MLSs and offered great networking opportunities in local areas. If you look at any one of the regional shows, it gives a vendor an opportunity to spend a couple of days in the market and see 20 or 30 existing clients and maybe entertain the opportunity to see at least 20 or 30 more potentials.

The Northeast Acquirers offers free registration for the winter show to MLSs, sales offices and small ISOs. The reason is we realize they just don’t have deep pockets to be out of the office two or three days and take on the extra expense of traveling and the rooms. We’ve cut our price to zero for advance registration. If you register at the door, it’s a different story.

**ISO&Agent:** When did the NEAA winter event begin?

**Breton:** February ’97 was the first winter event—in Rutland, Vt., and Killington, Vt. I don’t have the number of vendors, but the total headcount was like 60 people.

**ISO&Agent:** How many attend the winter event these days?

**Breton:** Right now, we have 80 vendors. That totals a maximum of about 180 vendor people, and then we end up with more than 300 attendees.

We have been very fortunate over the years to have more attendees than vendor people. NEAA does not allow for roaming vendors.

**ISO&Agent:** These days, the winter meeting’s in Mount Snow, Vt., which isn’t close to a major airport.

**Breton:** People moan, groan and complain that they can’t get there. But once they’re there, they love it. They’ve come to accept it now.

Quite honestly, I firmly believe in that kind of property—they’re destination resorts. The basic reason is that once you get there, you’ve got no place to go. So, you have a captive audience.
for a couple of days.
You network with your own group—with industry folks. From the vendors,
to the sponsors, to the attendees, you’ve
got constant communication. With most
of these properties we’ve gone to, it’s
just us. What happens is, that no matter
who you’re walking down the hall with,
it’s part of the group.

ISO&Agent: What’s the advantage
of holding the winter show in the same
place every year?
Breton: We’re 13 years at Mount
Snow. We’ve been there for so many
years that the property knows us, we
know them, they know our needs and
they can cater to this group.

ISO&Agent: Do attendees and ven-
dors like the familiarity?
Breton: One of the craziest things
about the Northeast show is our format
hasn’t changed in years. When you add
that it’s at the same property, that’s good
and bad. You’re going to see the same
walls. Yes, they’ve been painted, and
the rugs have changed.

But what we’ve attempted to do is cre-
ate activities so that the people coming
in early have something to do. Spon-
sors have underwritten snow tubing
and slalom ski races. We’re looking at
the possibility of dog sled rides. We’re
talking to the mountain and the snow-
mobile guys we’ve been using all these
years to take people for rides up the
mountain with a guide. We’ve thought
about sleigh rides.

What we’re trying to do after the
meetings is create activities where
people network.

ISO&Agent: Has heavy snowfall
caused problems at the winter show?
Breton: Three years ago, it started
snowing on a Tuesday night, and we
got up Wednesday morning and there
was 15 or 16 inches of snow. There
was mass panic. The roads were so
bad to the south that people didn’t get
there until 2 o’clock or 3 o’clock in the
morning. Those who came in Mon-
day wanted to leave Wednesday, but it
snowed all day Wednesday. The ones
who left Wednesday got stuck at the
airport because there were no planes.
The ones who left Thursday morning
drove down fairly decent roads and
made their flights.

Vermont road crews are experts in
clearing the roads. You’ve just got to
wait it out—that’s all. If you get there 20
minutes later because of the roads, it’s
not going to make a bit of difference.

ISO&Agent: Have you had any other
weather-related problems at Mount
Snow?
Breton: In the middle of the lobby
of the Grand Summit Hotel at Mt. Snow,
there’s a large double-faced fireplace.
On one particular night, the wind was
blowing so badly a backdraft occurred
in the fireplace, smoke ended up all over
the place and the fire alarms went off
at 3 o’clock in the morning.

There were some wild stories about that
one, but we’ll leave it the imagination.

ISO&Agent: Do many families at-
tend the winter show to take advantage
of the winter sports activities?
Breton: We have some friends and
family members who come up for the
weekend and some who come up for the
week. I think this year we’ll have 75 or
80 the weekend before the show.

ISO&Agent: What about summer
shows?
Breton: The Northeast Acquirers
started off as a summer show, but we
had two years where we didn’t have a
summer show. In 2008, we had the last
one, and we didn’t pick one up until
2011, when we went to Ellicott City,
Md. The next two were in New Jersey,
and the 2014 will be in Westchester
County, N.Y.

ISO&Agent: Why have two shows?
Breton: The winter show attracts
attendees from all over the nation, but
the summer show is more local. The
summer show is smaller, but the crowd
is appreciative.

Also, some folks didn’t want to travel
through the mountains in the winter
because they were afraid of the roads.
We thought that by having one in the
summer we would be able to attract a
whole bunch of new people.

ISO&Agent: Who else works on the
shows?
Breton: We have a board that con-
sists of seven people. Each one of
them has a distinct role. Alan For-
gione of Ingenico serves as NEAA
president and deals with the speak-
ers. Nancy Austin of Verifone, who’s
the association vice president, floats
between registration, the speakers
and whatever. Chris Butts from Chase
Paymentech is the emcee during the
event. Henry Helgeson and Jim Fink,
both of Merchant Warehouse, help out
at the registration area or wherever
we need them. Ruth Gorski of Amex
does sponsorships and works with
me, assisting with vendors.

ISO&Agent: What else can we say
about the show?
Breton: Without the vendors and
sponsors the show does not exist. The
NEAA thanks them all.
Guest Column BY CHRI S TAYLOR

Turn Customers Into Partners

TOO MANY ISOS PLAY THE ROLE OF A bank—providing merchants a checking-account-like approach to credit card processing. I don’t know about you, but checking accounts don’t really excite me.

My checking account serves a basic purpose—it provides access to my money. I’m happy with the service, but I would switch banks in a heartbeat for a better rate. After all, thousands of banks offer checking accounts just like mine.

Many merchants view ISO services as a simple commodity, creating a highly competitive industry with little differentiation other than price.

So how do you create profitable, long-term relationships in the payments industry? You stop finding customers, and start creating partners.

Customer relationships frequently result in a zero-sum game—a perfectly even trade of gains and losses between two parties. 1+1=2. Think of it as paying market value. By definition, market value’s a fair price. It’s also the same price I could get anywhere. Not exactly a differentiator.

Contrast that with a partnership. Partnerships are synergistic relationships where parties work together to produce a greater result than the sum of their individual efforts. If customers are 1+1=2, then partnerships would be 1+1=3.

When I say ‘partnership’ I don’t mean the marketing buzzword. I mean you should actually take a vested interest in the success of your merchants.

The difference between customers and partners really comes down to fair versus rare. Customers expect fair, and while fair is acceptable, it is easily replaced.

Partnerships, however, are a rare commodity and difficult to replace. As a partner, you help merchants achieve a level of success they can’t reach on their own. They realize they are a better business with you, than without you.

It’s not all about merchants though. Remember that partnerships produce greater results for both parties involved?

When your merchants make money, you make money. Anything you can do to help grow your merchants’ business will ultimately grow your own.

Merchant relationships become more profitable over time. Sales commissions, hardware placement, support calls, and other costs are typically absorbed early in the customer lifecycle, which means merchant accounts typically become more profitable as time goes on.

It’s easy for ISOs to get caught up in a game of expand and conquer, where all efforts focus on signing new merchants. For most organizations, increasing sales through existing channels is much more profitable. Building strong partnerships enables you to retain merchant relationships long into their highly profitable stages.

Many qualities characterize good partnerships: trust, good communication, shared goals… but I want to focus on a specific partner attribute—knowledge.

While many small merchants are experts in their field, few are experts in business. Your merchants are experts at fixing cars, cleaning teeth and styling hair—not marketing or accounting.

Become an educational resource for your merchants. That differentiates you from competitors that offer nothing more than a way to process credit cards.

Here are three topics your merchants will find valuable.

1. Increased sales. Increasing revenue tops every small-business owner’s wish list. But most lack the knowledge to turn that wish list into a to-do list.

You can teach your merchants marketing strategy and sales tactics. How about a Web seminar called Facebook 101: Using social media to increase sales?

2. New technology. Being a technology consultant means more than upselling terminals. Become a matchmaker by pairing merchants with the perfect technology to achieve their goals.

Technology creates first-mover opportunities for merchants. In 2013, for example, mobile processing enabled many merchants to expand sales to new customers outside their stores.

3. Data security. Although PCI helps safeguard data, ISOs hesitate to require merchants to comply, for fear it will drive away merchants. That’s far from the truth. Aggressive compliance programs strengthen merchant relationships.

ISOs with more than 90% portfolio compliance typically have the greatest merchant retention rates. That’s because they approach PCI compliance as a partnership. They focus on education to help merchants understand the importance of data security, present PCI validation as a priority and not a penalty, and provide resources and support to simplify compliance.

Approach merchant relationships with a partner mentality and remember a simple rule—if you help your merchants become more successful, you’ll become more successful.

Chris Taylor is the senior product marketing manager at SecurityMetrics. For more information, reach him at christaylor@securitymetrics.com.
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*ISO&AGENT 55*
Card Networks Share The Blame For Merchant Data Breaches

In the wake of the Target data breach, I am struck by the almost universal lack of understanding of the essential issues at hand. Consumers are the primary victims, but merchants take a hit, too. Why? Because our payment system is broken and does not have real security in place because the credit card companies that control the system can push the costs of fraud onto retailers.

To fully understand the magnitude of the systemic failure manifested in the Target breach, one needs to understand the “product” at the source of the breach: credit and debit cards. The two largest brands, Visa and MasterCard, control all of the elements related to the operation of their card networks—including the swipe fees, the largest part of what merchants are charged to accept the cards, how consumers’ account information is protected and who pays for fraud. For doing that, Visa and MasterCard reap a collective $8.1 billion in profits over the past 12 months, with minimal exposure to any financial loss related to security flaws in their products—like those that caused the Target breach.

Merchants have precious little say in how the card products in the consumer’s wallet are protected from theft, even though trade association studies have found merchants cover most losses from credit card fraud. While Visa and MasterCard dictate card security and allow transactions to proceed without authentication or encryption, they have little real interest in effective security because they don’t absorb many fraud losses.

In other words, doing what is right would cost Visa and MasterCard without adding to their revenue. So they don’t bother.

Some pundits disingenuously blame the Durbin Amendment to the Dodd-Frank Act. Durbin’s courageous attempt at curbing the runaway societal costs of the debit payment system paid to the largest banks has no direct financial impact on Visa and MasterCard. In fact, under Durbin, merchants paid $250 million in special interchange fees over the past year to the largest banks covered by the Durbin amendment to “innovate” data security methods that protect consumers. Any contention that Durbin may have financially hamstrung issuing banks (the fewer than 200 covered under Durbin) from doing the right thing is just wrong.

Merchants have invested tens of billions of dollars over the past five years in securing the estimated 12.6 million “endpoints” where consumers transact as part of the card brands’ mandates for improved data security. But much of that money was spent just to comply with Payment Card Industry data security standards. PCI is controlled by the major card companies and, instead of focusing on the most effective anti-fraud systems possible, such as simply requiring the use of PIN, PCI focuses on pushing costs onto merchants. Target complied with PCI standards. Clearly that wasn’t enough.

While it is easy to vilify Target, the retailer is a victim along with consumers. We’re all hurt by the major card companies devaluing security because they push the costs onto merchants. The card companies’ refusal to take on real card security has made the U.S. more vulnerable, and fraudsters around the world know it. Our country is a magnet for fraud even though we pay the highest swipe fees in the industrialized world. Real card security standards need to come from an objective source, such as a standard-setting organization or regulator, not the card companies, if we are ever going to turn around our dismal results.

Douglas Kantor is counsel for the Merchants Payments Coalition and a partner in the Washington office of Steptoe & Johnson.
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