



Satisfying Sponsors

Bank sponsorships hinge on ISOs' risk-management strategies and financial stability

By Richard H. Gamble

ISOs can't provide merchant card services without a bank identification number (BIN), and only a bank can provide this key to the kingdom and the official sponsorship that goes with it. Because it involves more bank risk-taking than ever, sponsorship is becoming harder and more expensive to get, and ISOs need to keep abreast of the shifting requirements.

First, understand that bank sponsors are scrutinizing ISOs they take on in four areas, says consultant Kurt Strawhecker, managing partner of the Strawhecker Group:

- Operations—the internal systems, the back-office platform, and the gateways. The more operations an ISO does for itself, the more areas a bank has to examine.

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- Financials—the ISO's financial stability and how well it could absorb charge-backs and other business setbacks.
- Risk-management resources (if the ISO does its own risk management)—in particular, the skill levels of the people responsible and their track records.
- PCI compliance—whether the ISO is itself compliant, whether any value-added resellers it may use are compliant, and the ISO's merchant compliance, particularly small, Level-4 merchants.

ISOs risk losing their sponsors if they don't manage their internal and merchant compliance with data security standards; start to board prohibited

or riskier merchants; incur high charge-backs; or if the bank sponsor hears complaints from merchants about the ISO's business practices, explains Greg Cohen, president of Moneris USA. However, as the marketplace has evolved in recent years, controversial business practices have declined as a source of friction and data security compliance has become the big cloud hanging over ISO-bank relationships, Cohen says.

Old and New Risks

For bank sponsors, which traditionally looked for profitability, risk has become the biggest concern. The familiar threat of basic fraud is still causing anxiety, so banks look for financial strength in an ISO and experienced management teams first.

"If an ISO can't pay its liabilities, the bank is stuck," Cohen notes. That could happen, he says, due to merchant fraud or a future-delivery merchant going out of business. "That risk is understood and quantifiable," he explains.

Then there is the new risk of data security, which is unfamiliar and difficult to quantify—but definitely growing. "The Heartland breach occurred at the ISO level," Cohen notes. "If Heartland is not able to cover the liability and remediation, Key Bank is ultimately responsible." Enforcing PCI compliance is not enough, he adds. "You have to know whom you are doing business with and that they have all operations buttoned up."

Data security compliance has raised the cost for bank sponsors "tremendously," says Cohen. "It has really flipped the risk/reward calculation. You have to question whether it's the best use of bank capital." That is one reason that some banks are getting out of the BIN sponsorship business and others are raising their prices and requiring ISOs to post reserves. To come to a bank for sponsorship today, an ISO has to be bigger and financially stronger than was the case five years ago, he points out.

Pure rent-a-BIN banks that sold access to the system but stayed out of the processing loop are disappearing, notes Donna Embry, senior vice president for strategic product development at Payment Alliance International in Louisville, Kentucky. "PCI compliance has brought increased responsibility, and the banks that remain are now a lot more engaged in the sponsorship relationships."

However, a few new players still are entering the bank sponsorship ranks, Strawhecker points out, citing Palm Desert National Bank in California as an example.

As banks exit the sponsoring business, ISOs are forced to find new sponsors. But the remaining banks generally are large players in merchant acquiring and understand the business well, Cohen says. "You really need to know the acquiring business now. Banks that have gotten into trouble sponsored access to the card networks with minimal oversight. They are unwilling to take that risk now."

Sponsoring ISOs is a marginally profitable business for banks that do it as a sideline, so they are tightening requirements to reduce their risk, raising their prices, or getting out of the business entirely, reports consultant Les Reidl, president of Speer & Associates in Atlanta. "These are tough times in the ISO business, particularly for small ISOs," he says. ISOs are disappearing, but it's sometimes hard to tell why and whether losing sponsorship is a factor, he adds.

Pyramid Structures

As a way to bring ISOs and bank sponsors together at acceptable risk and cost, pyramid structures have evolved, says Embry. In these arrangements, bank sponsors have a few primary relationships with processors and super ISOs, and those processors and super ISOs (often the same company) have the relationship with other ISOs, which deal with merchants.

“Super ISOs offer a bundled relationship,” she explains. “Once you sign up with a super ISO/processor, you get bank sponsorship and a BIN to use, so smaller ISOs don’t need to shop for a bank sponsor separately from a processor.” That package likely includes technology platforms, a variety of value-added services ISOs can offer, and sophisticated risk-management infrastructure. The idea is that the sub-ISO will concentrate on sales and service, leaving the high-tech and capital-intensive work for the large players.

ISOs can still be sponsored directly by acquiring banks that have their own ISO operations: They essentially become a sub-ISO under the bank’s ISO. A sub-ISO has less autonomy, and the back-office operations and controls stay in the hands of the bank, Cohen explains. ISOs that outsource more of the risk to a processor or larger ISO make it easier to get or keep bank sponsor-

ship—provided the bank has confidence in that processor or large ISO, he adds.

While the sub-ISOs usually handle the face-to-face meetings with merchants, super ISOs and processors can manage risk at the merchant level by controlling the equipment that merchants use. “We know what’s in the terminals that our ISOs place,” Embry says. “We know the applications that have been loaded into them, and merchants can’t go in and change the programming to capture sensitive data they shouldn’t be capturing. Of course, you can’t stop a person from manually writing down a card number.”

“When they register with us, they don’t need to get their own BIN,” adds Tony Abruzzio, senior vice president at Global Payments in Atlanta. Global uses a single BIN from its bank sponsor, HSBC, to cover a lot of ISOs and sub-ISOs that use the company as their processor, he

explains. “We insulate them from some of the overhead and hassles of having their own BIN.”

Some ISOs prefer their own BIN because they think it makes their portfolios more portable and therefore worth more when they sell. Not so, says Abruzzio. “Portability is a contract issue. Portability does add to the value of a portfolio, but it’s the contract, not the BIN, that determines portability,” he says.

To offset growing risk, more ISOs are selling data security and chargeback insurance to merchants. The premiums are low, but the coverage brings ISOs some much-needed revenue and makes them more attractive to bank sponsors because some risk has been transferred. **TT**

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