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GOING GLOBAL:
THE STATUS OF
INTERNATIONAL
ACQUIRING

PRESENTED BY THE
COMMITTEE ON INTERNATIONAL
DEVELOPMENT OF THE
ELECTRONIC TRANSACTIONS
ASSOCIATION
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paper



ABOUT THE ELECTRONIC TRANSACTIONS ASSOCIATION

The Electronic Transactions Association (ETA) is an international trade association representing companies offering electronic transaction processing products and services to merchants within the acquiring industry. Members include financial institutions, independent sales organizations and manufacturers/distributors of software, equipment, and point-of-sale devices. ETA was established in 1990 to influence policy within the industry by providing leadership through education, advocacy and the exchange of information.

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This White Paper was prepared by members of the Committee on International Development of the Electronic Transactions Association (the "Committee") and reflects the Committee's interpretation of relevant credit card association rules and regulations. This White Paper is for general informational purposes only. The Committee recommends that the ETA membership consult directly with the appropriate credit card association with specific questions regarding the interpretation of any Visa or MasterCard rule or regulation.

Visa and MasterCard International did not participate in the preparation of this paper and do not endorse it in any way.

OVERVIEW

The problem typically presents itself as follows: you are a prominent American-based merchant acquirer and you receive a general inquiry from a merchant. Initially, the inquiring merchant appears to be perfect acquisition for your bank- it is involved in a low-risk industry and its projected transaction volume could prove to be very profitable to your company. However, when you ask where the merchant is located, you become more guarded in your exuberance after you are told that it is based in Canada. The dilemma is what you do with this lead. You could simply tell this potential client that it will have to take its business elsewhere, namely a bank located within Canada. Do you have any other option?

The business realities arising from the card associations' prohibition against cross-border acquiring becomes obvious when taken against the backdrop of the recent technological advancements that have transformed the way the world does business. As a result, merchants that had previously been restricted by the limitations of standard distribution and marketing channels suddenly have the ability to conduct business seamlessly on a global basis. However, while the technological innovations have served to effectively eliminate the physical borders that once limited merchants, the credit card acquiring industry, for a variety of reasons, is still restricted in terms of the geographical areas where business may be conducted.

As a result, now more than ever, acquirers seeking to fulfill the credit card processing needs of the new global merchant must be fully aware of the card associations' long-standing rules and regulations prohibiting the cross-border acquiring of merchants. There is little doubt that these rules still are a prominent feature of the card association landscape. Still, recently there have been numerous rumors of wholesale change and some subtle developments as Visa and MasterCard, recognizing the need for flexibility, grapple with these delicate issues while balancing the competing interests of merchants, cardholders and member banks.

In full recognition of the impact of the cross-border acquiring scheme upon its membership, the International Committee of the Electronic Transaction Association has prepared this White Paper in order to provide a broad overview of: (1) the opportunities presented by cross-border acquiring; (2) the cross-border acquiring rules; (3) current alternative models to accommodate international processing needs of global-minded merchants; and (4) the likely future of cross-border acquiring.

THE OPPORTUNITY

The Promise of the Internet

It is quite obvious that the industry of merchant acquiring is becoming a global affair. Although there are many reasons for this fundamental shift, probably the greatest contributing factor is the advent of the Internet and electronic commerce.

The Internet has revolutionized the way the world does business in any number of ways, but perhaps most importantly, by facilitating communication between transacting parties. Companies can reach customers and suppliers more quickly and in a more cost efficient manner through the Internet. Another obvious benefit of the web is the potential audience that it commands, which has the practical effect of opening entirely new marketing channels to merchants. A business no longer has to limit its marketing strategy to a specific geographical area. Instead, a merchant can utilize a web site to create a virtual "global" store which can be visited by millions of users throughout the world. In addition, a merchant can streamline its distribution channel by selling directly to the end user, thereby avoiding or minimizing the expense of a brick-and-mortar operation and the cost associated with distributors.

In terms of total dollar amount, the opportunities created by the globalization of the world's economy through the Internet are enormous. Further, it is clear that the business waiting to be tapped in the near future is not located exclusively within the confines of the United States or any other country or region. In fact, according to a study conducted by eStats, nearly one-half of the total global e-commerce transaction volume will originate from merchants located outside of the United States by the year 2003. This same study estimates that by 2003, approximately twenty five percent of Internet users will reside in Europe with close to fifteen percent of users located in Asia and the Pacific Rim.

Consequently, given the massive explosion of e-commerce within the relatively short time frame involved, any merchant acquirer that intends to become seriously involved in the new global economy must act now to develop a true international strategy, including a good understanding of all the regional rules imposed by both Visa and MasterCard.

The Credit Card as the Currency for E-Commerce and the Opportunity for Domestic Acquirers

The impact and contribution of the credit card industry with respect to the rapid expansion and development of e-commerce cannot be understated. Numerous studies have shown that the vast majority of all e-commerce based transactions are completed using some form of credit or debit product. For example, a recent study conducted by Jupiter Communications suggests that approximately 95% of all web-based transactions involve credit cards as the method of payment. This same study predicts that 81% of all e-commerce sales will be completed with credit cards by 2003, suggesting that the credit card will continue as the currency of the Internet in the long term as well.

As a result, even as alternative payment mechanisms for e-commerce emerge, they will remain a very small overall percentage of this rapidly growing marketplace. Thus, for the foreseeable future, the credit card will remain *the* currency of e-commerce. This fortuitous circumstance places the acquiring industry in the advantageous position of effectively financing the growth of e-commerce. In fact, a recent article in the *New York Times*, extolling the credit card's role in e-commerce, quoted a senior official at Visa, who stated: "I've been running around the office rallying the troops, saying 'We've been waiting 40 years for an opportunity like this.'" (*Internet is*

Credit Card Industry's New Best Friend, The New York Times, December 15, 1998).

The opportunities for acquirers based in the United States becomes even more pronounced when one considers that the United States dollar is the world's primary currency for e-commerce as well as traditional transactions. Many foreign nations are embracing the United States dollar and creating special trade zones, such as Argentina, Bermuda, Antigua, Honduras, Guatemala and Panama. The economic advantage for small countries to cater to the Internet is tremendous and brings prosperity to their country. As a result, the services of an American-based acquirer, namely the ability to provide United States dollar denominated credit card merchant processing, are in high demand.

The competitive advantage enjoyed by domestic financial institutions is highlighted by the fact that the acquiring industry outside of the United States is years behind in a number of key areas. For example, many foreign acquirers have not yet invested in or integrated with the technology that is necessary for the enabling of e-merchants, such as Address Verification Systems and sophisticated front-end data scrubbing facilities. Obviously the standard Point-of-Sale device has limited application in the context of an e-commerce transaction. Most e-merchants require the ability to process and authorize transactions in real-time via the web. This requires costly development and integration of a "payment gateway," that is, the software mechanism by which credit card information is forwarded to the associations via the Internet in real time and in an acceptable format for authorization and settlement purposes.

In addition, certain foreign acquirers have yet to develop the sophisticated risk-management and due diligence procedures that are required to effectively process and analyze applications to identify potential problem e-merchants. The Internet has led to the introduction of a dizzying array of new products and services being sold - from digitally delivered music files to online chat rooms. A financial institutional must have a solid working knowledge of these new business models if it has any hope of conducting effective due diligence. This factor, coupled with the either real or exaggerated fear of fraud associated with e-commerce, have left many of the foreign acquirers on the side-lines with respect to the placement of their local e-commerce enabled merchants. This hesitancy on the part of foreign acquirers has led to a vast pool of international merchants in need of a credit card solution.

THE RULE: PRESENT AND FUTURE

Definition of the Rule

Prior to discussing the reasoning behind and the future of cross-border acquiring, it is necessary to establish a working definition of the term. With respect to domestic acquirers, the general prohibition against cross-border acquiring can be found within Rule 6.4 of the Visa USA Operating Regulations, which mandates:

“An acquirer may only enter into a Merchant Agreement for Merchant Outlets . . . located within the United States and its territories . . .”

A similar restriction contained within Visa International's Operating Regulation serves to place identical restrictions upon acquirers operating in the respective regions outside of the United States. Similarly, MasterCard International Bylaws and Rules include a similar prohibition against cross-border acquiring of merchants.

Although the rule would appear relatively easy to apply, matters are complicated when one considers the definition of location in the context of the Internet which, by its very nature, is a medium that is not bound by geographical borders. A merchant can be incorporated in one country, while operating from a physical world office located in a second country, while by placement of its Internet servers or storefront in yet another country, can claim to transact business there as well. This begs the question, “In which jurisdiction the merchant is located for the purpose of the cross-border acquiring regulations?” In order to simplify matters in determining the “location” of a business, Visa has adopted a two part test to establish presence. For the purpose of the regulations, it looks to: (1) in which country is the merchant legally registered or incorporated? and (2) does the merchant have some physical nexus, such as its back office support, call center or transactional server, in this country? The practical effect

of this test is the recognition that an e-merchant, more so than the standard brick-and-mortar business, can easily be located anywhere in the world it chooses.

The Exceptions

As is the case with any rule, there are exceptions to the general prohibition against the cross-border acquiring of merchants. For example, MasterCard allows financial institutions to acquire cross-border if the merchant is involved in the mail or telephone order business or if merchant's business involves recurring transactions such as insurance premiums and magazine subscriptions, with certain limitations. Visa's policy is much more limited and contains an exception which allows merchants to engage in processing of transactions for United States military bases and United States territorial possessions. In addition, both associations permit the cross-border processing of international airline transactions. Significantly, the card associations have not yet carved an exception for e-commerce transactions.

The Reasoning Behind the Rule

The rule against cross-border acquiring is not an arbitrary or outdated policy on the part of the credit card associations. Rather, it is quite necessary given the complexities of acquiring merchants on an international basis.

One factor that undoubtedly played a major role in the passage of the regulation is the realization that in most countries around the world, the acquiring side of the credit card business is usually less profitable than the issuing side. As such, MasterCard and Visa hope to promote the development of merchant acquiring in these local markets. Cross-border acquiring could prove contrary to this goal by allowing the more prominent global acquirers to simply “cherry pick” major and more profitable merchants while leaving

only the smaller and less desirable merchants for the local acquirers. As a result, the incentive for local acquirers to promote the MasterCard and Visa brands within these markets would be largely removed.

Another consideration is that the established banking communities that currently dominate certain markets have fiercely resisted any move by the credit card associations that would allow foreign acquirers, especially those located within the United States, to enter their jurisdiction (*Credit Card Management*, March 2000, Page 24). Perhaps foreign acquirers are particularly sensitive to the United States acquirers since there is a perception that these institutions, with their significant economies of scale, will simply take the most attractive merchants, especially those engaged in the travel and entertainment business.

Furthermore, in all likelihood, Visa and MasterCard will continue to enforce the regulation out of genuine concern for the merchant and cardholders. As will be more fully addressed later in this White Paper, the project of becoming a global acquirer is no easy task with the unwary potentially subjecting both the merchant and its customers to poor service. This subpar customer experience, in turn, could tarnish the card associations brands, to the detriment of all parties.

Recent Developments

Two recent developments in MasterCard/Visa Cross Border Acquiring rules and policy may shed some light into the evolution of cross border acquiring. The first pertains to both card associations while the second is MasterCard only, at present.

Elimination of Cross Border Acquiring Prohibitions in Europe

Beginning as early as 1994, MasterCard and Visa, influenced by the European Union,

began to open European acquiring across country borders in Western Europe. Basic requirements of the program call for the merchant to be in business in at least 3 European countries and to have a “centrally administered processing system.” Additionally, the European rules to date apply only to credit as opposed to debit transactions, though expansion to debit will likely occur in the near future. It is also important to note that these rules are only for “physical, brick and mortar merchants”. The central acquiring rules of Europay, MasterCard’s partner in Europe, do not address mail/phone order or electronic commerce merchants. Also, these rules apply only to intra-Europe transactions. As such, a US acquirer, for example, is still prohibited from processing transactions for a European based merchant.

The Travel & Entertainment (T&E) markets, including hotels, auto rental and cruise lines/ferries, were the first industries where “Central Acquiring” (The Europay term for Cross Border Acquiring) was allowed. The program has since evolved to include all merchant segments. Since 1999, slightly more than a dozen European acquirers have received licenses to process centrally acquired transactions on a country-by-country basis. To date Europay reports that little centrally acquired processing has actually occurred. They expect the petroleum industry, followed by T&E, to be the first industries to be significantly impacted. The fact that cross-border acquiring has not significantly expanded in Europe speaks to the cultural and socioeconomic difficulties of acquirers moving into other countries for card acquiring.

MasterCard Global Cross Border Acquiring of Electronic Commerce Transactions

Earlier this year, MasterCard announced that, effective January 1, 2001, MasterCard acquirers will be permitted to acquire Elec-

tronic Commerce transactions from any merchant at any location globally. However, MasterCard recently decided to rescind this decision. Still, it is worth discussing the policy as it was proposed to consider how cross-border acquiring could work.

•**Registration** – Acquirers would submit a cross-border acquiring action plan to register and receive approval from MasterCard prior to commencing with cross-border acquiring of e-commerce transactions. A separate registration would need to be submitted for each country and all e-commerce merchants and their subsidiaries must be identified.

•**Cross Border Electronic Commerce Transactions** – Cross-border acquirers would have to comply with all “domestic” rules of the merchant’s country including interchange rules.

•**Exclusive Agreements** – The card associations still have some countries with exclusive agreements to acquirer transactions; no other members may acquire transactions in that country. MasterCard’s Cross Border Acquiring Electronic Commerce rules would require that members obtain permission from these exclusive entities prior to processing cross-border transactions. (As an aside, it is worth noting that these exclusive rights were at one time quite common in Europe. Now the only European country with exclusive acquiring rights is Norway).

•**Penalties for non-compliance** - Failure to obtain approval from MasterCard for cross-border acquiring would result in penalties to the wrongdoer.

Visa is considering, but has not announced, a program for cross-border acquiring for e-commerce transactions. In light of MasterCard’s decision not to alter the cross-border prohibition, Visa is not likely to announce a decision very soon. Whichever association jumps first, one thing is certain:

not much will change until the other follows.

In sum, it is clear that once e-commerce becomes more established and better understood, the cross-border regulations will effectively ease. More than anything else, this fact is attributable to the mobile and borderless nature of the Internet. For example, the next anticipated wave of activity will be in the area of mobile commerce, or the ability to transact business utilizing a mobile phone or handheld computer or organizer. This begs the question of where the credit card transaction is occurring for the purpose of the regulations. What if a French acquirer issued a merchant account to a German e-merchant that was allowing consumers to transact business using a web-enabled phone. Obviously a traditional brick and mortar merchant could not apply for a merchant account and then set-up a POS device in England in order to transact business. However, are the web-enabled phones the functional equivalent of a POS device? If a consumer consummates a transaction using a web-enabled phone in England, would this run afoul of the cross-border regulations? These, and many other questions, will continue to arise as the technological underpinnings of electronic commerce continue to advance. These business realities, in turn, will force the card associations to amend the rules in order to keep pace.

The Barriers to Becoming a Global Acquirer

In the unlikely event that the cross-border regulations are repealed in their entirety, a merchant acquirer should be fully cognizant of the significant work that would be required in order to become an effective global acquirer. Understanding these significant hurdles is also helpful in appreciating the card associations’ reason-

ing in establishing cross-border regulations in the first place.

One common fallacy that exists today is that an acquirer could simply replicate its current domestic United States operation and transport it overseas and expect that the system will work efficiently on an international basis. As an initial matter, an acquirer must have the ability to offer multi-currency to its international merchants. Although multi-currency as a general proposition is ill-defined and subject to interpretation, at a minimum, an acquirer must enable its merchants the ability to offer its goods for sale in the local currency while still permitting the merchant to receive settlement in the currency of its choice. While this sounds easy enough to accomplish in principal, in practice it is extremely difficult to perfect.

For example, the cross-border regulations aside, say a domestic acquirer issues a merchant account to a merchant in Japan. Obviously, the merchant will require settlement as well as the ability to accept Yen on its website. How would a United States-based acquirer handle the front-end purchase and back-end settlement of a credit card transaction which is consummated in a foreign currency? This must be accomplished through an effective currency conversion regime, which if not done properly, could expose the banking institution to financial loss in the event of currency fluctuation (to say nothing of the chargeback and customer service complexities). Consequently, only a few acquirers in Europe and the Caribbean have developed multi-currency functionality. Further, it is quite clear that the road that an acquirer must travel to incorporate a functioning currency conversion regime is quite long and expensive. However, an acquirer that does not possess the ability to localize its merchant service offering to individual marketplaces has little chance of succeeding on an international level.

Acquirers also need a complete understanding of the marketplace that they are trying to penetrate. For example, acquirers seeking entry into Latin America need to be wary of local tax structures that strongly favor local business. In addition, in many foreign markets, such as Mexico, the credit card market is effectively a closed system dominated by a few players, making entry by a foreign financial institution almost impossible (*Credit Card Management*, March, 2000, Page 24). Another example can be found in Chile where only one bank, TransBank, acquires for the entire country, since the 22 issuing member banks each own a portion of it. The entire merchant discount rate is passed on to the card issuer. Obviously, this does not provide any economic or financial reason to establish a processing center in Chile.

In addition, the political and economic situations in certain areas of the world can be volatile, which could pose a threat to the profitability of an acquirer's global operation. For example, the rush of Asian governments to devalue their local currency during the financial crisis of 1997 would have seriously impacted upon an acquirer's activity within this geographical area. Political instability in certain Latin American countries could lead to a sudden and dramatic change in leadership and financial policy of a government and, under the worst-case scenario, could lead to nationalization of the country's banks.

Another problem that could be easily overlooked by an acquirer is the process of risk management and due diligence procedures in connection with foreign merchant applicants. Acquirers in the United States have the benefit of a developed network of efficient and inexpensive corporate and investigative reporting. However, the availability and scope of such information is quite limited outside of the

United States which begs the question of how an acquirer can efficiently develop a global fraud screening model to identify problem merchants and thereby avoid excessive charge-back losses. Further, the question of how to conduct a credit check proves problematic in the face the Privacy Directive recently enacted by the European Union. This Directive severely limits the types of personal and financial information that can be obtained for citizens of the European Union. For example, France will not allow the credit card associations to provide Address Verification Services (“AVS”) as doing so would violate the country’s privacy laws, thus exposing the acquirers to additional potential losses. Perhaps most concerning is that an acquirer who runs afoul of these rules could be subject to harsh penalties.

An acquirer must also be prepared to commit to learning the nuances of each individual country’s legal and business system (e.g., what a certificate of incorporation is called in Argentina) so that it is able to specifically request the local documentation that is required for due diligence purposes. Otherwise, a global acquirer’s application could become bogged down and quickly grind to a halt, or worse, a bad merchant could slip through.

Although certain merchants may be swayed by the lure of lower discount rates and transaction fees, an acquirer must also be aware that certain countries are subject to extreme nationalistic tendencies, as a result of which, foreign companies could be viewed with a certain degree of skepticism. Consequently, in order to counter this preference to do business with local companies, an acquirer must be willing to invest in build-

ing a local presence for marketing and customer service purposes. Even if an acquirer chooses to centralize its customer service operation with the United States, dedicated multi-lingual personnel must be added in order to service its international clients.

Finally, an acquirer must fully understand the payment preferences of the local population. For example, the European credit card market is dominated by “smart” card technology. In Canada, debit products are extremely popular with consumers and the debit transactions in Canada are processed through a separate processing network than standard Visa and Mastercard processing channels (*Credit Card Management*, March, 2000, Page 20). An acquirer hoping to compete in these markets must have the ability to offer merchants the ability to accept local customized credit card products and must understand the integration into local processing platforms as well.

It should, at this point, be quite clear from this discussion that the concept of a true global acquirer is extremely difficult to achieve in a short period of time. Even in the unlikely event that the cross-border regulations are eliminated entirely, an acquirer must be dedicated to commit a huge expenditure of time and money in order to develop the infrastructure necessary for the globalization of a domestic merchant acquiring business.

Alternative Models and Solutions

As was discussed earlier, many credit card merchant acquirers do not have the infrastructure in terms of technology or risk management procedures to service the rapidly expanding base of e-commerce merchants that are springing-up all over the globe. In addition, for the most part, the cross-border acquiring restrictions have prohibited acquirers with the ability and desire to enable these merchants from doing so. As a result, a vast pool of small to middle-sized merchants has been excluded from the traditional banking model and left without a means to process credit cards. In recognition of this need, a number of innovative models have been developed to fill this void by providing a global payment solution that can be utilized by merchants anywhere in the world. A discussion of these non-traditional alternative models, including the relative strengths and weaknesses of each system, follows.

Incorporation Services for Merchants

Some Independent Sales Organizations and Merchant Services Providers have long obtained credit card merchant accounts from United States-based acquirers by incorporating the foreign business within this country. The benefits of this system are quite obvious in that a merchant has the ability, through carefully choosing or altering its incorporation jurisdiction, to access the acquiring system that best suits its needs in terms of technology and price. However, the negatives of this model could serve to offset any positive financial effects that a merchant enjoys under this regime.

The easiest way to illustrate the drawbacks of this model is through a hypothetical. Say for instance, a French e-merchant is looking to a United States acquirer to obtain a credit card merchant account. It may choose one of the many incorporation services to establish a presence within

this country- typically at a cost of only several hundred dollars. Once incorporated, the new “American” entity can obtain a merchant account through a US acquirer. After conducting business using the account, the merchant soon receives an inquiry from the Internal Revenue Service. The merchant suddenly realizes that by incorporating in the United States, it has now exposed itself to tax liability in this country.

In addition to the inquiry from the tax authorities, the merchant soon thereafter receives a lawsuit in the mail from a customer that was injured by a product purchased on its website. Since the merchant incorporated in the US, it has unwittingly subjected itself to the jurisdiction of the United States court system. As a general proposition, pursuing a lawsuit against a foreign entity is much more difficult in terms of obtaining jurisdiction through collecting a judgment. The French merchant, by establishing a legal local presence, just simplified the matter and effectively eliminated all of these impediments.

The e-Suite

The e-Suite is an entity that has been created by special legislation in several offshore jurisdictions, most notably in Bermuda. A merchant purchases the e-Suite service which enables the merchant to effectively enjoy similar rights and privileges as that of a corporate entity in that jurisdiction. An acquirer is normally associated with the e-Suite provider and issues all qualifying members with a credit card merchant account.

A merchant that locates its business within an e-Suite does establish a presence for the purpose of the cross-border acquiring regulations (remember the two part test). However, the model is subject to several drawbacks. For example, the acquirer involved in an e-Suite normally charges a higher dis-

count rate for transactions that occur outside of the e-Suite's jurisdiction. In addition, the model normally involves high due diligence and start-up costs that make the arrangement financially unpractical. Further, the small to middle-sized merchant normally finds the structure of the arrangement quite complex. Finally, larger companies, which can afford the service, are more likely to simply incorporate in the jurisdiction using the traditional method. As a result, the success of the e-Suite has been limited.

The Master Merchant

The Master Merchant model is remarkably uncomplicated yet it presents the most problems of all of the alternative models discussed in this White Paper. A Master Merchant applies to a traditional acquirer and receives a credit card merchant account. The Master Merchant, in turn, allows its merchant account to be used by third parties in order to complete sales. In this scenario, the third party seller transacts directly with its customers through its own web site. When the customer agrees to buy the good or services, the credit card account of the Master Merchant is used to settle the transaction. The third party seller remains responsible for fulfillment and shipment of the goods or delivery of the service.

Overall, the Master Merchant model is fraught with risk. Obviously one question that immediately arises is whether this model is permissible under the rules of the card associations. A merchant that uses a credit card account to process sales belonging to an un-named third party is engaging in what is commonly known as "factoring." Factoring, as a general proposition, is frowned upon by the card associations for several reasons.

One common problem with the Master Merchant model is the likelihood of customer confusion and resultant chargebacks. Al-

though the customer thinks that it is transacting business with the third party seller through its web site, the billing description on the cardholders contains the name of the Master Merchant, the owner of the merchant account. The customer, not recognizing the Master Merchant's name, disputes the transaction resulting in a chargeback to the acquirer and Master Merchant.

The risk of financial loss on the part of acquirer and Master Merchant is high under this model for other reasons as well. As an initial matter, risk management on the part of an acquirer is next to impossible. Often times, a large measure of control is removed from the acquirer since the true identity of the ultimate seller, who could be involved in a risk-prone or illegal industry, is hidden. Furthermore, the Master Merchant itself is exposed to a large amount of risk since it is the merchant of record for the purpose of the transaction. This scenario presents risks to the acquirer as well since if the Master Merchant cannot satisfy the chargeback obligations, the acquirer is left holding the bag. In addition, the acquirer must be concerned that the Master Merchant itself is fraudulent and that it may simply disappear after receiving payment due to the third parties.

Internet Billing Service

The final model to be discussed in this White Paper, the Internet Billing Service ("IBS"), is the best alternative model. Low in risk and easy to operate, the IBS fills the void created by the demands of today's e-commerce merchants and cardholders while providing acquirers and card associations time to deliberate the best course of action. Under this model, the Internet Billing Service provider is the merchant of record.

The IBS provider enters into separate contractual relationships with a network of

suppliers who wish to sell their goods on the Internet and receive payment therefore. Pursuant to these contracts, the supplier agrees to provide its goods or services to the IBS provider, who as sales agent, sells the goods or services to the customer on the supplier's behalf. Once the sale is complete, the supplier handles the fulfillment of the transaction and arranges delivery to the customer. The IBS completes payment and guarantees the transaction for the customer.

This model is not new, of course. The IBS model has been operated successfully by Skymall™ for years. Recently, Internet companies such as Amazon.com have applied the model to e-commerce.

The IBS model avoids the risk of the alternative arrangements while still providing a payment solution to merchants irrespective of geographical location and simultaneously upholding the associations' policies. For example, the issue of customer confusion is avoided by full disclosure explaining the nature of the arrangement on both the supplier's website as well as in the descriptor field on the cardholder's billing statement. In addition, since the IBS provider is taking title to the goods or services and actually selling the items to the customer as a sales agent for the supplier, the IBS model is in full compliance with card association rules and regulations.

The IBS model is an ideal solution for the acquirer that is looking to expand its merchant service offering into the new economy. Companies such as Planet Payment, CCNow, Internet Secure and MSBill.com have formed alliances with prominent US acquirers to offer an Internet payment solution to merchants whose needs would otherwise be overlooked.

These companies have worked closely with their acquiring partners to develop sophisticated due diligence and application processes which serve the dual purpose of limiting chargeback risks as well as providing the acquirer with the ultimate decision relative to which supplier provide their goods through the Internet billing service.

In addition, from the acquirer's prospective, the transactions are, in essence, risk free. Since the IBS provider is the merchant for the purpose of the merchant services agreement, the acquirer can look to the IBS provider for recovery of chargebacks. The leading IBS providers have procured insurance policies that protect themselves from fraudulent transactions on the part of their suppliers. Planet Payment, for one, has taken the additional step of adding its acquiring partners as additional insureds on its insurance policy, thereby affording the acquirer an additional measure of safety.

In sum, the Internet Billing Service model, if done correctly, can serve the interests of all parties to a credit card transaction. The cardmember, as always, is protected against fraud by the associations, and the acquirers are protected by the financial strength and insurance policies of the Internet Billing Service. Furthermore, the Internet Billing Service model provides much-needed liquidity to the marketplace by fulfilling the credit card merchant services needs of those entities that previously had no other solution, while effectively eliminating the risk from the equation. Finally, the acquirer through close working relationships with the Internet Billing Service providers is able to enter into lucrative and risk-free arrangements for to finance e-commerce on a global basis.

Conclusion

Due to the increasingly global nature of e-commerce, and business in general, MasterCard and Visa will, out of necessity, eventually develop a model to allow cross-border acquiring. However, they will have to first develop a methodology to ensure that issuers receive their domestic interchange rates, as opposed to the international rates that would normally apply to cross-border transactions. Successful and profitable growth of the Internet marketplace will depend on the card association's ability to level the playing field and allow the acquirer to profitably accept merchant transactions over the Internet.



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