GS The Green Sheet
The Financial Services Industry Source for Education, Inspiration and Actionable Advice

January 27, 2003
Issue 03:01:02

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Through Associate Membership in WesPay, ISOs can meet in person with industry professionals at seminars or, if geography is an issue, can take courses online.

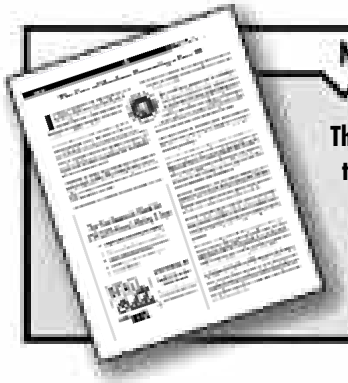
GS-WesPay Partnership Provides Access to Special Training

ISOs seeking to understand the latest developments facing the Automated Clearing House (ACH) and the nation's electronic payments system in 2003 will have an opportunity to purchase payment publications and enroll in seminars and workshops at discounted prices through a partnership between The Green Sheet and Western Payments Alliance (WesPay).

Through March 31, 2003, WesPay will allow Green Sheet subscribers to buy any of 25 publications and sign up for any of a dozen highly acclaimed workshops and seminars usually offered only to WesPay members. Discounts will save ISOs 20% to 50% off the regular price of WesPay's publications and/or seminars.

"Green Sheet readers realize that their success in growing sales and getting closer to customers depends on a thorough knowledge of the ACH and the entire payments system," said Julie O'Ryan-Dempsey, Vice President/General Manager

See PARTNERSHIP on Page 6



Notable Quote:

This brazen attempt by FDC to push aside Visa is the kind of thing that can happen when you outsource your core business, as the vast majority of Visa members have done with their acquiring and issuing processing. The chickens have come home to roost.

See Story on Page 18

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Thales mobile terminals guarantee fast, secure payment transactions anywhere. Primarily developed to enable delivery services, taxis street vendors, and limousines, the unit is also great for up scale retail points-of-sale.

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In some countries, Thales offers integrated solutions designed for multilane environments such as grocery stores. With their unique architecture, these solutions can be adapted to any company's existing point-of-sale data system.

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Thales builds terminals using the latest and most reliable technology to make point-of-sale transactions easier, faster, and more secure. Talento is the terminal of choice for many, while Artema Desk is designed for the most demanding retail points-of-sale.

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Smooth Ride on Learning Curve

Paul,
I recently became involved in the payment-processing business as an ISO/MSO. I would like to thank and commend you on the splendid service that you are rendering to the ISO/MSO community with your publishing activities. Your publications enabled me to get up to speed very quickly on the economics and workings of the industry.

Michael Liew
General Manager
Rentors LLC

The Process of Becoming Self-sufficient

Hi,
I hope you can help me. I'm a sales rep and can't find a good processing company to which I would be comfortable submitting my application. Lately, it looks as if the companies are looking for reasons to decline applications rather than looking for ways to approve them.

I wonder: Can a sales rep open his own processing company? Do I need a lot of money to set aside with Visa/MasterCard or buy insurance to cover fraud losses? I want to handle my own risk decisions, etc., and find a company that will do the electronic transactions for me. How can I learn about the process and what is needed to start it? If I need to find a bank for a partnership, is there a list of banks looking for people like me?

Thanks,
Lee Zamed

Lee:
The Green Sheet does not recommend or endorse any product or service. We encourage you to register for the ISO Forum online, a networking space for ISOs in the payment-processing industry (www.greensheet.com/forum/).

Also, check out our company profiles, FAQs and extensive backlist for information on numerous issues relating to this industry.

Good Selling!
The Green Sheet Staff

Natural Resource

Do you have an updated list of ISOs looking for agents with the bank they represent, buy rates, statement fees, residual information, other services, package of materials, etc. Thanks!

Jerry Gilstrap

Jerry:
The listing "ISOs Looking for Agents" appears in every issue of The Green Sheet and online in our Resource Guide: www.greensheet.com/resource/

Additionally, we have published an update to this report each year in the GSQ. The most recent report was the July 2002 issue "Feet on the Street." Our GSQ publication is now available online. Simply register on the GSQ page and you will be able to download the PDF of all of the back issues of our quarterly publication.

Good Selling!
The Green Sheet Staff

CLARIFICATION:

An FYISOs item about Cynergy Data's alliance with Lipman in the Jan. 13, 2003 issue (03:01:01) of The Green Sheet appeared with the wrong headline. However, Cynergy does have an alliance with Secure Payment Systems as well – see Page 60 of this issue.

Becoming An Associate Member In WesPay

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[1]Membership includes one copy of the following publications: ACH Rule Book, ACH Risk Management Handbook, ACH Compliance Manual, Self-Audit Survival Guide, Return Entry Survival Guide and Regulation E Book – Guidelines for ACH Compliance. Value: S510. Additional copies and other publications may be purchased at member-discounted prices.

[2]WesPay Educational Workshops, Teleseminar and Online Workshops are available to members at a member-discounted price.

PARTNERSHIP from Page 1

of The Green Sheet. "As one of the most innovative payment organizations in the country, WesPay can help ISOs by providing a wealth of detailed insight and understanding of the key payment issues facing financial institutions.

"Offering ISOs a discount on WesPay products and services – as well as Associate Membership in the organization – is yet another way The Green Sheet is adding value for readers."

Founded in 1876, WesPay (www.wespay.org) has more than 1,000 member banks, thrifts and credit unions in the western U.S. and Pacific region. As a cooperative, non-profit payment organization, WesPay enables members to efficiently process paper-based and electronic financial transactions. Each day, WesPay collects and clears more than 7 million checks totaling $7 billion in value. As a NACHA member, WesPay also acts as the rulemaking authority governing member transactions flowing through the ACH.

"WesPay is delighted to partner with The Green Sheet to offer ISOs a valuable tool to help them achieve their business objectives," said Gerard F. Milano, President and Chief Executive Officer of WesPay. "WesPay recognizes the increasingly important role that ISOs play in providing innovative technology solutions for a new era of electronic payments.

"WesPay's nationally recognized workshops, seminars and publications are among the many benefits that ISOs can routinely receive as Associate Members of the nation's pre-eminent payment organization."

WesPay's workshops and seminars offer a core curriculum that includes the following classroom courses:

- ACH Rules Implementation.
- Fundamentals of ACH Receiving
- ACH Compliance
- Payments Risk Management
- Government Payments
- ACH Origination
- Advanced Payment Topics
- Fundamentals of Check Processing and Check Fraud

These courses take place regularly and are offered in cities throughout WesPay's service area, including San Francisco, Los Angeles, San Diego, Pasadena, Sacramento, Portland, Las Vegas and Las Vegas.

To ensure that classes are accessible regardless of geography, WesPay's Payments Academy Online allows participants to complete courses via the Internet.

Complementing WesPay's educational programs is a full range of publications to keep ISOs updated on the latest rules, regulations and trends impacting the ACH and the payment industry. WesPay's best-selling publications include:

- What is the ACH?
- Self-Audit Survival Guide for ACH Rule Compliance
- ACH Return Entry Survival Guide
- AAP Exam Preparation

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The Benefits of Membership

Milano said that after this special offer expires on March 31 2003, ISOs can continue to enjoy discounted pricing on seminars and publications – in addition to a variety of other benefits – by becoming an Associate Member of the organization.

"WesPay is very interested in having ISOs take a greater role in Payments Symposium 2003 and is working on ISO sessions and sponsorship opportunities to achieve that goal."

– Gerard Milano
CEO, WesPay

WesPay offers silver-, gold- and platinum-level memberships that provide a comprehensive suite of services, including access to WesPay membership and participation in sponsorship opportunities and other programs. Associate Membership starts at $625 per year.

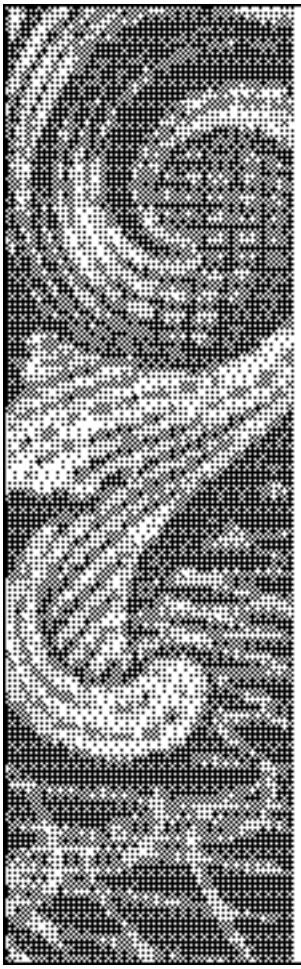
A key benefit of Associate Membership is Payments Symposium 2003, the premier payments conference in the western U.S., scheduled for Oct. 29-31, 2003.

Payments Symposium 2002, which took place Nov. 3-5 at the Palace Hotel in San Francisco, attracted more than 200 bankers and payment professionals. Featured presentations included one by Federal Reserve Board Vice Chairman Roger Ferguson. Payments Symposium 2002 also had 15 corporate sponsors who exhibited during the show and appeared in both print and online materials about the event.

"Payments Symposium 2003 is tailor-made for ISOs seeking to reach payment professionals working for the most influential banks in the western U.S.," Milano said. "WesPay is very interested in having ISOs take a greater role in Payments Symposium 2003 and is working on ISO sessions and sponsorship opportunities to achieve that goal. We are pleased to have The Green Sheet participate as a Media Sponsor for the 2003 Symposium."

To purchase a publication or enroll in a WesPay workshop or seminar, visit www.wespay.org, download the order form and fax it to WesPay at 415-433-1370. Publications, seminars and workshops are subject to availability – first come, first served.

To find out more about Associate Membership or Payments Symposium 2003, phone 415-433-1230 or send an e-mail to greensheet@wespay.org.



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Holiday Retail Sales: Good or Bad?

You might have noticed something amiss in the 2002 holiday shopping season: fewer salespeople working the floor, a deeper discounting of merchandise before Christmas and, by gosh, where were all the shoppers? The numbers are in for holiday sales, and they aren't pretty. But was it as bad as we think?

The Wall Street Journal has officially called this year's holiday shopping season "crummy." This comes as no surprise. Companies slashed 101,000 jobs in December 2002, leaving the unemployment rate at an eight-year high of 6% at the close of the year, and a recent consumer credit report shows consumer debt posted a $2.2 billion decline in November 2002.

Same-store sales data points to a disappointing season as well. The data (also known as "comps") shows the worst holiday shopping season since 1970, when same-store sales first were tracked.

Same-store sales compare sales from stores open a year or more, and many consider the figures to be the best indicator of a retailer's health. The numbers help investors evaluate what proportion of new sales comes from actual sales growth, compared with growth from the opening of new locations.

December 2002 same-store sales rose only 1%, not a large enough gain to make up for the 1.1% decline the previous month. That's a meager 0.5% increase for the months combined – two important months that account for 25% of a retailer's yearly revenues.

Although Gap Inc. and J.C. Penney Co., Inc. surprised many with modest increases in sales, department stores and mall-based apparel stores such as The Talbots, Inc. and Ann Taylor Stores Corp. did poorly. In fact, retailers such as Kohl's; Toys "R" Us, Inc.; Saks Inc.; and Borders Group, Inc. lowered their Q4 2002 earnings outlooks recently, attributing mediocre sales and aggressive discounting in order to move merchandise off the shelves.

Online sales, on the other hand, are picking up. Perhaps six fewer shopping days between Thanksgiving and Christmas last year and free shipping incentives from many online retailers contributed to this increase. Sears, Roebuck & Co. and Best Buy Co., Inc. recently reported that their online revenues more than doubled from December 2001.

According to the eSpending Report from The Goldman Sachs Group, Inc., Harris Interactive and Nielsen//Net Ratings, online spending for the holiday shopping season jumped more than 24% year-over-year to $13.7 billion, up from $11 billion spent in 2001; research from comScore Networks Inc. estimates that online sales increased 28% to $13.8 billion from $10.8 billion last year. (The U.S. Department of Commerce's U.S. Census Bureau e-commerce numbers will not be available until February 2003.)

More good news: The Commerce Department recently reported that overall retail sales rose 1.2% in December 2002, thanks to a boost in discounted automobile sales at the end of the month, when manufacturers slash prices of the current year's models to get ready for next year's.

So what does all this mean? Not as much as we think, according to Tom Redburn, a columnist for the New York Times. "Real" retail sales, says Redburn, are adjusted for changes in the price of goods and actually have decreased several times since 1970. Retail sales data does not account for inflation that occurs every year or for deflation in the price of retail merchandise.

"The failure to account for this simple difference leads to a serious misunderstanding of the economy," Redburn wrote.

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Merchants Request Summary Judgment

The seven-year legal battle pitting Visa and MasterCard against Wal-Mart and millions of other retailers isn't scheduled to go to trial until April 28, 2003, but the two sides were in court Jan. 13 for a three-hour summary judgment hearing in U.S. District Court in Brooklyn, N.Y.

Visa and MasterCard recently joined forces and asked Judge John Gleeson to throw out the lawsuit. A summary judgment is a decision made by a judge on the basis of statements and evidence presented for the record without a trial. It is used when there is no dispute as to the facts of the case and one party is entitled to judgment as a matter of law.

Wal-Mart and millions of other retailers filed a class-action lawsuit in 1996 claiming that as part of their "honor all cards" policy, Visa and MasterCard violate antitrust laws by forcing merchants to accept their more costly offline debit cards, which require a signature, rather than cheaper online debit cards, which require a PIN. The merchants are seeking billions of dollars in damages.

In the Jan. 13 hearing, Visa and MasterCard argued that other payment networks, especially the PIN networks, are in fact thriving (Visa said the PIN networks grew by more than 38% between 2001 and 2002) and that the associations' policies give consumers even more of a choice for method of payment. Kevin Arquit, an attorney for MasterCard, told the judge there's no evidence of a conspiracy.

The merchants, led by Lloyd Constantine, claim a paper trail proves that the defendants deliberately set out to crush independent electronic networks. Constantine asked Gleeson to rule in favor of their antitrust claims, which would leave only damages to be decided in the trial.

The merchants' attorneys presented more than 1,000 documents and extensive deposition testimony as evidence supporting the their request for the court to grant summary judgment on Visa's and MasterCard's alleged "tying of products" and "attempt to monopolize" the debit market. Gleeson said he would take all of the motions under advisement but did not make any ruling at the hearing.

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ETA Goes to Washington

The Electronic Transactions Association announced it is taking the next step in the growth of the organization: New headquarters in Washington, D.C., and a full-time staff dedicated to running the non-profit payment industry association soon will be realities.

"This has been talked about for many, many years," ETA President Mary Gerdts said. "The timing was just right. This is a very exciting move for the organization."

Gerdts said the board reached the decision after carefully considering the recommendations of a consulting firm, Consensus Management Group (CMG). ETA's contract with the Robstan Group of Kansas City, Mo., expires on June 30, 2003; Gerdts said the Robstan Group has been responsible for day-to-day operations of ETA since 1991.

Washington was selected because it will give the association better access to government officials, policymakers and high caliber job applicants, she said.

The new staff will take over all duties, such as administration and publications production. She compared the ETA's plan to hire an executive director and a staff of up to seven to an ISO no longer contracting out for back-office services and instead bringing them in-house.

CMG will continue on retainer with ETA to oversee the move and hiring processes. It will look for an executive director with previous association management experience; because the payment industry is so complicated, Gerdts said, the ideal candidate also will have experience in this area.

Gerdts has served on the ETA board for eight years, including her current one-year term as President. She said the board has faced some serious issues in the last year and credits board members with putting in tremendous amounts of volunteer time to deal with problems facing both the payment industry and the ETA itself.

President-elect Mary Dees will begin serving in her new role on July 1, 2003.

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Watered-Down Guidelines to Govern Card Issuers

Federal regulators intended to set more stringest standards for credit card lending practices when they recently issued new guidelines.

Some industry experts say, though, that the rules lack the impact of the initial draft submitted for review in July 2002 and won't do enough to eliminate inappropriate practices or to reduce increasing consumer debt and defaults.

The regulators, from a group of four agencies operating under the auspices of the Federal Financial Institutions Examinations Council, which oversees the financial services industry, developed the rules in response to recent examinations that disclosed a number of inappropriate account-management, risk-management and loss-allowance practices.

The guidelines will apply to all banks and thrifts but are aimed at credit card companies that target customers with poor credit histories. According to the Wall Street Journal, some analysts and investors believe that the final version of the guidelines has been diluted from those that were originally drafted and really only benefits the credit card companies.

Three companies that deal with the sub-prime market all posted market gains the day the regulations were issued; Capitol One stock was up 10%, Providian Financial Corp. went up 3.3% and Metris Companies was up 12%.

In particular, the final version of one rule that deals with over-limit fees charged to customers was softened considerably from the earlier proposal. When it was first submitted, regulators were ready to end the practice; financial institutions were allowed to review and respond to the proposed guidelines.

Thanks to successful lobbying, the final rule restricts, not prohibits, those fees, which have been significant revenue generators for the companies. At Capitol One, over-limit fees bring in an estimated $650 million, or 7% of its total annual income.

The agencies (Federal Reserve Board, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision) believe the guidelines will serve the purpose for which they were intended. The regulating agencies also are expecting ongoing full compliance with generally accepted accounting principles and existing interagency policies as well as with the new rules.

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The Cost of Merchant Processing – Part III

If the cost of processing the "next transaction" is in the $.005 to $.012 range (see Part II) and if interchange costs are equal for all merchant acquirers (see Part I), then why do merchant processing costs vary so much from one ISO to another?

To answer this, we need to revisit the subject of transaction-based costs. We have not yet discussed the fixed costs of running a processing center. We also need to discuss the fixed and variable monthly costs of customer service and back-end processing. To round out the discussion, we need to factor in things like capital costs of interest, depreciation and amortization, and income taxes and profits.

Depending on which set of figures you use, there are approximately 4 million U.S. merchant locations processing about 28 billion transactions at the point-of-sale. If true, this means the average merchant location processes 7,000 transactions per year.

The aggregate U.S. bankcard volume processed for 2002 will be about $1.2 trillion for an average ticket of about $39 and an average process volume of $275,000 per location annually.

But we all know averages can be misleading. Sixty percent of the transactions processed in the country, according to Marc Abbey's article in the January 2003 issue of Card Management magazine, are processed by the top 230 merchants. If we assume that the top 230 merchants accept cards in an average of 1,000 locations, that means the rest of the merchant locations process an average of a little less than 3,000 transactions per year.

Let's try to make an educated guess about what the largest merchants are paying for transaction processing. What, for example, do you think Wal-Mart is paying for merchant processing?

I know for a fact that one of the smallest transaction platforms recently bid 3 cents over interchange for one of the largest merchants in the country and that that bid was the highest bid out of 14. Thirteen platforms bid less than 3 cents. I am told by a usually reliable source that Wal-Mart pays less than $.003 per transaction. Most of the largest merchants in the country, I am told, pay less than one penny a transaction plus interchange.

Although interesting, this isn't really relevant to ISOs because few of us do the kind of volume that Wal-Mart processes, and each of our merchant locations needs and receives service levels above and beyond what Wal-Mart asks from its merchant acquirer at the store level.

Another important factor is that ISO volumes are spread across hundreds of different kinds of terminal and software platforms deployed in thousands of different kinds of environments using multiple communication protocols and lots of different people calling in asking all sorts of questions.

But if ISOs can't get Wal-Mart's pricing from their processing partner, how do they get the best deal? Not surprisingly, the deal the ISO gets boils down to the negotiating power of the ISO. The power to get the best deal is based on existing and projected volumes of transactions and service levels that are acceptable to the ISO.

As I indicated in Part II, most ISOs are paying in the range of 5 to 12 cents per transaction. In addition, I believe that most ISOs are paying another $2 to $5 per month per merchant location for settlement, back-end and call center services plus another per-call fee of $1 to $2.50 per incoming customer service call. These fees often are bundled into the transaction fee.

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For back-end processing services there are a few extra variable costs of sending a merchant statement (postage, envelope and paper) and there are minuscule variable costs of storing transactions and masterfile data and granting Internet access. But all of these combined are less than $.50 per merchant location per month. We previously discussed telecom costs, which also apply to the variable cost of taking service calls for 800 numbers.

How does all of this get reconciled to the transaction costs for the "next transaction" of $.005 to $.012? Part of the answer is the additional cost of providing banking services. All non-bank acquirers must process through a bank and therefore pay their sponsor bank for their services.

These services include accepting the primary level of risk of the portfolio with Visa and MasterCard, sending and collecting merchant monies via ACH, and often providing funding to cover the cost of the cash advanced for interchange each day while the ISO provides monthly or weekly billing of discount fees to the merchants.

What do these services cost? The last time I checked, the highest variable cost of an ACH transaction to a bank was $.007 and the lowest variable cost was $.00. (Yes, the Federal Reserve also gives banks compensating balance credits against their fees!)

If prime rate is in the 4% range, then it costs the bank another $.00275 or so to cover the prime rate interest expense for ISOs who collect discounts monthly. Of course, daily discounting and weekly discounting cost considerably less to the bank because the advances for interchange funds are repaid either daily or weekly.

Of course, ISOs like to offload the risk whenever possible, and the banks must provide for the cost of their losses as well. Losses in our industry run as low as .00005% (half of a basis point) of process volume to more than 1%.

My understanding is that the large ISO banks average

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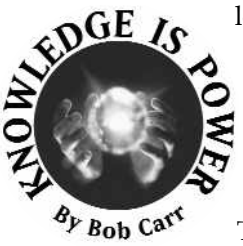

losses in the 2-3 basis point range. Of course, a couple of ISO banks have failed recently because of their ISO business, so their costs must have been a lot higher – but that's another story.

The bank has to mark up all of these costs and often charges a per-transaction fee, sometimes called a BIN fee or sponsorship fee. For alliance banks such as Chase or Wells Fargo or Key or Wachovia, etc., this is often part of the structure of the alliance arrangement, and these costs are covered out of the alliance bank's share of the spread. For others, bank transaction fees range from $.001 to $.02 depending on the number of transactions and whether the fee includes the MasterCard INET fees billed weekly to the bank (see Part II).

The key driver of costs (no surprise) is the allocation of the fixed costs to the number of transactions processed on a specific platform. It costs millions of dollars to operate a processing center, and the variable transaction-processing costs are loaded with costs and expenses such as equipment purchases, software development and maintenance costs, disaster site operations, personnel, facilities and utilities.

It isn't difficult math to divide the fixed costs by the number of transactions. But don't forget to factor in an EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) margin as well. A large shop is going to need 40% of its gross margin to drop to the EBITDA line to cover capital costs and income taxes and earn an acceptable bottom line.

As an example, if it costs $1 million per month to operate a processing center and the price of the transaction is marked up to 5 cents over the variable costs, then the center needs to process 33,333,333 transactions per month to generate a 40% EBITDA. At 10 cents, the number of transactions is obviously cut in half.

One can make the argument that it doesn't have to cost a $1 million per month to operate a processing center, and that is true. But do you think there are very many existing platforms available to ISOs that cost much less than this? I think the answer is no for any platform that an ISO could use.

Almost every ISO seems to need a little bit of this and a little bit of that. There just isn't product focus on much of anything from most ISOs except to process a transaction however the merchant wants to send it.

This hodge-podge of service offerings demands the continual tweaking and maintenance of hardware and ongoing development and maintenance of an expensive array

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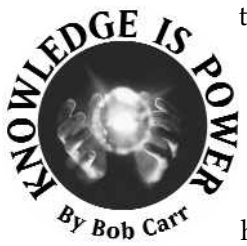

to injure itself in order to benefit a rival.' "

To this industry observer, Visa makes strong arguments against FDC's attempt to jumpstart First Data Net. It seems to me that Visa has a good chance of getting the countersuit dismissed. If the schedule holds, March 12 is going to be a big day for all acquirers and ISOs. If Visa does not prevail on the dismissal of FDC's countersuit, then a call to action by the acquiring and ISO community will be mandatory, in my view.

Visa is doing a lot of heavy lifting right now to preserve its brand and financial integrity. First Data is working hard to gain a competitive advantage that it alone could have as both a large issuing processor and a large acquiring processor. While these titans fight it out, Visa is coincidentally fighting for the preservation of the level playing field all acquirers and ISOs require to survive.

This brazen attempt by FDC to push aside Visa is the kind of thing that can happen when you outsource your core business, as the vast majority of Visa members have done with their acquiring and issuing processing. The chickens have come home to roost.

While I am optimistic that eventually this litigation will get resolved favorably for the rest of us, there are other lessons to learn from this case. Look to this series of articles for ongoing monitoring of this litigation as well as more commentary on these topics.

Bob Carr is the Founder, CEO and Chairman of Heartland Payment Systems, the nation's largest privately owned merchant acquirer and ninth largest overall, with annual revenues exceeding $300,000,000. Heartland was recognized by INC Magazine as the 57th fastest-growing private company in America and is one of the 10 largest INC 500 companies. Bob was a Founder and Vice President from 1988 to '90 of the Bankcard Services Association, which has since become the ETA.

Before entering the bankcard industry in 1986, he developed computer software systems for unattended fuel pumps and created the first integrated accounting applications for PCs. He also started the computer department at the Bank of Illinois and served as the Director of the Computer Center and as a mathematics instructor for Parkland College. He earned degrees in mathematics and computer science from the University of Illinois in 1966 and 1967.

To learn more about Heartland, visit www.hpsteammates.com or www.heartlandpaymentsystems.com, or e-mail Bob at Bob.Carr@e-hps.com

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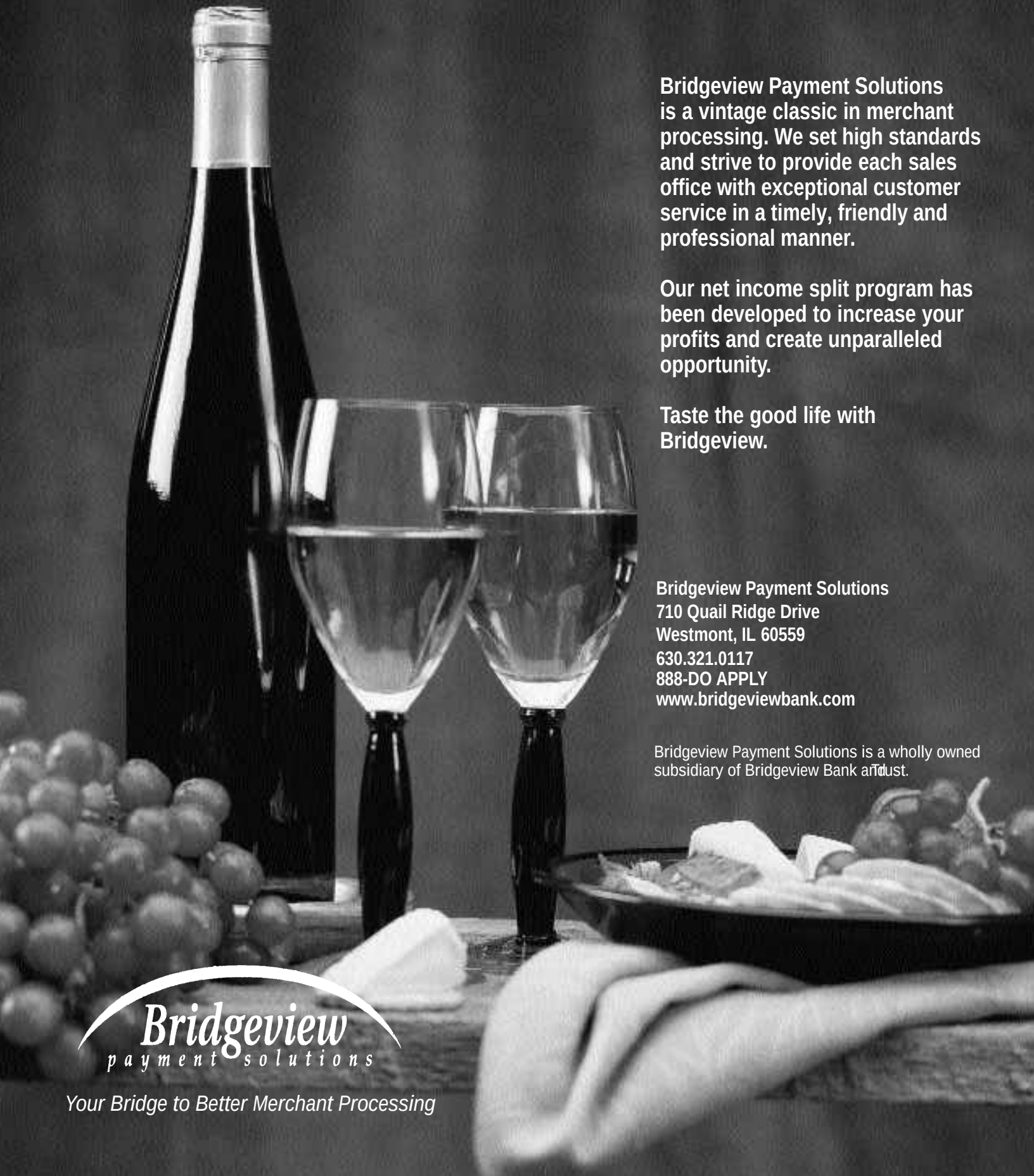

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WHITE PAPER

Latest Trends in Online Credit Card Fraud – and Preventing It

By Eric Thomson

The rapid growth of Internet sales represents new opportunities and challenges for traditional retailers and Web-only merchants. Credible research organizations are predicting that by 2004, business-to-consumer Internet sales will exceed $150 billion. More than 90% of these sales will be made on credit and debit cards. These "card-not-present" conditions of purchase result in most of the fraud liability falling on the retailers' shoulders.

According to a recent Gartner study, chargeback dollar value as a percentage of total card sales is 0.09% for in-store sales, 0.38% for mail or phone sales and 1.14% for Internet sales. Of course, fraud does not settle on all merchants equally. In general, fraud risk is greatest for those selling digital content with no physical address for delivery, sellers of high-cost, easily resold physical goods and those with a high percentage of cross-border sales.

Therefore, understanding the merchants' perspective on online fraud and what options they have to deal with this source of losses are the objectives of this column. Two different white papers are reviewed, both dealing with merchant online card fraud. One is a survey of merchants' views on this topic, and the second provides a guide to online fraud prevention.

Exclusive Merchant Survey

Author: CyberSource Corp.
Date: October 2001
Size: 19 pages
Relevance Rating: High
Web Address: www.cybersource.com/resources/collateral/Resource_Center/whitepapers_and_reports/2001_fraud_report.pdf

CyberSource was founded in 1994 and provides transaction-enabling services for Internet businesses – including credit card and fraud protection. The company started as a software retailer that evolved its business into a back-office infrastructure company to support its expanding offerings to a customer base of more than 3,000 online merchants.

This CyberSource report represents the third annual survey of merchants' views of the impact of online fraud. The document starts by describing the survey methodology and representative interviewing based upon annual sales, duration of selling online, monthly transaction volumes and sales channels used (online, call center, retail store and other).

The focus of the survey was on four aspects of online fraud:

1. The impact that online fraud has on merchants.
2. How merchants are managing fraud.
3. The holiday outlook for fraud.
4. Consumer privacy.

The primary findings and trends on fraud's impact on the retailers' business include:

• 57% view online credit card fraud as a very serious/serious concern.

• The inability to accurately detect fraud remains a top concern.

• Fraud drains valuable resources – revenue, staff time and bank/processor fees.

• Fraud is as big or bigger in the online portion of the business for the majority of retailers surveyed.

• Fraudulent transactions are estimated at 3% of online sales and represent this same percentage of losses on overall revenue.

• Human intervention to deter fraud involves techniques that directly inconvenience customers.

Findings on retailers' approach to managing fraud:

• Perception is that most cardholder fraud occurs from

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physical theft, identity theft and credit card numbers stolen off the Internet.

• 65% of respondents are taking more precautions this year than last.

• Acceptable investment in fraud prevention is 4% of online revenues.

• The top three processes for managing online credit card fraud are internally built business rules, manual reviews and Address Verification System (AVS).

• Most have no plans for implementing additional online fraud protection in the next year.

Merchant views on consumer privacy:

• 85% of respondents maintain consumer information in their databases.

• Of these, 45% encrypt customer credit card numbers.

• The majority of retailers surveyed have not performed a penetration audit of their site.

Fraud Prevention Guide for Online Merchants

Author: ClearCommerce
Date: March 2001
Size: 23 pages
Relevance Rating: High
Web Address: www.clearcommerce.com/pdf/whitepapers/ClearCommerce_Fraud_Prevention_White_Paper.pdf

ClearCommerce was founded in 1995 as an online order processor for Internet merchants. Currently, it is shipping the fourth generation of its integrated processing engine, comprised of payment processing, fraud protection, reporting, APIs for both storefront and legacy system integration, shipping, tax calculators and an electronic download component to ease the sale of digital products such as music, software and videos.

The ClearCommerce business model is to sell the solution for a fixed-price software-purchase fee and no transaction charges. Smaller merchants are being served through alliances with organizations such as EDS and MSN. In addition to a strong functionality set, ClearCommerce has devoted extensive resources to building integration to legacy systems such as PeopleSoft, SAP and Oracle and claims compatibility with 90% of credit card processors and acquirers.

This combination of focus and functionality has placed ClearCommerce with a customer base of more than 40,000 online merchants – 10 times larger than its closest competitor. Consequently, this white paper describing ClearCommerce's views on adequate online fraud protection is worth reading.

Recently, I attended the annual convention of the International Association of Financial Crimes Investigators (IAFCI), where a large segment of the agenda was devoted to card fraud. It became clear that a new source of online card fraud has entered the market in the form of terrorists.

FBI and the U.S. Secret Service presenters documented that in the past, the primary threat from cyber-crime came from hackers and organized crime. Both organizations state that they have documented evidence that terrorists often steal needed funding through credit card fraud. Also clear is that attempted fraud is increasing across the board, and attacks are more and more ingenious.

As a practical matter, merchants are coming to realize that they must rely on their own resources to fight this type of fraud as government agencies shift their attention to pursuing terrorists. As merchants devote more resources to preventing online fraud, they realize these dollars are well spent. It takes only a few large fraud attacks to put a merchant's Web site of out business, either from six-digit

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Best Wishes,
J. David Siembieda
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penalty fees imposed by credit card organizations or from devastating fraud losses.

This fraud-protection guide first sizes up the problem by drawing upon statistics obtained from user data contributed into the ClearCommerce Data Consortium database. Comparing customer experience with that supplied by the card associations, ClearCommerce concludes that its clients are experiencing 50-75% of the industry averages.

The next section of the guide details the components of costs merchants incur from cyber-fraud:

• **Cost of goods sold:** Seldom does merchandise delivered on purchases through fraudulent cards get recovered.

• **Shipping cost:** Merchants also absorb the cost of shipping for fraudulent orders.

• **Card association fees:** Both Visa and MasterCard have strict programs that penalize merchants generating high rates of chargebacks. Originally, these penalties were meant to screen out low-quality retailers that generated dissatisfied cardholder experiences within the merchant base. Cyber-fraud attacks on high-quality merchants are generating chargeback rates that exceed the card association guidelines for any three-month period (e.g., 1% of all transactions or 2.5% of the total dollar amount). The first month of penalties will be $25 a chargeback, but it increases to $100 per chargeback the following month if the rate doesn't drop back to acceptable levels. Furthermore, the card associations will assess fines from $5,500 to $100,000 a month for merchants with excessive chargeback rates. The final recourse that card associations have against merchant unable to control these rates is to terminate their card-accepting privileges, effectively putting the merchant out of the online business.

• **Merchant bank fees:** The processor or acquirer bank typically will charge $10-25 for each chargeback processed against a merchant. Not mentioned in the white paper, but clearly obvious to every online retailer, is the fact that they are paying a premium discount rate – typically 100% higher than what they are paying to deposit card-present POS transactions.

• **Administrative cost:** Every fraud chargeback represents serious clerical processing costs in the form of setting up a claim, researching its origin, contacting the cardholder and responding to the acquiring and issuer banks with documentation. Furthermore, the more sophisticated retailers are feeding each fraud experience into their fraud models to train them for increased effectiveness on screening future transactions.

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Leading a New Era

New online merchants are lulled into a false sense of security as they experience little or no fraud in the early days of operation only to be overwhelmed as their sales grow and start installing fraud-prevention techniques.

ClearCommerce estimates that each chargeback on low-cost merchandise easily can add up to more than a hundred dollars of loss – an estimate that would be much larger for retailers with high-ticket items such as computers, electronics or jewelry.

This document describes another interesting dimension of the profile of Internet fraud. Research has shown that fraud grows almost directly with the rate of new visitors to a site. Another sinister aspect of online fraud is that it typically will show up in the form a chargeback a couple of months after the transaction originally took place.

According to ClearCommerce client experience, the average time lag between transaction date and chargeback notification is 72 days. And 20% of fraudulent transactions will show up 100 days or more after the transaction first took place.

Therefore, new online merchants are lulled into a false sense of security as they experience little or no fraud in the early days of operation only to be overwhelmed as their sales grow and start installing fraud-prevention techniques.

Next, the document summarizes the sources of fraud, primarily the obtaining of a valid credit card number and expiration date. There are numerous ways in which fraudsters can obtain this information.

Stolen or lost cards provide all of the information needed. Card receipts contain this detail, and unscrupulous clerks and restaurant waiters are using small hand-held card "skimmers" to pull this information off the magnetic stripe on the back of your card. Hackers are breaking into merchant Web sites and stealing customer file information on cardholders and then posting them for sale on the Internet.

At this year's IAFCI convention, a Visa spokesperson said the association is monitoring this behavior and is seeing an average of 2,000 new cardholder account numbers a day being posted for sale in this manner.

The rest of the ClearCommerce fraud guide details the various fraud-detection tools available to merchants. All of these options have costs associated with them and include:

• **Address Verification System (AVS):** Validates that the billing-address information provided by the consumer via a Web form or over the phone matches the billing address for that cardholder. AVS has a high failure rate: Typically, less than 60% of the transactions will obtain a full match on AVS. One component of this result is the fact that it only applies to cards issued in the U.S. According to the guide, more than 98% of the transactions that fail both ZIP and street address are legitimate. ClearCommerce recommends the tool as a form of detection as part of a more comprehensive risk-management program.

• **Card Verification Methods (CVM):** Consists of a three- or four-digit numeric code that is printed on the card but not embossed on the card or available in the magnetic stripe. The merchant can ask that the consumer provide this code with the order and submit it with the authorization. There is no further protection afforded the retailer in the way of chargeback rights from using CVM, but fraud rates on CVM-validated transactions are 80% lower than those for non-CVM transactions.

• **Lockout Mechanisms:** Automated card number generators represent a new tool used by fraudsters. These programs easily can be downloaded from the various Web sites and are able to generate thousands of "valid" credit card numbers. These programs can generate numbers

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that an issuer bank might have issued, but the vast majority correspond to non-existent account numbers. The report describes various transaction patterns that reflect use of these type of numbers until they achieve a transaction approval. Then the account number is run up rapidly. The Lockout Mechanism enables merchants to monitor and then block such accounts from use at their site.

• **Negative and Positive Lists:** This is the same practice used by check guarantee companies to decide on approving checks online. For card transactions, you are building a file containing past fraudulent card accounts or high-risk addresses or country-of-origin filters that effectively block transactions that are on these lists.

• **Fraud Rules:** Rely upon expert rules defined to identify specific types of high-risk transactions. They use "if-then" logic to screen transactions for either investigator review or rejection. The guide provides an example of how a typical fraud rule might be designed to flag all orders more than $500 with multiple purchases of the same product. Positive rules, as an example, will approve all transactions less than $50 that also pass the AVS test.

• **Risk Scoring:** These are statistical models designed to identify transaction characteristics and accumulate a "score" that allows the merchant to automatically set approval rules. As an example, on a scale of 100 to 1,000, the higher the score the higher the probability the transaction is fraudulent. The merchant might set an automatic approval on all transactions that are scored at less than 600. For transactions between 601 and 750, the transaction is approved but is referred to an investigator for review. And all scores of more than 751 are automatically declined.

The next section of the ClearCommerce fraud guide paper details the fraud-detection components and workflow the company recommends as a "best practice" risk-management process. To demonstrate the effectiveness of this process, ClearCommerce provides a case study on a representative merchant, detailing the cost of fraud and the justification for implementing the ClearCommerce risk-management process. Finally, the document closes with a list of guidelines for high-risk transactions and guidelines for reporting and prosecuting fraudsters.

Web Sites for More Information

www.iafci.org/

International Association of Financial Crimes Investigators is a professional organization made up of law enforcement, corporate and card organizations dedicated to shared experience and prevention of financial crimes.

www.cybersource.com/resources/collateral/pdf/ifs_wp111500.pdf

"Managing Risk on the Net: What Internet Merchants Need to Know," white paper by Cybersource Corp., May 2000.

www.windowsix.com/whitepapers/Controlling_Online_Credit_Card_Fraud.pdf

"Controlling Online Credit Card Fraud," white paper by Window Six, January 2002.

www.merchantfraudsquad.com/

Web site for Worldwide E-Commerce Fraud Prevention Network, a not-for-profit group dedicated to helping merchants fight internet fraud.

www.diogenesllc.com/creditcardfraud.pdf

"Credit Card Fraud," a white paper by Diogenes LLC.

www.siia.net/sharedcontent/piracy/news/auction2001.pdf

"Piracy on Internet Auction Sites – What Consumers Need to Know," by the Software & Information Industry Association.

www.cfenet.com/pdfs/FrdPrevCheckUp.pdf

"The Fraud Prevention Check-up," by the Association of Certified Fraud Examiners.

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COMPANY PROFILE

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Phone: 847-490-7980
Fax: 847-490-9264
Web site: www.ezic.com

ISO benefits:
- Provides sophisticated digital-payment, reseller and merchant-management solutions.
- Hottest product is Fraud Barricade, a new and configurable anti-fraud toolset that protects merchants from all types of Internet fraud.
- Master Agent System is a proprietary reseller tool that provides technology to control comprehensive processes involved in building and managing a sales organization.
- Competitive prices, with a great opportunity for resellers to upsell for additional services.
- Technology platform designed to respond quickly and efficiently to what the market demands.
- Free training for ISOs as well as access to its tech support and marketing staff via teleconference, e-mail and the Ezic system.

A Welcome Gatekeeper

What do you do if you're a savvy professional in the payment-processing industry and you recognize that the needs of experienced high-volume users who have outgrown first-generation gateway technology aren't being served? Why, you start your own company, of course. And that is exactly what the founders of Ezic, Inc. did.

"We figured back then that if we start now developing the kinds of tools the payment-processing industry needs, we'll be ready when they are ready," says CEO Locke Walsh. "That's still our goal. We target experienced, high-volume and sophisticated merchants who four years ago didn't know the potential of their business enhanced by digital payment processing. Now they are successful, and they realize their needs are not being met. But they can be met with our sophisticated tools and products we developed because we forecasted and planned for this."

That keen insight was first realized when co-founders Fredrik Sjoholm and Bob Cappel first went into developmental mode in 1999. Ezic expanded to a full-scale operation in July 2000 when Walsh joined the team by way of Ernst & Young, now Cap Gemini Ernst & Young (CGE&Y). Ezic had participated in an Ernst & Young e-commerce accelerated lab project. E&Y selected it as the company most likely to succeed, and Ezic won a $500,000 consulting project. But rather than take a fee, E&Y took stock.

Smart move. Walsh was brought in at that time. Ernst & Young recognized not only that Ezic was right on target but that Walsh was the type of leader to guarantee a successful relationship; he had specialized in retail technology-based portfolio management for more than 10 years.

Today, CGE&Y remains one of Ezic's investors. What also remains is the same business philosophy that was initiated in 1999.

"We continue to provide market-driven capability to the digital payment-processing industry," Walsh says. "Our differentiator is that we turned profitable in our first two quarters and have been profitable for the last six quarters. We survived the big shakeout of e-commerce companies."

According to Walsh, what also sets Ezic apart is that it has been successful in attracting ISOs and merchants with unique, high performance requirements. Its business plan has clicked at a time when stiff competition can cause major disconnects.

"There are lots of gateways out there, but we offer much more than digital payment processing," says Walsh. "The breadth and depth of our capabilities are far more advanced."

Ezic's products might not be appropriate for the small merchant who processes a couple of thousand transactions per month and requires only simple online reporting. Ezic's services provide sophisticated solu-

tions for customers with aggressive business goals.

Those solutions can be found in a technology platform that allows Ezic to respond quickly to market-driven requirements. As merchants become more successful, they often discover their platform needs become more specialized, such as reporting and billing variables. An ISO's Web site might need to support multiple merchant accounts. Hand in hand with increased revenue comes increased risk.

"The high-volume merchants who started four or five years ago now know what they want their platform to do," says Walsh. "They know the kind of risk-management tools they've got to have. Our services build their business and manage their needs, for both merchant and reseller."

Latest Releases

Ezic's hottest product is Fraud Barricade, a new and configurable anti-fraud toolset that protects merchants from all types of Internet fraud.

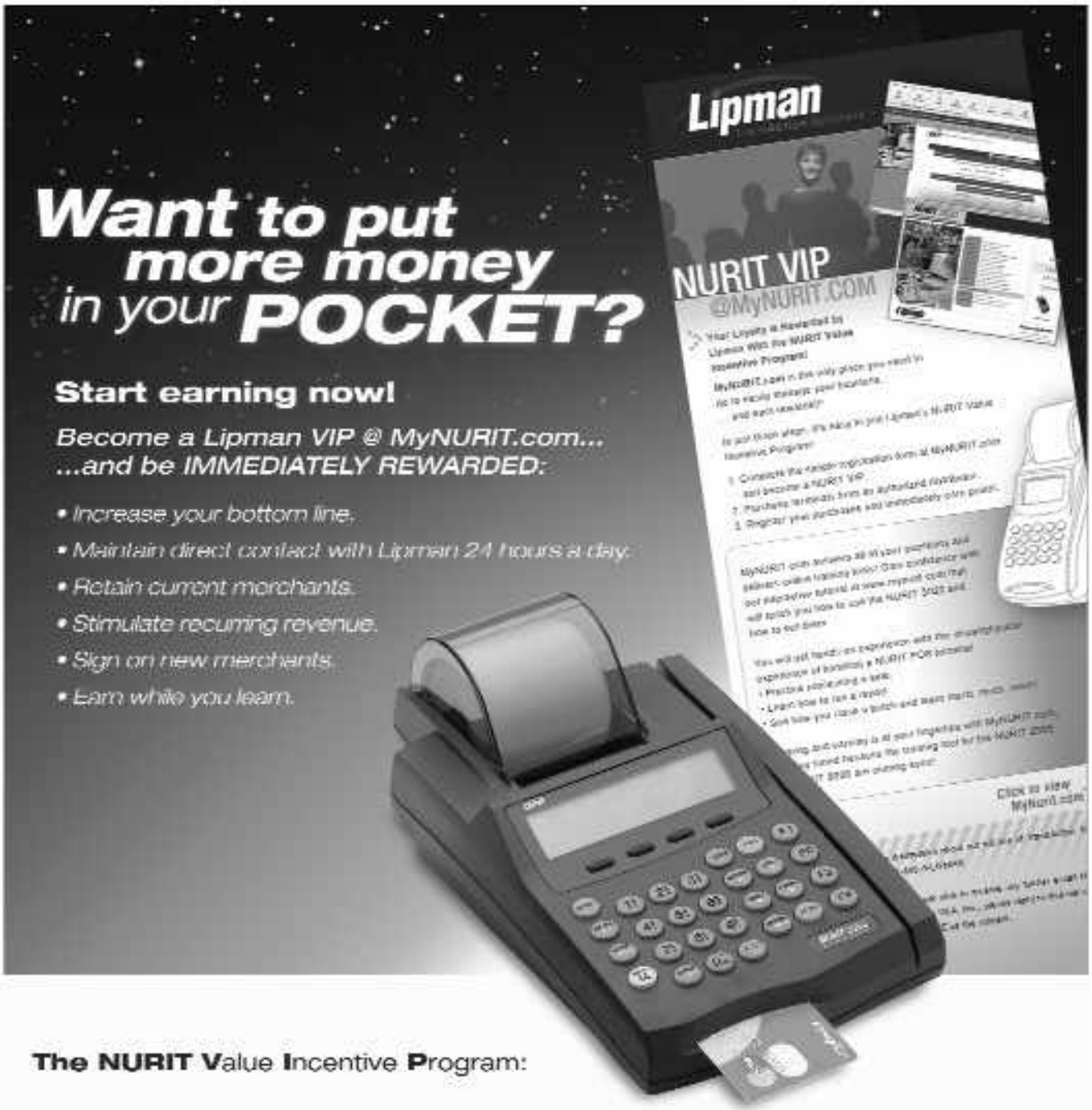
Fraud Barricade includes three areas of protection: Identity Authentication Controls reject transactions from customers using false or hidden identities; Order Integrity Controls prevent hackers from falsifying order details; and Velocity Controls stop fraudsters. Fraud Barricade doesn't hide behind obscure and arbitrary scoring systems. Merchants choose which fraud controls best fit their unique risk-management needs.

Ezic Master Agents can set the fraud parameters for its agents and subagents and, like third-party processors, can control the fraud parameters for all merchants to enforce merchant acquirer policies and decrease portfolio attrition.

"Using Fraud Barricade saves high-volume and high-risk merchants significant amounts of money," said Kristy Kunert, Ezic's Chief Financial Officer. "By stopping transactions before they reach the bank authorization network, merchants will avoid both transaction fees and bank authorization network fees."

Ezic offers the only Master Agent System, a proprietary solution that provides its resellers with the technology to control comprehensive processes involved in building and managing a sales organization, including merchant account and sales force management, commissions, invoicing and advanced reporting.

Simply put, this product promises unprecedented management of and access to merchant accounts. Catering to the merchant services industry as well as turn-key services providers such as developers, Web designers, ISPs and Web hosting companies, this Web-based solution offers



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"Our Master Agent System is getting an exceptional amount of interest," says Walsh. "This is something people in the credit card industry have wanted for a long time, allowing acquiring or issuing banks in the distribution channel as well as MSPs, ISOs and agents to be managed all in one system. If you're a big ISO and you have subagents, you can provide them and their merchants access to the Ezic system without their seeing other merchant accounts. You can manage all steps of distribution, yet each step affords your agents and merchants complete individual access and monitoring."

"We chose Ezic specifically for its Master Agent System," said Stephen Ferrell, CEO of WebMenu, LLC, an application service company providing e-commerce solutions for the restaurant industry. "We can provide our clients with the technology they need to pursue their business goals while significantly contributing to our own financial goals."

In February 2003, Ezic plans to release Affiliate Stampede, an advanced management solution to streamline the comprehensive processes involved in building and managing large affiliate portfolios to drive traffic to merchant sites.

Flexible Solution to Suit and Grow Merchants

The number of high-volume merchants who take advantage of Ezic's solutions is in the thousands, according to Walsh, but Ezic also boasts a lot of small merchants on its roster.

"We have the capability to provide services for all sizes as well, but frankly there are simple gateways better suited for their needs," says Walsh, adding that Ezic has handled more than 25 million transactions, worth almost a billion dollars in revenue merchant sales, since July 2000.

Are the costs of Ezic's solutions as impressive as its transaction figures? "Our prices are very competitive in the industry," says Walsh. "We do have a great opportunity for resellers to upsell for additional services. In addition to the basic sale, we have advanced features for private label, enhanced revenue and other options."

Those other options include Fraud Barricade.

"Our system is highly scalable. For example, your merchant might not be in a high-risk industry. He may just be selling books, so he doesn't need to spend more on fraud control," says Walsh. "Whereas if you are selling long-distance phone cards, the nature of the business dictates that the services the ISO provides be very sophisticated.

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"High-volume and high-risk merchants that manage multiple accounts rely on Ezic's solutions, including the Fallback Matrix that redirects transactions to a secondary processing network if the merchant's primary processing network slows down or fails."

Ezic is a fully global operation, present in six out of eight Visa regions throughout the world. According to Walsh, Ezic is the backbone of more than 2,700 banks in Europe alone.

What does this all mean to the American ISO? It means having the ability to provide advanced e-commerce technology to merchants who are desperate for increased sales.

"We think we have attractive programs and we have the ability to put multiple pricing plans together for different customers," says Walsh. "We are not like the bank who pays a residual rate. We give the ISO the tools to provide different pricing programs for different categories of merchants for their upsale. We pay promptly the 18th of every month the difference between what they buy it for from us and what they sell it for to their customers."

Seeking ISOs

Ezic works with 40 to 50 top ISOs and always is looking to expand that channel.

"We look for an ISO that has a specialized type of customer," says Walsh. "That merchant may not have started out as that type, but they now are. We look for established ISOs. Right now, we have a strong group."

Training may be the key to that strength. Ezic provides free training for all of its ISOs as well as access to its tech staff through teleconferencing, e-mail and the Ezic system. While Ezic welcomes onsite training, few find it necessary to travel to its corporate offices in Illinois. Ezic prides itself on its one-click setup policy that's easy to navigate, hassle free and quick. An ISO can have his merchant up and running within minutes.

Because of its low maintenance, Ezic doesn't require much Tier 1 customer support. It does, however, offer a Tier 2 Web-based 24/7 support service, live voice included.

"We can handle any type of backup support call from any of our resellers, whether it's simple or complex," says Walsh. "Most of the calls are more sophisticated. With Ezic's straightforward system and user tools, our ISOs can quickly provide customer service and answer merchant user questions."

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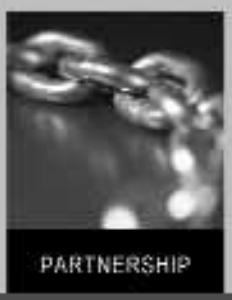

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Ezic believes its state-of-the-art security systems are essential to its solutions' success.

"We have the most access-secure, next generation payment solution," says Walsh. "There are three components. We have triple credential requirements just to get in. Once you log in, the administrator of the account for the merchant can assign unique passwords to each subagent or individual who needs access to the system. They can even assign further authorizations in the Ezic system as to what actions can be performed in the system. We have a very sophisticated user-management system."

Ezic also implements two other security tools.

One is an audit trail that is important for financial purposes that require access to the complete financial activity of each account. It runs sequentially and is unalterable. That is of particular value for internal as well as external control.

The other tool is an event log that keeps an accurate record of each account's activity. As with the audit trail, the event log is ongoing and unalterable.

Working in conjunction with these components is Ezic's advanced real-time reporting service. Ezic recognizes that the more sophisticated the customer, the more information and speed the customer needs.

"The main benefit of our reporting capability is that it improves the operating efficiency of an ISO," says Walsh. Ezic offers one-click reporting whereby a customer can view merchant account activities at any time of the day or night. For even more sophisticated customers, Ezic provides a report generator that is accessible to all online users. All reports are exportable either as text, into accounting programs or Excel.

"Our setup process is faster and cheaper," says Walsh. "Resellers can start a merchant processing quickly via our backward compatibility and emulations modes. If you're switching your accounts from one processor to another, we do it instantly."

Speaking of processors, Ezic is certified with First Data (both Omaha and Nashville), NOVA, Vital Processing and a number of foreign banks. Would the average ISO find the foreign connection appealing? Walsh says yes.

"What's happening nationally is that a lot of ISOs with high-risk accounts have to find offshore accounts because there are some industries that some banks don't want to do a lot of business with," says Walsh. "More and more foreign banks are competing for high-volume and high-risk U.S. merchant accounts.

"You can get better high-risk rates with foreign banks as well as better reserves and requirements. We do not facilitate the bank end part of it. We just deal with resellers and want them to be aware that there are lots of variables that keep these high-volume accounts moving around."

Ezic picks its alliances, whether foreign or domestic, with a clear focus. According to Walsh, Ezic chooses partners who provide valuable data online for integration into its gateway and then on to its customers.

"When we partner with a First Data or a Vital or a foreign bank, it is a requirement that we have direct access to their online chargeback reporting so our merchants can manage their chargebacks," he says. "This is very important."

Forecast

Walsh also places great importance on the fact that Ezic's biggest accomplishment to date has been its ability to demonstrate that its technology can respond quickly to market-driven demands.

"We have a technology platform that was designed from the ground up that responds quickly and efficiently to what the market demands," says Walsh. "Digital and e-

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commerce is still rapidly evolving, and no one knows what the demands will be in the future. We have demonstrated that we can respond quickly to the demands of our resellers so they can not only attract but keep customers, increase their revenue, lower their operating cost and enhance their revenue with upsales."

Walsh continues, "We focus on what the ISO needs. That's been our largest success. We have conservatively managed our financials so we are profitable and not dependent on venture capital. We have an infinite future."

What challenges does Walsh see in Ezic's future? "Keeping up with the growth of our target market," says Walsh. "We are restrained in terms of finding qualified account execs and salespeople we can add to bring in more business."

Walsh also believes the payment-processing industry will be challenged in continuing to improve its chargeback issues. "Nobody wants chargebacks," says Walsh. "The banks don't. The merchants and the resellers certainly don't want them. Collectively, we all need to work closer with Visa and MasterCard to provide the kind of info to the merchant in order to better manage chargebacks."

Walsh sees the industry expanding beyond Internet sites with a lot of business integrating into call centers. Because of that vision, Ezic is happy to offer its resellers the opportunity to branch out into new markets such as MO/TO and call center access.

And as with any successful industry, Walsh is aware of the gobbling that could threaten Ezic.

"We don't fear acquisition," says Walsh. "We know it's happening all around us because we are being approached now. We don't really agree with their valuation at the moment. When you are profitable, you don't need venture capital. We are not ruling out acquisition or merger, but if and when you need the capital, you don't have to give up the ship to the venture guys.

"We intend on having many more discussions with strategic investors, bigger players that know they need this kind of engine both in the short term and the long term if they want to stay in the forefront of this industry."

Where does that position Ezic? "We will continue to aggressively respond to market-driven needs as they evolve," says Walsh. "We have the technology base and the human expertise to interpret it and do it. We have a top-tier group of resellers who give us valuable feedback that enables us to aggressively pursue new business. We have real rubber to the road here."

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- Newest product: VirutalE Draft, designed for high-risk merchants or merchants that cannot legally process ACH payments (telemarketing).
- Low up-front costs for merchants.

That, in a nutshell, is the business philosophy behind National Cash Management Systems. Founded in 1998, NCMS acts as both a processor and a VAR that has matured into a major ACH services provider in the last few years. "We now have the ability to pick and choose among the best processors, developers and end users," says Frank Lewis, Executive Vice President of Sales for NCMS. "Our customers trust that we will bring to the table only the best options on the market."

While many other solution providers make similar claims, Lewis truly believes NCMS is a breed apart. "We use a 'solution-broker approach' instead of an ISO approach," says Lewis.

Lewis realized from talking to clients that NCMS had entered an industry that was geared toward both people and service. On a mission to hunt down companies that could support personal service, NCMS hooked up with a West Coast ACH processor that met most of its needs regarding small to medium-size merchants. NCMS officials noticed that there still were some applications missing that mainly applied to Fortune 500-type clients, so their next alliance was with a company whose core focus was EDI (electronic data interchange).

"We recognized that the concept of blending an EDI platform with the Federal Reserve ACH network was a marriage made in heaven," says Lewis. "It's been more than we could have ever anticipated. Because of this, we have put together the most complete suite of services available from any one organization in the industry.

"In the first 60 days of offering this expanded line of services, we signed two Fortune 500 companies that are leaders within their industry."

One of most in-demand NCMS products is a direct result of its EDI alliance. "One of the biggest things we're doing is electronic payroll for companies with employees who don't have bank accounts," says Lewis. "In fact, our main differentiator is our debit payment card system with no monthly fee to either merchant or employee."

Lewis says another differentiator is the staff at NCMS. "We have people in our organization who have worked in different industries, so they have insight into many areas, such as banking and real estate," says Lewis. "Our expertise is **inside** our company. We can really talk to people on their level as well as see applications they can't see."

NCMS provides payment solutions to hundreds of customers and targets higher-end businesses, including insurance companies, utilities, hospitals, credit unions, and savings and loans. "We also serve a lot of smaller businesses," says Lewis. "It

"Our systems are not designed to cost a lot up front. I know we kick butt on transaction fees. Our set-up fees are as low as $500 to as high as $2,000 for EPASS. No one can touch us on this."

– Frank Lewis
Executive Vice President of Sales, NCMS

basically depends on the program."

NCMS programs are multifaceted. Offerings include a full range of payment solutions, from ACH/EFT software to virtual terminals.

"The flexibility of our product line gives merchants the ability to receive payments via check or credit card," says Lewis. "All of our products allow merchants to accept single or recurring payments or process credits such as refunds, direct deposits or vendor payments. Our online check and payment gateway provides the real-time processing tools merchants demand while our real-time Internet verification product utilizes the ATM network."

Real-time reporting with crisp, jazzy spreadsheets is provided through yet another alliance, with Crystal Reports.

While the core competency of NCMS is comprehensive business solutions, its hottest product and service is its EPASS and debit payment card program.

"It all goes back to electronic business services," says Lewis. "What's happening is a big push in the payroll industry to cut costs. It's such a huge problem, especially with lost checks. ... [People are] getting ripped off at check-cashing places. Our program is the solution.

"Our card gives an employee a 50-cent-per-hour pay increase, saving money on the back side, so to speak. Unbanked employees pay 1% to 3% to get their checks cashed. Then Western Union gets them for wiring money back home. With our card, it's one free swipe per pay period. They can do a corresponding card back home, saving all those fees. Plus, there's the security of not having to worry about cash. They can use the card to get money back at any supermarket. They can move money from card to card. It's even ideal for kids away at school."

NCMS has satellite offices in Puerto Rico and Hawaii to support the great demand in these locales for the debit payment card program.

What is the price for keeping cash flowing through NCMS? "Our systems are not designed to cost a lot up front," says Lewis. "I know we kick butt on transaction fees. Our set-up fees are as low as $500 to as high as $2,000 for EPASS. No one can touch us on this. We are not in it for the big fees, and all transaction fees are negotiable depending on the size of the client."

As for turnaround time, Lewis says it can take as little as three days to as much as 60 days, depending on bank interaction. NCMS works with several sponsor banks, and though it is interconnected with Bank of America, it is not tied to any one institution.

All of these programs, alliances and services translate to big appeal for ISOs and ISAs, but NCMS is picky about whom it welcomes into the family. "We don't take on everybody," says Lewis. "We want people who are serious about the business. We want them to stay for one year, minimum, with NCMS. We want them to put in the time. We take only one out of every 50 inquiries we get in regard to representing our product line."

For all agents who put in that time, NCMS offers multiple programs, including a 50-50 program. Agents get products and services at cost and sell where and when they see fit for a 50-50 split with NCMS. Leads are often supplied to agents from the popular NCMS Web site.

"We're really not out there looking for agents," says Lewis. "It takes such a long time to train them. We like the good ones, the people with industry experience but not particularly in this industry. What's most important to us is that they have business experience so they can talk to clients."

What NCMS looks for in a partner is technology. "We're interested in cutting edge because we are on the edge," says Lewis. "We pride ourselves on that as well as the fact that we are constantly looking for new apps."

At press time, NCMS was in the process of releasing its latest service, VirtualE Draft, which Lewis says "was designed as a direct result of NACHA's latest rule changes that affected the telemarketing industry."

VirtualE Draft is a Web-based service that generates a paper draft draft file instead of a NACHA file. NCMS takes this file and prints out drafts for the merchant.

"We're interested in cutting edge because we are on the edge. We pride ourselves on that as well as the fact that we are constantly looking for new apps."

– Frank Lewis

"This product is truly amazing," says Lewis. "We have all the bells and whistles that most ACH terminals have. In fact, we have incorporated new technology into this terminal not found anywhere else. The VirtualE Draft program has both the STAR Check and RMRS check systems integrated in at no charge.

"Our system can even help with authorization. Our terminal has the ability to print postcards that recap the entire transaction. If postcards aren't needed, we can also generate e-mail notifications."

What really sets this program apart is the Daily Deposit Program provided by NCMS.

"We not only print and sort both drafts and postcards; we will also deposit these drafts to the merchant account every day if their financial institution is located in our area," Lewis says. "Our service is unmatched and unchallenged when it comes to this product offering."

What is even more amazing is that this complete service, in many cases, is less expensive for the merchant compared to ACH processing. And if the merchant has a good banking relationship, he or she can get immediate credit for the checks that are deposited daily instead of waiting up to seven calendar days, as offered by most ACH processors.

"Every day, it amazes me even more

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how much the high-risk market has been taken advantage of by some ACH processors. We love pointing that out when presenting this product to this segment of the market," Lewis says.

"Merchants are not understanding what technology is all about. ... I think right now that only 4% of businesses out there are doing it right. Within the next three to five years, this will increase to 70%."

– Frank Lewis

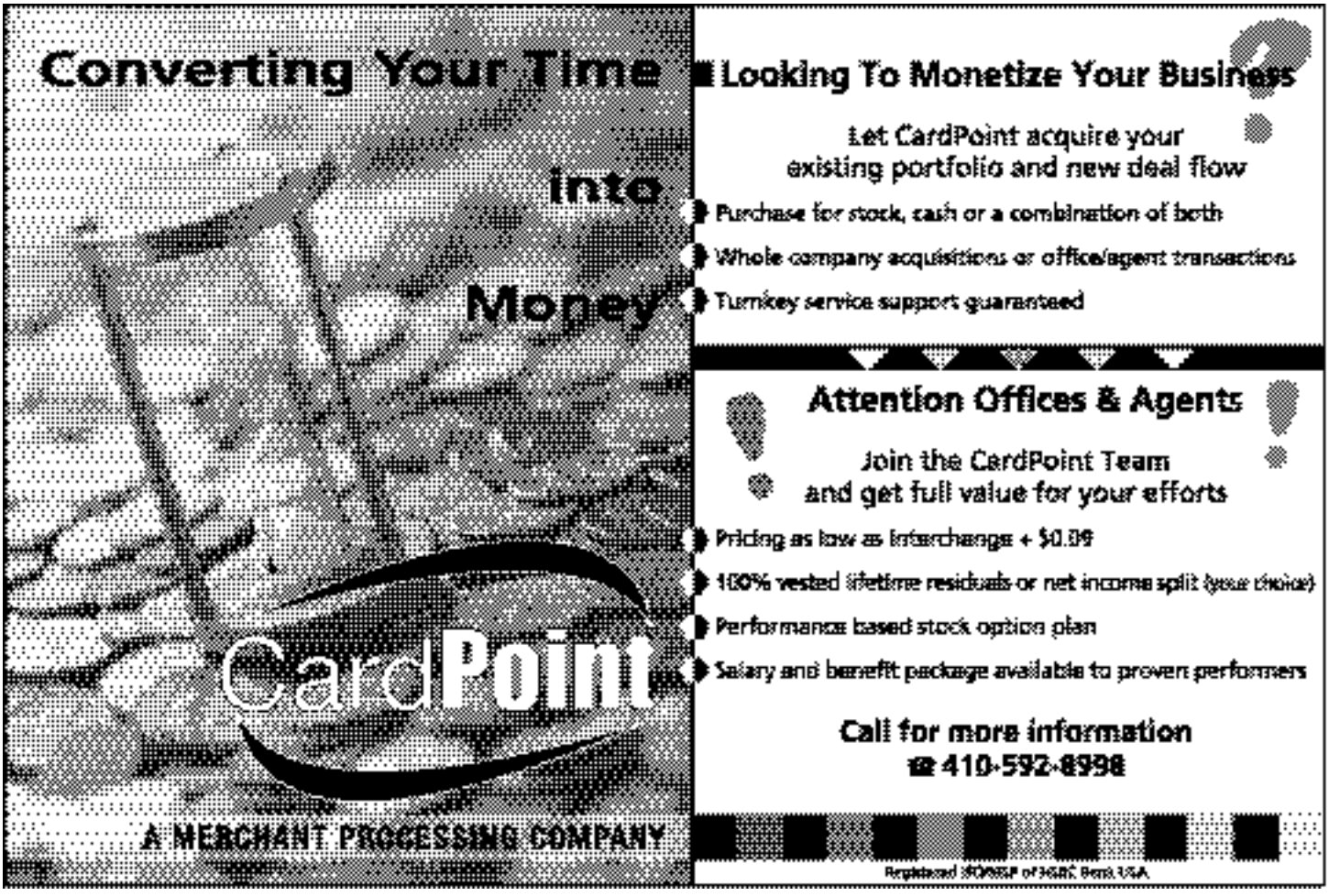
According to Lewis, the biggest challenge facing NCMS is time. "It is serious," says Lewis. "We put in 12-hour days covering coast to coast and beyond to Hawaii. Businesses are all looking for ways to save money in this economy with electronic processes."

Lewis says the biggest challenge facing the industry is understanding.

"It's all about being able to have enough people out there who realize what's going on," says Lewis. "Merchants are not understanding what technology is all about. Businesses are segmented and don't know that you can do things like e-mail invoices and do it for less than it costs to send them with a stamp.

"I think right now that only 4% of businesses out there are doing it right. Within the next three to five years, this will increase to 70%. The volume is unreal. Our approach is, 'What I'm going to show you will work better today AND 20 years down the road. I don't know if you'll do it with **me**, but you **will** do it.' I see electronic payment across the board for everything, and big businesses are pushing hard to get it done."

Lewis also sees NCMS as perfectly positioned for that push. "We are in the forefront of this," says Lewis. "I think we probably will expand into other areas of the country. I see our software expanded internationally as well. We already have that started with negotiations in Brazil and Canada. Right now, time and people is our biggest problem."



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NEW PRODUCTS

to three business days and are processed all in one batch. Since transactions are processed all at once after the event is over, a phone line is not needed at the fundraiser. AuctionPay's credit card terminals also provide alerts that a credit card is expired.

Users of AuctionPay's solution range from large non-profits to schools and include clients such as Ronald McDonald House, Good Samaritan Foundation and the National Kidney Foundation.

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Here's a New Selling Point for Auctions

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If you've ever waited in line at the end of a charitable event or auction to make a donation or to pick up your winning item and you found that the line was moving rather slowly, AuctionPay offers a solution.

Targeting non-profit organizations and other charities, AuctionPay's electronic payment system speeds up the registration and donation process at these types of events. A slow or confusing check-in or checkout at a live event can be frustrating for attendees, donors and volunteers. The founder of the company, Jeff Jetton, a payment industry veteran and frequent auction attendee, started AuctionPay after standing in one too many long lines.

The system uses AuctionPay's proprietary software and touch-screen prompts on a credit card processing terminal to capture guests' payment information at registration as well as collect payments at the end of the event. All attendee information is stored in a centralized and highly secure database.

AuctionPay uses Wells Fargo Merchant Services for processing payments. Transactions are completed within two

Global Tries its Hand at Casino Check Cashing

VIP Preferred Card

Global Payments Inc.

Check fraud poses a threat to any establishment that cashes checks, from financial institutions and check cashing businesses to grocery stores – even casinos are at risk. Global Payments Inc. designed its check cashing VIP Preferred card program especially for gaming establishments, including casinos, dog tracks, bingo parlors and cruise boats.

The VIP Preferred program is a consumer check cashing system for both paper and electronic checks. Once a customer sets up an account with a casino, he or she is issued a VIP Preferred card, and the payments of the customer's checks to the establishment are 100% guaranteed, including stop payments.

Global Payments' proprietary software is behind the program, allowing casinos to access a database of more than 135 million records. The records are provided by banks, recovery agencies and check authorization companies in order to verify fund availability. The program uses scoring models to determine customers' check cashing limits up to $8,000 in less than 90 seconds.

For paper checks, customers present their VIP Preferred cards to casino cashiers along with their check and ID. For electronic check transactions, customers show their Preferred card and ID to the cashier and request an amount. The cashier swipes the VIP card through an authorization terminal and enters the amount for approval. For electronic checks, when the approval is received, a customer signs a receipt printed by the terminal.

Global Payments says more than 500,000 people use the VIP Preferred card at approximately 85 gaming establishments across the U.S. The company recently announced several more casinos have added the service, including Atlantic Casino Cruises in Gloucester, Mass.; the Imperial Palace Casino Hotel in Biloxi, Miss.; The Brewery in Las Vegas, Nev.; and the Thunder Bird Casino in Norman, Okla.

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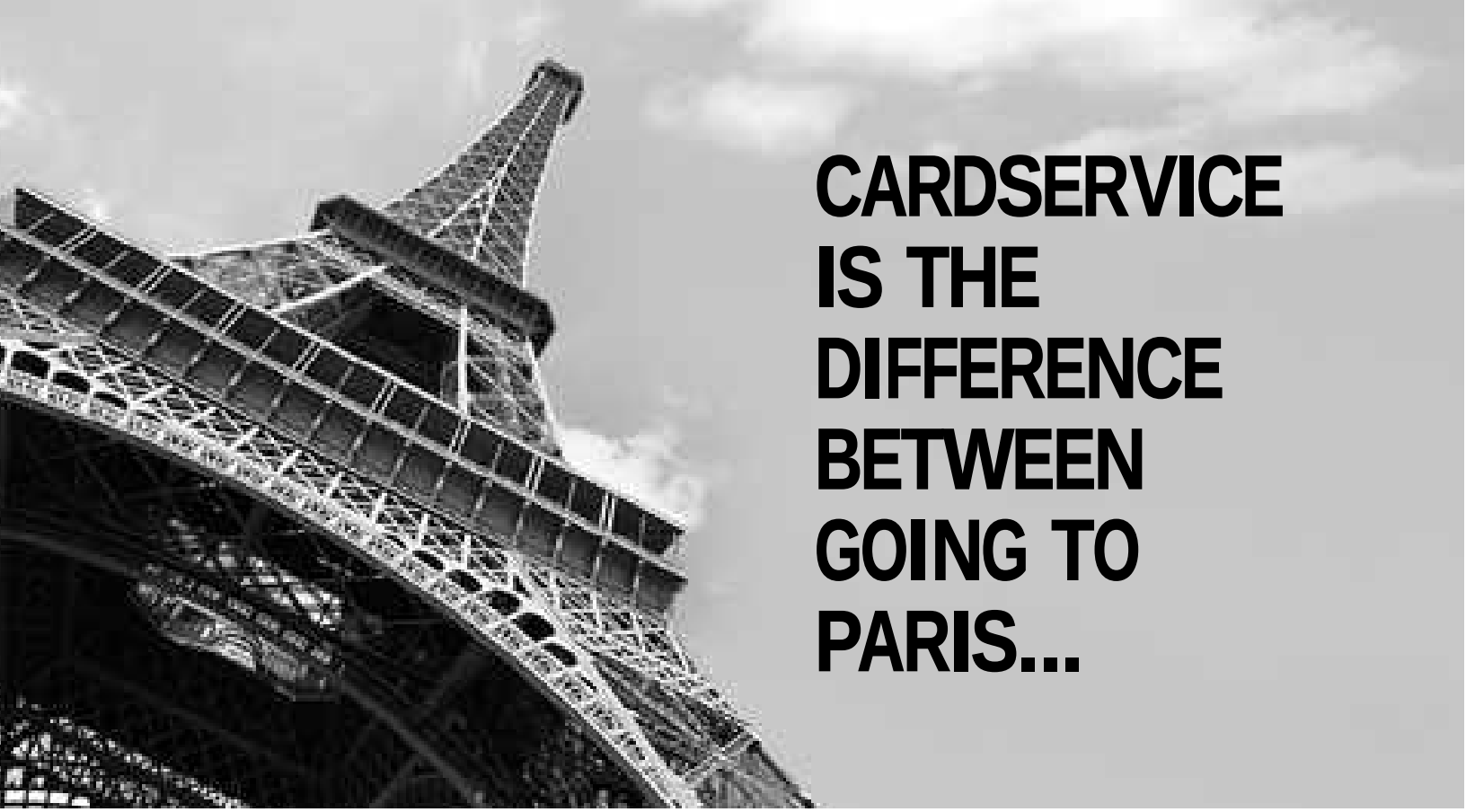

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NEWS

Canadian Check Use Declining?

Because of an increase in consumers' use of debit cards as a payment method, Canadian retailers such as **Sears Canada Inc., Wal-Mart, The Bay** and **Zellers** have stopped accepting checks (or "cheques" as they are called in Canada) over the past five years. Most recently, **Loblaw Companies. Ltd.**, Canada's largest food distributor, announced it no longer will accept personal checks at its 72 Ontario stores at the end of January 2003.

According to a story in Canada's National Post, a spokesman for Loblaw said that checks used for payment in their stores have declined to less than 2%; 10 years ago, checks represented about 25% of payment. Interac Association, which oversees Canada's direct debit payment system, reported that, in 1997, 7% of shoppers paid for goods with a check, but by 2001 that figure had fallen to just 2%.

In addition, the Canadian Payments Association reported that check use is dropping by 2% to 3% annually. "Cheque" writers should not be too alarmed, however; many retailers and supermarkets in Canada still take checks and have no plans to stop accepting them anytime soon.

Wal-Mart Offering Discount Financial Services

Wal-Mart announced plans to offer basic financial services to its U.S. customers such as money orders, wire transfers and check cashing services. These types of services do not require ownership of a bank, which the retail giant has attempted twice in the last three years but was blocked because of changes in state and federal legislation.

Wal-Mart will provide the services by renting out space in many of its stores to local banks, the Financial Times Limited reported. Competitors such as First Data's Western Union and the U.S. Postal Service beware: Wal-Mart plans to offer payroll check cashing at a flat $3 charge up to a certain value (compared with rivals' 3-6% commission rate) as well as charge $0.46 for money orders (compared to an average $1 charge at the post office).

The chain plans to expand from its current count of 3,400 stores across the U.S. to 5,000 stores in five years, according to a recent article in Time Magazine. "Our long-term strategy is to be where we're not," said Lee Scott, Wal-Mart's President and CEO.

Bring on the Biometrics

American consumers are ready for biometric transactions, according to results from a survey conducted by **SEARCH**, a national consortium of criminal justice agencies, the **U.S. Department of Justice's Bureau of Justice Statistics**, and **Privacy and American Business (P&AB).** Although most consumers have little experience using this type of technology, the survey of more than 1,000 people indicates consumers approve using biometrics in the following areas:

- Verifying the identity of customers making credit card purchases (85%).
- Withdrawing funds from an ATM (78%).
- Accessing sensitive files, such as medical or financial (77%).
- Conducting background checks (76%).
- Screening persons banned from gambling or professional card counters in casinos (56%).

A majority of those surveyed believe that privacy safeguards also need to be established by the federal government and adopted voluntarily by companies using biometrics in to gain consumers' trust.

Consumer Credit Declines

The **Federal Reserve** said consumer credit declined $2.2 billion in November 2002 from $1724.1 trillion the previous month. This was the first drop in more than four

BOTTOM LINES
HEADLINES FROM THE RETAIL WORLD

- **Wal-Mart Stores Inc.**, which owns British grocery chain ASDA, placed an all-cash bid on British supermarket chain Safeway Plc.
- **Kmart Corp.** said it's closing 326 of its 1,800 stores and a distribution center and will cut 37,000 jobs. The company also announced its December 2002 sales were down 5.7%.
- **The U.S. Department of Commerce** reported that U.S. retailers' profits fell in Q3 2002.
- **The value of the U.S. dollar** is down 11% since its peak in early 2002, according to the Wall Street Journal, which says a weaker dollar almost always translates to higher prices for U.S. consumers.
- **ConocoPhillips** said it plans to sell most of its retail stores, including the Circle K chain. The company operates 3,700 convenience stores and gas stations around the world, including 2,500 in the U.S.

years and the largest decline in 11 years. Consumer credit is a tally of debt assumed by U.S. consumers from purchasing a good or a service other than a home mortgage.

Dell Making Cash Registers

Dell Computer Corp. announced plans to develop PC-based cash registers in addition to specialized software, services and equipment for linking a store's checkout system to a retailer's corporate information systems. The point-of-sale technology will include a Dell Optiflex desktop computer and a flat-panel screen. Prices for the high-tech cash registers will start at $1,794. Dell is partnering with Retek Inc., AutoGas, GERS Retail Systems and MSS Global to develop the systems. Apilot program is already in place at fashion retailer The Wet Seal, Inc.'s 588 stores.

ANNOUNCEMENTS

Schlumberger Making a Difference

Schlumberger's SEED program (Schlumberger Excellence in Educational Development), started in 1998 as a non-profit foundation and run by Schlumberger employees and their families, reaches 82 schools and 133,000 children in 24 countries. Driven by the goal to build a worldwide learning community, SEED connects students in developing countries to the Internet, including a multilingual online science center, and organizes collaborative projects between school children around the world. The program offers students opportunities made possible through access to learning and new technologies.

EPX Changes Name to InterCept

Electronic Payment Exchange, Inc. (EPX), a merchant transaction processor, has changed its name to **InterCept Payment Solutions, Inc**. The company said the reason for the name change is to gain stronger brand recognition with its parent company InterCept, Inc. InterCept acquired EPX in May 2002.

PARTNERSHIPS

Cynergy to Process Gift Cards

Credit card processor **Cynergy Data** announced it will offer **Secure Payment Systems, Inc.**'s gift card processing services to merchants through its independent sales offices.

TeleCheck Wins Limited

First Data subsidiary **TeleCheck Services, Inc.**, will provide its check verification services to **Limited Brands, Inc.**, which operates 4,574 specialty stores through Victoria's Secret, Bath & Body Works, Express, Structure, Limited Stores, White Barn Candle Co. and Henri Bendel.

Hypercom Is Good Fit for Shoe Company

Genesco Inc., a retailer of footwear, is implementing **Hypercom Corp.**'s ICE card payment technology and terminals in more than 975 U.S. retail locations. Genesco's stores include Journeys, Journeys Kidz, Jarman, Underground Station and Johnston & Murphy. Hypercom said it expects all stores to have the technology by midyear 2003.

Ingenico Products Go Green

Data services and computer systems provider **CCITRIAD**'s Hardlines and Lumber Group in Livermore, Calif., has integrated **Ingenico**'s eN-Touch 1000 touch screen and signature capture terminal and the eN-Crypt 2100 payment terminal with point-of-sale solutions for the hardlines and lumber, retail agribusiness, and lawn and garden industries.

MPS and Datasym Partner

Mercury Payment Systems, LLC, a credit and debit card merchant service provider focused on the retail and restaurant industries, has partnered with **Datasym, Inc.**, an Ontario, Canada-based provider of single-source

point-of-sale software and hardware with more than 150,000 installations in North America. Datasym will actively promote Mercury Payment's two- to three-second payment-processing services to both new and existing retail customers. So what's in it for Datasym? Mercury Payment Systems says it shares a percentage of all merchant transaction revenue with developers and dealers.

ACQUISITIONS

First Data Buys BillingZone

eONE Global, LP, a subsidiary of First Data Corp., acquired **BillingZone, LLC** from PNC Bank, National Association and Perot Systems Corp. BillingZone is a provider of electronic invoices and payment services. eONE Global says its goal is to change manual and paper transactions that occur between trading partners to electronic and paperless transactions by offering an electronic invoice and payment solution.

Verus Acquires Another

Continuing with plans to create a leading payment-processing firm by consolidating other processors, **Verus Financial Management, Inc.** has purchased a second company: Alpharetta, Ga., based-**Cornerstone Payment Systems**, a credit card processing firm. Network 1 Financial, a credit card and automated clearinghouse processor, was Verus' first acquisition. Verus said all Cornerstone management and staff will remain with the company.

Concord Sets Sights on Credit Union 24

Concord EFS, Inc. said it has signed a non-binding letter of intent with **Credit Union 24, Inc.** to acquire the Credit Union 24 Network, an ATM and point-of-sale network based in Tallahassee, Fla. The Credit Union 24 Network connects 400 credit unions through 7,200 ATMs and 7 million cardholders in 35 states. Concord EFS said it expects a definitive agreement in the first quarter of 2003, and closing of the deal will depend on final shareholder approval.

APPOINTMENTS

InterCept Recruits Industry Veteran

InterCept, Inc. has added **John M. Perry** to its executive team as CEO of InterCept Merchant Services. Before joining InterCept, Perry was Chairman and CEO of Spectrum EBP, LLC, an electronic bill presentment and payment company acquired by Metavante in August 2002. From 1996 to 2000, Perry worked for NOVA Information Systems, serving two years as its President and Chief Operating Officer preceded by two years as Executive Vice President of Sales and Marketing. Perry also spent four years with First Data Corp. and has worked at Wells Fargo Bank and Visa USA.

Devitt Goes to Cisco

Payment-processing veteran **George E. Devitt** has been appointed Director of Marketing at **Cisco Systems, Inc.** supporting the firm's Enterprise Sales Organization in North America. Devitt previously held the positions of General Manager for CardSwipe.net, LLC and Senior Vice President and Chief Marketing Officer of Hypercom Corp. He has served in senior sales and marketing positions at VeriFone, Inc., Hewlett-Packard Company and IBM Corp.

Ingram Promoted to CFO

Global eTelecom's Board of Directors has promoted **Douglas T. Ingram, Jr., CPA** to Chief Financial Officer from Chief Accounting Officer. Before joining Global eTelecom, Ingram was Senior Accountant at Wilson, Price, Barranco, Billingsley and Blankenship in Montgomery, Ala. Gregory S. Oswalt, who served as Chief Financial Officer since the corporation's inception until Ingram's appointment, will remain Secretary and Treasurer, positions he also has held the last few years.

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INSPIRATION

When It's Early in the Game, Go for the Tie

The question of what to wear for that all-important first sales call has become somewhat murky. It used to be that the only answer was to wear a suit and tie for the gentlemen, and for the ladies a conservative, skirted suit was the only answer. But changing times and relaxed dress codes can now make these answers seem a bit too pat.

The dot-com phenomenon changed business models and also the rules of doing business. Employees were now encouraged to dress down, probably because they were required to work such long and arduous hours. Blue jeans, T-shirts, shorts ... it seemed as if there were no more rules. But with the demise of the dot-com economy, this "no-rules" attitude is also changing.

So how do you keep up? We all know that the first impression is the most important. But showing up for every sales call in a suit and tie can make some clients feel a bit intimidated. The best way to know the answer is to ask the question. When setting up the appointment, ask the client what their dress standard is and dress accordingly.

As with everything, there are some exceptions. Never show up for a sales call in jeans and a T-shirt. Casual slacks, a button-down shirt with collar, or a nice sweater are acceptable for business casual. Make sure the clothing is clean and pressed, and wear shoes that are polished. Don't wear sneakers.

Women should wear a nice dress or slacks and a blouse. Avoid anything low-cut or too tight. Skirts should hit at or below the knee.

If you are in doubt about a client's dress code or are cold-calling, the best bet is to stick with the old suit and tie. It lets everyone know that you are a professional and that you have credibility and mean business.

The Perfect Way to Benefit from Mistakes

Mark Twain once said, "I don't trust anyone who can't spell a word two ways." In other words, he was in touch with his imperfect side. Are you in touch with yours? And do you encourage your team to positively acknowledge theirs?

Embracing shortcomings rather than evading them is the sign of any successful and self-confident salesperson. Is there a professional out there who doesn't make their quota of errors? But owning up to them and learning from them is a skill too many find too elusive.

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Smart Card Alliance

Educational Institute and Mid-Winter Meeting

Highlights: Expert panels will examine and highlight specific roles in which we use our identities: as a public citizen (such as crossing borders, at airports, in voting booths), as a corporate citizen (accessing buildings, networks, private databases), as a private citizen (in retail stores, on the Internet, and using wireless devices), the ways we protect our identities and the risks to our privacy if we do not protect them.

When: Tuesday, Feb. 11, 2003, Pre-Conference Educational Institute Courses: 101, Introduction to Smart Cards, 8 a.m. to 5 p.m.; 201, Advanced Business of Smart Cards, 8 a.m. to 5 p.m.; Wednesday and Thursday, Feb. 12-13, 2003, Mid-Winter Meeting, 8:30 a.m. to 5 p.m.

Where: Salt Lake City Center Hilton.

Registration Fees: Fees vary by membership level, events attended and registration date.

How to Sign Up: Visit www.smartcardalliance.org or phone 801-328-2000.

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The payment-processing environment is changing at such an alarming rate that few players have the time to master the rules before they're changed. That constant movement means you'll be making a mistake or two. If you can admit to them, laugh at them and learn from them, you'll be able to leave them behind and advance to the next challenge.

Here are a few pointers to encourage the team to turn mistakes into a positive:

• **Perfect Retort Principle.** In the middle of a PowerPoint presentation, a typo rears its ugly head on the 20-foot screen. Or while co-reading the hottest and slickest presentation you've ever put together with the prospect, he finds a misspelled word. Remember, it's all in the delivery. Just say, "My assistant knows I am a perfectionist. He always adds one or two errors so I'll experience the joy of finding one." If that doesn't elicit a chuckle or two, you're in the wrong room!

• **Standing Ovation Strategy.** If a co-worker is having a bad day and, despite Herculean efforts, is struggling with a sales presentation, have him or her stand up and receive a robust round of applause. It will stimulate smiles and ease tension. It will show the team that every effort is rewarded.

• **Blunder Bonus.** At the end of your next staff meeting, put a $10 or $20 bill (or whatever you consider an appropriate amount) on your conference table and share with the team your latest blooper. End with, "Anyone who can top that deserves this bill."

As stories are shared around the room, trust is reinforced since everyone is demonstrating their willingness to show their imperfect side. The personal anecdotes will surely evoke laughter. When lessons are learned from each other's mistakes with humor, those are lessons that will be remembered.

Being perfect takes a whole lot of energy and squeezes all the joy out of the job. Acknowledging your imperfections, on the other hand, opens all sorts of avenues for energy to flow and deals to finalize.

Remember, it's all about laughing at what you do, not who you are. It's easy to admit you made a mistake when the environment is designed to promote productivity and self-confidence. Self-confidence translates to sales.

Good Selling!

Paul H. Green

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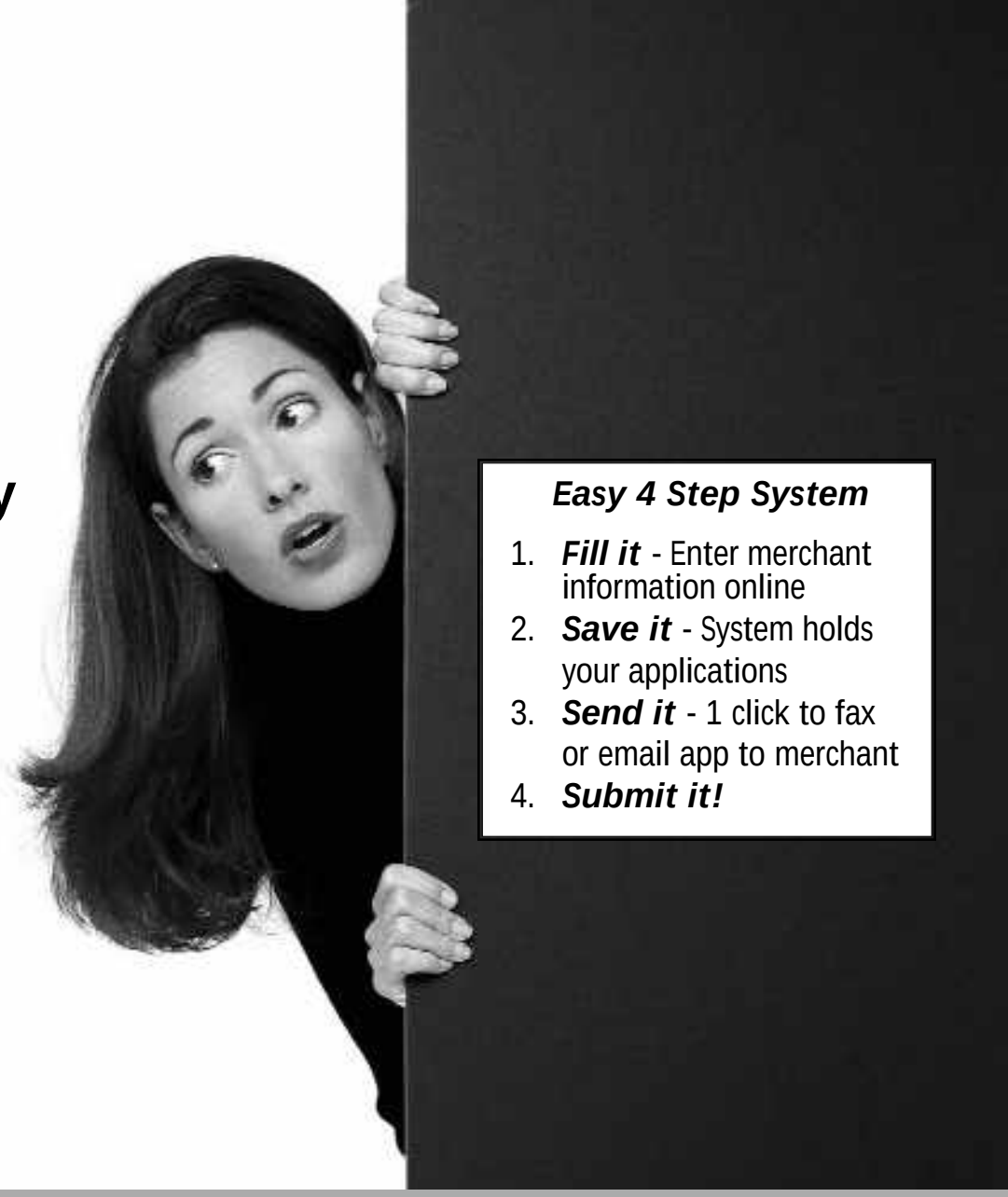

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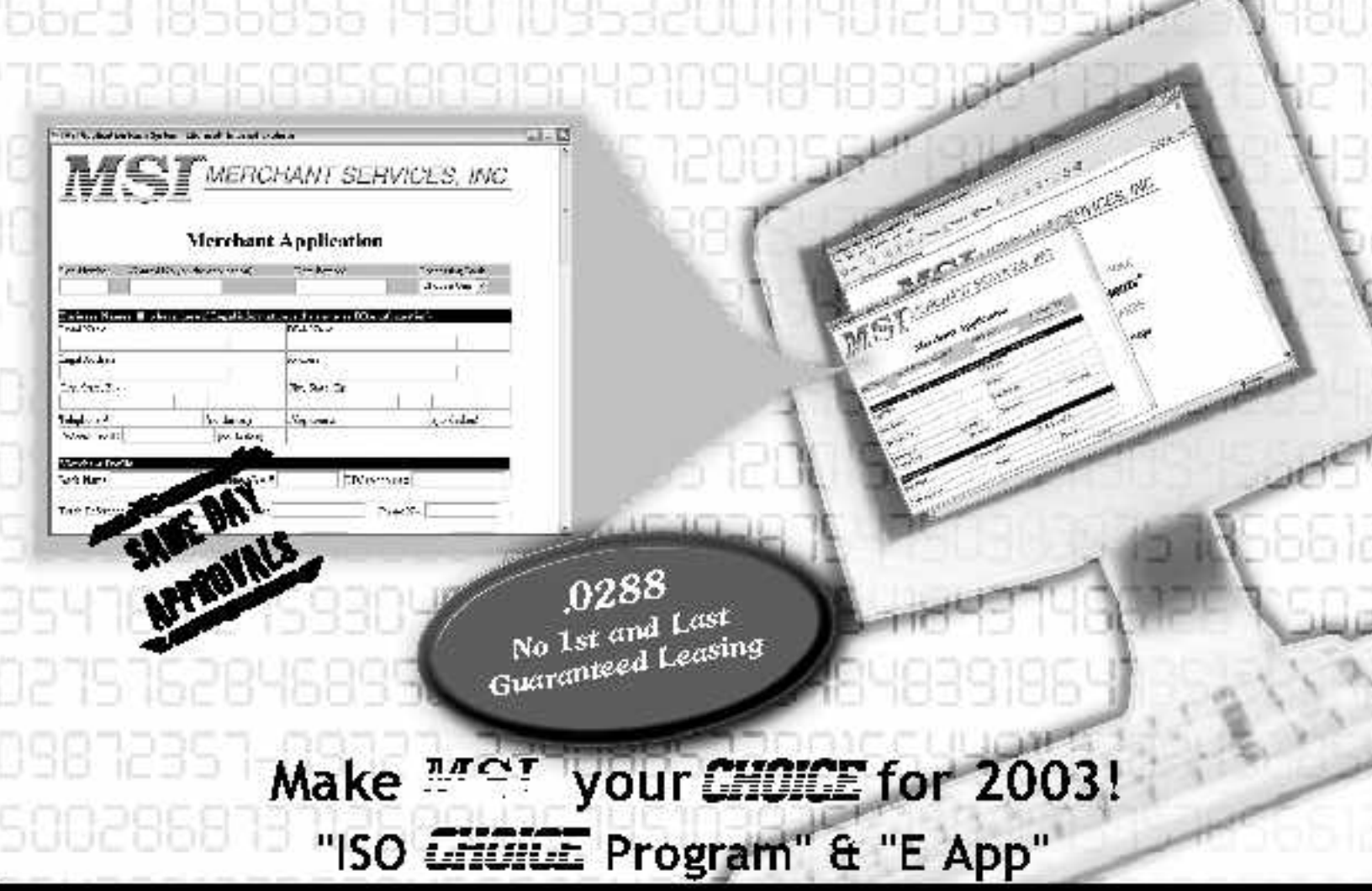

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