Pay Choices

What bankers need to know about new pay options

Storm season checkup
New ways to assess credit risk
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Payments landscape:

“Still Crazy After All These Years”

By Lisa Valentine, contributing editor
Few clear winners stand out, leaving banks mostly still watching. Herewith an informal “new payments scorecard”

“It seems mobile payments has been the next big thing for the last five years, and we still haven’t seen a lot of volume,” says Steve Kenneally, vice-president of ABA’s Center for Regulatory Compliance. And so goes payments. A lot of talk and not a lot of action. There are a handful of successes, however. Starbucks generates more than three million mobile transactions each week in the United States. That’s a lot of lattes. And prepaid cards are booming.

When it comes to payments, except for prepaid, many banks are sitting on the sidelines, waiting for definitive technology standards, a fail-proof proof business case, and assurance that merchants and consumers will come on board. In its annual survey of community banks, Abound Resources found that interest in mobile payments is waning. In 2012, 28% of community banks listed mobile payments as a priority. By 2013, that number fell to 14%.

Banks are continually scolded for not being innovative in a world of Google Wallet and PayPal, but for many, it’s unclear how to win customers’ physical and virtual wallets.

In a complex payments ecosystem that continues to evolve, are there clear winners and others in a tenuous position of non-relevance? To paraphrase Yogi Berra, it’s difficult to make predictions, especially about the future of payments. That said, the following is an update on innovations and best guesses on where the industry is headed.

**Prepaid debit outperforms**

Prepaid debit and payroll cards are one payment innovation that has surpassed industry expectations. Initiatives, such as Green Dot, which links a Visa debit card to a traditional checking account; Bluebird, a mobile prepaid account offered by American Express and distributed through Walmart; NetSpend, which is targeted to underbanked consumers; and ABA’s prepaid program, offered in partnership with TransCard and MasterCard, are a few examples among literally hundreds.

Aite Group projects that prepaid debit and payroll cards will grow from 9.7 million in 2010 to 29.2 million by 2016. Madeline Aufseeser, Aite Group senior analyst, attributes this growth to four factors: a decline in free checking for low-balance customers; the entrance of big brands into the prepaid market; consumer-friendly pricing; and more employers adopting payroll programs.

Although first positioned as a product for the unbanked or underbanked, prepaid is popular with consumers from all income brackets. Reloadable prepaid cards with fee transparency and an inability to be overdrawn are replacing traditional checking accounts, notes Ginger Schmeltzer, senior vice-president of emerging payments at Fiserv. “If prepaid takes off as an alternative to a checking account, that’s a game changer for banks,” she says.

Banks are becoming prepaid believers. In a 2012 survey conducted by Mercator Advisory Group for ABA, more than 80% of banks reported that their customers would be interested in prepaid.

In addition, a mandate from the U.S. government that all federal benefits be paid electronically is a significant driver in prepaid growth, says Kenneally, noting the government has moved about 9 million recipients to prepaid.

Another driver, says Christopher McClintone, vice-president of payments solutions at ABA, is the banks’ need to replace lost fee income. But since community banks traditionally participate in a larger bank’s agent program, they lose out on capturing customer deposits. To improve the economics, ABA’s prepaid program provides a suite of products, including payroll, gift, and reloadable cards. Since ABA is not a bank, the banks keep the deposits.

**EMV: full speed ahead**

As of second-quarter 2012, 1.55 billion EMV (EuroPay MasterCard and Visa) chip-based payment cards were in use worldwide. In the United States, migration from
magnetic-stripe cards to more secure EMV cards is well underway. As the last G20 country to move to EMV, the United States has become an easy target for fraudsters, notes Julie Conroy, Aite Group research director, with issuers reporting up to a 50% increase in counterfeit card fraud. Also, EMV card costs have fallen from a high of $4 to about $1.30 per card. Today, it’s almost impossible to buy a point-of-sale terminal that does not support EMV, giving merchants no choice but to install EMV terminals as part of their POS refresh cycle. Another factor: the October 2015 liability shift, holding merchants without EMV acceptance liable for losses.

For banks, EMV represents more than an opportunity to reduce card fraud. Suzanne Glavin, director of product management at Elan, foresees that the EMV chip will be the impetus for deeper customer relationships by enabling issuers to merge payments with other value-added services, such as couponing and rewards.

**NFC: slow progress**

Two years ago, the Federal Reserve Banks of Boston and Atlanta jointly published *Mobile Payments in the United States: Mapping Out the Road Ahead*, in which the banks touted near-field communications (NFC) as the technology that would—finally—enable mobile payments.

In their updated May 2013 report, *U.S. Mobile Payments Landscape—Two Years Later*, the banks are much less certain that NFC will be mobile payments’ knight in shining armor, listing cloud-based POS solutions and quick response (QR) codes as possible contenders.

It seems the payments industry miscalculated just how challenging creating a payments ecosystem to support NFC would be. Delays in mobile device certification, a lack of merchants willing to install NFC terminals, and difficulties in convincing financial institutions to install payments applications on mobile devices have contributed to NFC’s lackluster adoption.

The NFC market also has slowed down due to Google’s reassessment of its Google Wallet and the delay in Isis mobile wallet pilots in Salt Lake City, Utah, and Austin, Tex., says Randy Vanderhoof, executive director of the Smart Card Alliance.

During the Alliance’s recent NFC Solutions Summit, Vanderhoof heard positive feedback from merchants participating in the Isis pilots. “The technology is working extremely well, and merchants are excited by the opportunities NFC mobile wallets create for engaging customers and influencing shopping behaviors,” relates Vanderhoof.

Dean Seifert, senior vice-president of product strategy at Vanitiv, is not betting on NFC, however. “Because NFC is not ubiquitous at the point of sale or the mobile device, [it] is going to fall by the wayside,” he predicts.

**The digital wallet: Will banks find a way?**

Today, about 168 different digital wallets are available, says Matthew Friend, managing director of Accenture Payment Services North America, and he expects that number to grow before the industry consolidates. The winners will be the digital wallets that offer payment options as well as loyalty and rewards cards, receipt tracking, and other financial management tools in a secure environment.

“Banks are in the best position to provide a digital wallet,” says Friend. But they shouldn’t delay. “Consumers want banks to provide the digital wallet, but will banks move fast enough for consumers?” asks Friend. “It will be tricky for banks to balance the investments needed for a digital wallet in a capital-constrained environment.”

Others agree that it makes sense for banks to own the digital-wallet space. “Any digital-wallet provider that thinks it’s going to succeed by disintermediating the card networks simply isn’t going to work,” says Scott Hansen, executive vice-president of business development at Harland Financial Solutions. “Until banks enable the data flow using conventional card-authentication networks, digital wallets will stall. The credit card information must remain with the bank and not a technology or telecommunications company.”
Banks are less certain NFC will be mobile payments’ knight in shining armor. New contenders are cloud-based POS solutions and quick response codes.

Kenneth Moy, group head of MasterCard’s U.S. emerging payments, says that consumers want a digital wallet from their trusted financial institution, rather than a technology company. He says the MasterPass digital wallet, currently in beta, is not a MasterCard-branded wallet, but the wallet of financial institutions that accept MasterCard. He adds that the wallet is open to others, including Visa, American Express, and private-label cards.

Today, 180 merchants in the United States are live with MasterPass, and Moy says MasterCard plans to extend that number to hundreds of thousands by the end of 2013.

Visa’s online payment service V.me., launched in late 2012, has 82 financial institution partners and 37 e-commerce retailers, with an additional 180 merchants waiting to go live, according to a Visa spokesperson.

One of the biggest challenges with the digital wallet, says Jim Simpson, senior vice-president and chief technology officer at City Bank Texas, is that the current card-swipe process is not broken. For consumers, paying with a card is easy. Simpson’s solution is to focus, instead, on what happens before and after the swipe, suggesting that banks improve the digital wallet to provide a great experience for customers, with incentives and rewards.

Niti Badarinath, head of mobile banking at U.S. Bank, agrees that banks should focus less on changing the form factor from a plastic card to a mobile device, but more on bundling value-added services onto the device, such as loyalty and rewards and even geo location-based services that take advantage of the device’s GPS.

**P2P: riding the rails**

ClearXchange (Bank of America, Chase, and Wells Fargo), Popmoney (Fiserv), and PayPal are three of the biggest players in the person-to-person (P2P) payments space. But challenges in widespread adoption of P2P remain.

To receive a payment, the payee is asked for his banking account information via email or text message, something that fraud-fearful consumers are loath to provide. And since transactions are transmitted via the ACH network, they take several days to clear.

The key to P2P adoption, believes Hansen, is expedited P2P payments.

To solve these challenges, Computer Services, Inc. (CSI) is using the existing credit card payment rails to initiate instantaneous payments, explains Derrick Bretz, product manager. The solution, in beta and planned for general release by mid-summer, allows consumers with a checking or savings account to transfer funds to anyone with a Visa account.

The P2P application has business uses as well, notes Bretz, explaining that merchants with a Visa card can ask consumers to make payments directly to the merchant’s credit card account.

**Crypto-currencies**

Bitcoin calls itself “an open source, P2P digital currency,” and, as of April 2013, reports that the total value of bitcoins in circulation is more than $1.3 billion. What are Bitcoin and other crypto-currencies, really?

Hansen calls Bitcoin “an anti-establishment movement at heart.” Why? Because it is completely independent of any banking system, regulatory agency, or government, and allows Bitcoin users to send money anonymously across borders.

Consumers store bitcoins in digital wallets and use them to purchase goods and services from online merchants, or sell them on an exchange site, such as Mt. Gox.

For banks, just monitoring the rogue currencies is enough, for now. “The world of virtual currency will continue to play out for a long time,” points out Accenture’s
Friend. “The market is small and a novelty, but it is creating a true global currency.”

Square off

Square—the San Francisco, Calif., startup that revolutionized small businesses payments with its card reader attached to a mobile device—boasts that it processes more than $15 billion in payments annually. Small businesses pay either $275 per month or 2.75% per swipe for use.

Others offer competing products. Vanitiv’s Vanitiv Accept is a mobile app and card reader that allows merchants to swipe credit, debit, or prepaid cards on a smartphone or tablet. In addition to small businesses such as plumbers or craft fair vendors, Vanitiv Accept appeals to large merchants that want to accept payments anywhere in the store (so called “line-busting”) or need a back-up payment system if the power goes out, explains Seifert. Vanitiv’s next step: connect merchant and consumer mobile devices. “We’re getting to a world where I can input my grocery list on my phone, pay for it, and send it to the supermarket, and pick up my order when I arrive,” he says.

Mobile billpay innovations

Although about three-quarters of consumers use online banking, only about 25% use their bank’s online bill payment feature, says Ralph Marcuccilli, president of Allied Payment Network. The number using mobile billpay is even less. Robb Gaynor, founder and chief product officer at Malauzi, says only 3.5% of active mobile banking users pay bills using a mobile device, mainly because it’s difficult to enter bill payment information on a mobile phone.

To boost adoption by overcoming the lack of a traditional keyboard, Malauzi is reselling Allied’s recently launched Picture Pay. Consumers take a photo of a bill using a mobile device, enter the amount, and select the payment delivery option, including next day. Allied is hoping to roll out a pay-by-voice version at summer’s end.

City Bank Texas has offered Picture Pay as part of its mobile banking lineup for several months. While still evaluating the success, Simpson reports that customers who did not pay bills online before are now snapping photos.

Simpson is particularly pleased with the number of customers who are using the pay-again feature. “Customers like their first experience and are coming back for more. It’s a sticky solution,” he says.

“If banks don’t find a way to make bill payment easier, banks will be disintermediated by biller-direct websites or providers, such as PayPal,” says Marcuccilli. “The entity that enrolls the customer in billpay owns that relationship.”

Payments: room for everyone?

As we wait for more of the payments dust to settle, banks should begin laying a foundation for mobile payments to get customers comfortable using their mobile devices for banking transactions, according to Ginger Schmeltzer. “Explore how your customers like to use mobile and what their concerns are, and what the bank can do to make it a more compelling experience,” she encourages.

Suzanne Glavin believes that banks also should look beyond mobile for ways to innovate more traditional payment environments, such as ATMs and branches with advanced interactive tellers.

U.S. Bank’s Niti Badarinath suggests that banks get off the sidelines, even with the uncertainty inherent in the payments ecosystem.

“Make a number of small bets and move in many directions quickly,” Badarinath says. “We don’t know which payment innovation will win, but we need to be prepared.”

ABA’s Emerging Payments Advisory Group

As an advocacy organization, ABA has launched several payments-focused initiatives. One of the most recent is the Emerging Payments Advisory Group, a consortium of banks of various sizes that will meet periodically to discuss policy issues in payments.


The report’s recommendations center on what Ken Clayton, executive vice-president of legislative affairs and chief counsel, calls three pillars:

Consumer protection. Currently, regulations for emerging payments are uneven or not well defined and can negatively impact consumers.

Payment systems integrity. Banks must work to ensure that new players in the payments space have adequate controls and oversight, so as not to put the payments system at risk.

Competitive equity and level playing field. Not playing by the same rules can drive participants away from the regulated market and into the shadow payments world.

Clayton describes how current payment rules are inadequate. For example, a nonbank payment provider may allow a consumer to initiate a credit card transaction on her mobile phone. The payment is processed as two separate transactions, and the nonbank transaction may not be subject to the same consumer protections as a bank-to-bank transaction. The Emerging Payments Advisory Group seeks to bring clarity to this sort of situation, according to Clayton.