

Key trends and insights on merchant payments 2019/2020

SCA: How to minimise conversion risk



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MERCHANT
PAYMENTS
ECOSYSTEM

Free webinar
August 16, 2019
15:00 CEST

Agenda

- ❑ Key trends and insights on merchant payments 2019/2020
- ❑ SCA: How to minimise conversion risk
- ❑ Q&A



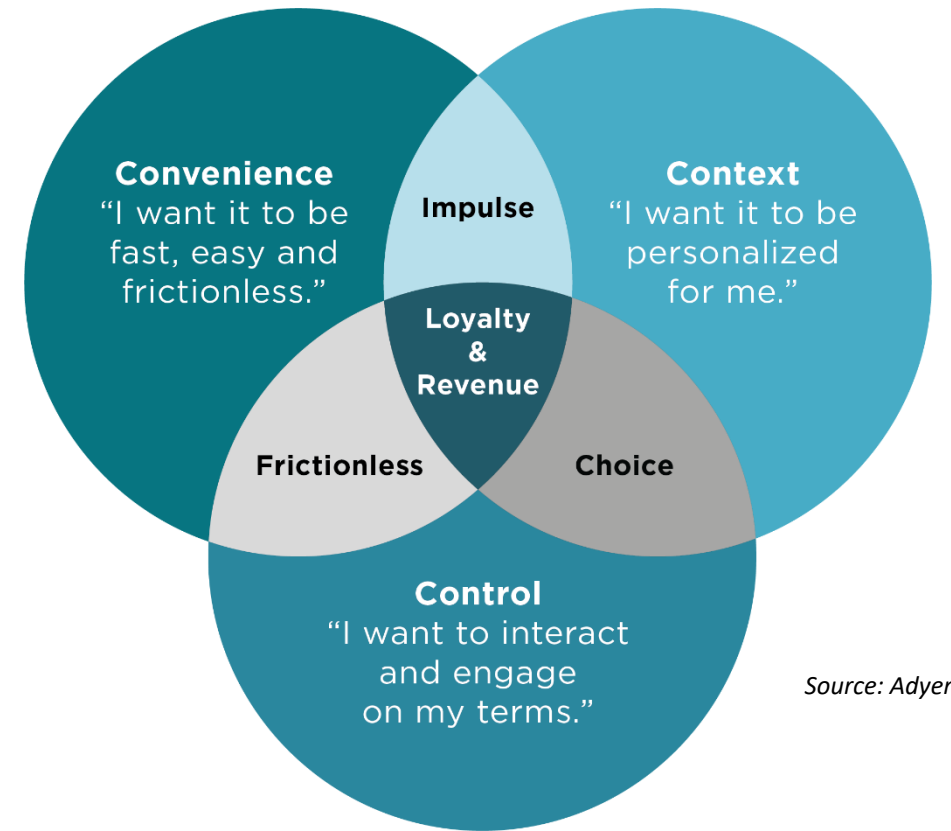
Key trends and insights on merchant payments

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Senior Analyst at Aite Group

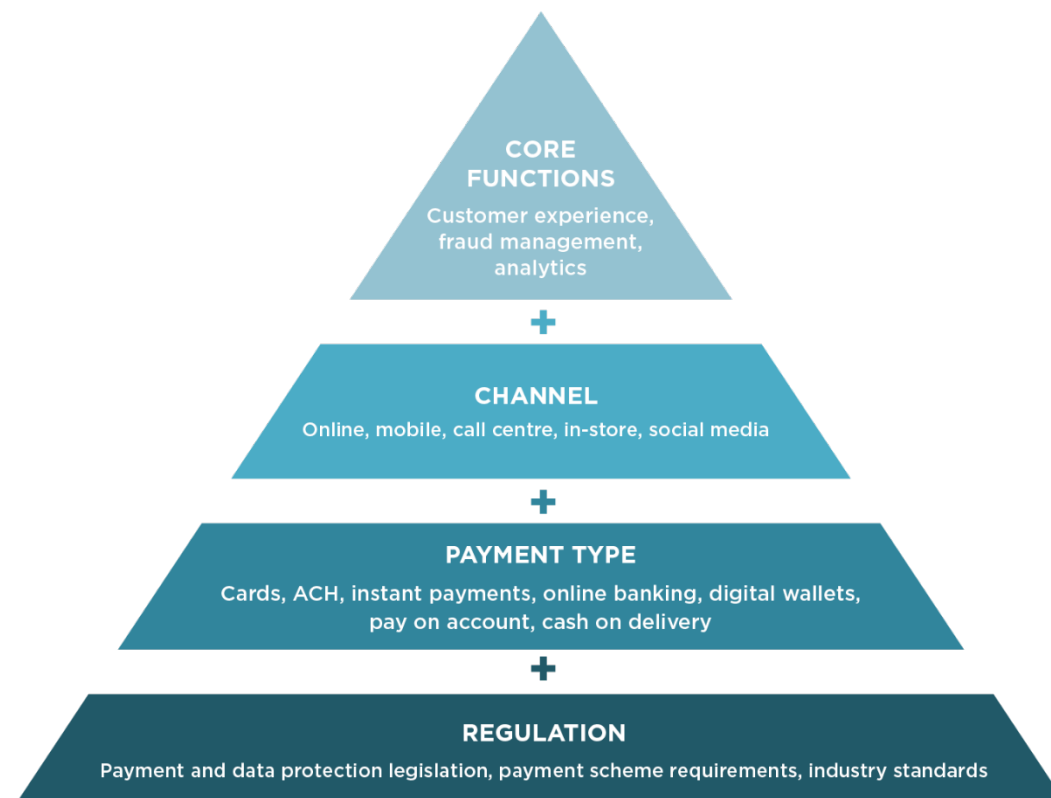
Digital Experiences Are Becoming the Basis of Competition

- The digitization of global commerce drives merchant demand for payment innovation to deliver superior customer experiences.
- The digital checkout experience is critical for merchants to drive conversion.
- The digital journey is becoming the basis of competition, with customers requiring a convenient and personalized experience. And they want to be in control, interacting on their own terms rather than the provider's.
- To succeed, businesses must remove friction for online consumers at every touch point.



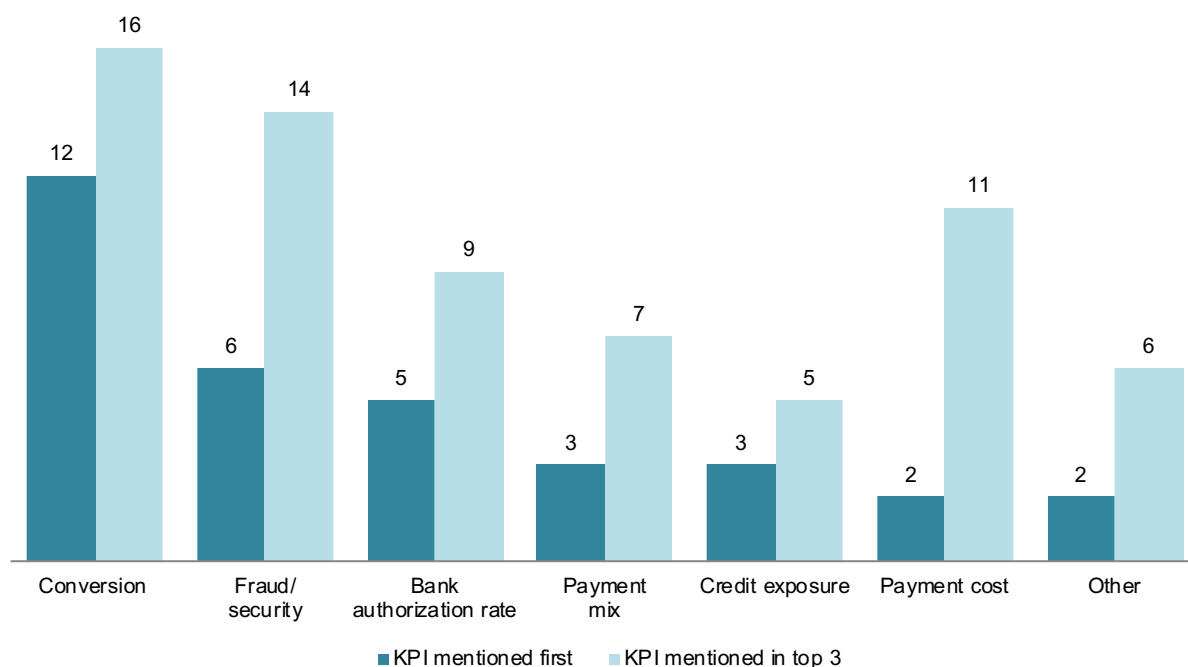
Source: Adyen

Merchant payment management is increasingly complex



Merchant payments KPIs: balancing conversion and risk

Q. What are your most important KPIs?
(n=33)

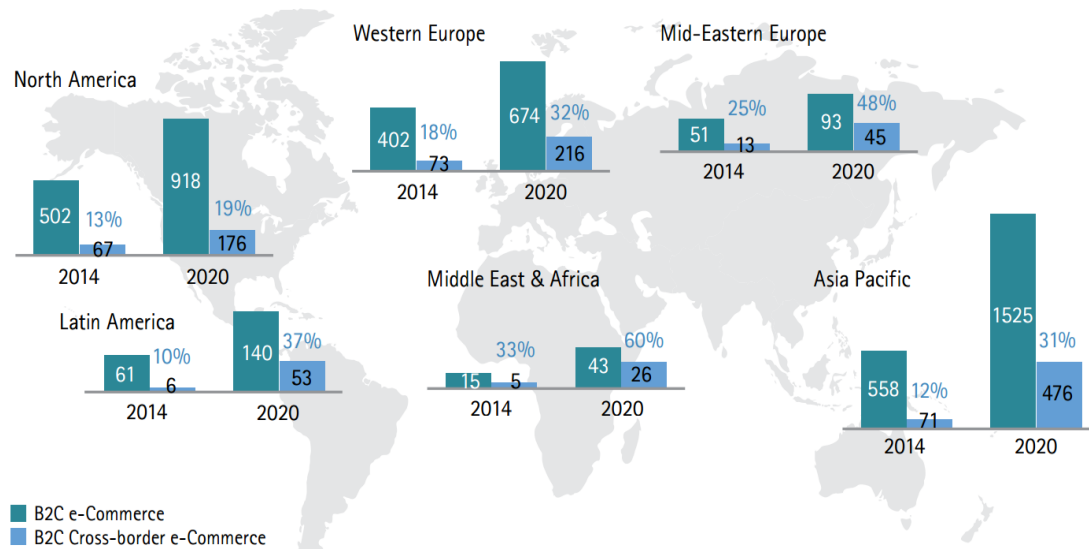


Source: Aite Group interviews with 40 global merchants, September to November 2017

- **Conversion is mentioned as the most important payment KPI.** A frictionless payment experience and “one click” payment is reported as a must-have to compete with the likes of Amazon.
- **Mobile optimization of the customer checkout experience is very important.** Merchants are increasingly taking a “mobile first” approach in their web shop design.
- **False declines are a major issue for merchants that operate in highly competitive markets.** Any false decline could lead to the long term loss of a customer if they find an alternative to buy from.
- **Best-in-class companies seek to personalize the payment experience for their customers.** Such companies use predictive analytics and risk scoring to offer the right payment instruments. The goal is to optimize the payment experience, reduce friction as much as possible while keeping fraud and cost at acceptable levels.

E-commerce is crossing borders

Global cross-border B2C e-Commerce transaction value (US\$ billion)



	2014-20 incremental B2C cross-border e-Commerce trade volume (billion dollars)	Contribution of global total incremental trade volume (%)
Asia Pacific	405	53.6%
Western Europe	143	18.9%
North America	109	14.4%
Latin America	47	6.2%
Mid-eastern Europe	32	4.2%
Middle-East and Africa	21	2.7%

Source: EIU, ISI, World Bank, Accenture Analysis

- By 2020, 30% of all purchases will be cross-border, reaching US\$1 trillion in value. China is the largest market for cross-border commerce, accounting for about 25% of total value.
- The growth of cross-border commerce (estimated at more than US\$750 billion between 2014 and 2020, an annual growth rate of 27%) offers a huge opportunity for online merchants. To monetize that, online merchants need to convince online shoppers in foreign countries to trust their brand for product quality, price, delivery, and service.
- Payment has to be as easy and convenient as possible. But in some of the largest markets in the world, international credit cards are not the preferred payment method. This means that merchants require support of local payment methods, such as Alipay, WeChat Pay, and Union Pay in China; SEPA bank transfers and direct debits in Germany; and Yandex, Qiwi, and WebMoney wallets in Russia. Also, they need to offer the choice to pay in local currency.

Alternative payment methods overtake cards

- Worldwide, cards are losing their dominant position as a means of payment on the internet.
- Alternative (non-card) payment methods (APMs) now account for more than 50% of e-commerce transaction volume (source: WorldPay).
- The growing use of APMs is expected to continue and even accelerate in the coming years.

Drivers

Optimizing the customer experience

Growth of cross-border commerce

Payment innovation

Regulation

Advantages for e-merchants

Higher conversion of customer visits into sales by offering popular APMs

Support of local payment methods provides trust and convenience to cross-border shoppers, winning new business

Innovative APMs e.g., based on real-time payments rails, offer advantages over cards in terms of speed, cost and certainty of funds

Regulation such as PSD2 in Europe opens up bank account data for third party providers, creating new APMs for merchants

Omni-channel payment acceptance becomes a must-have

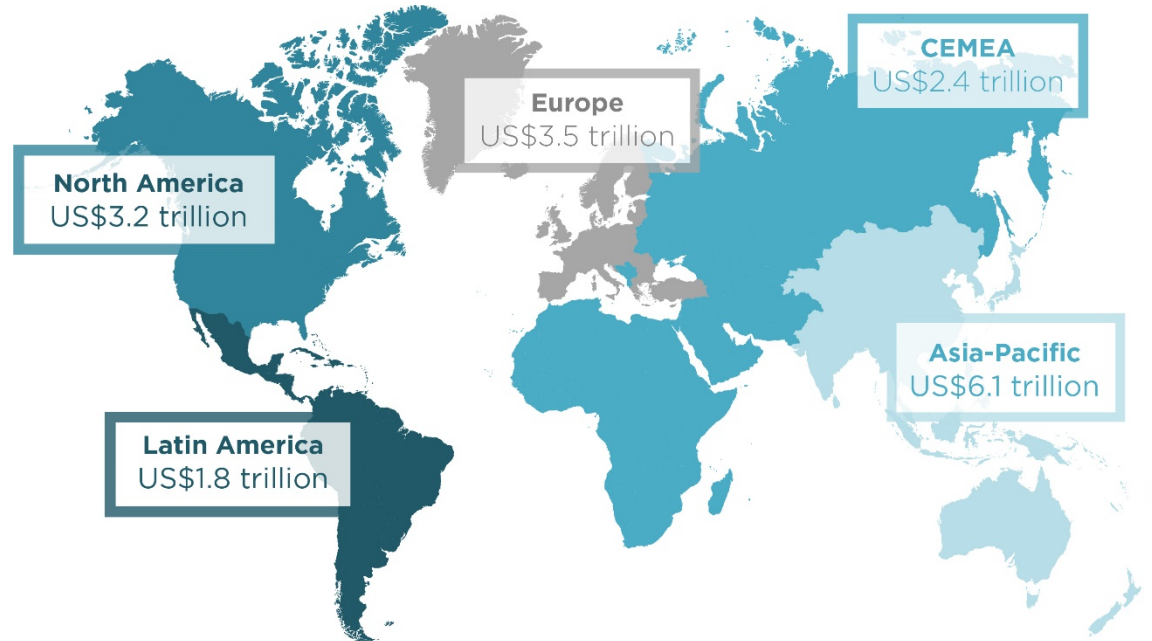


- Consumers expect to be able to transact with their favorite brand over any channel, be that the merchant's website, mobile app, or physical store. Acquirers can help merchants manage this transition to omni-channel commerce, enabling them to do the following:
 - Accept payments through a variety of card and non-card payment methods and channels, including EMV contact and contactless card payments, digital wallets, and mobile payments
 - Manage sales cross-channel, e.g., allow consumers to buy online and pick up the item in store, or choose from online inventory in the store
 - Obtain an integrated view on payments across all sales channels
- Merchants need to deploy omnichannel acceptance of payments and to better meet their customer's needs for anytime, anywhere commerce.

Contactless payments displace cash

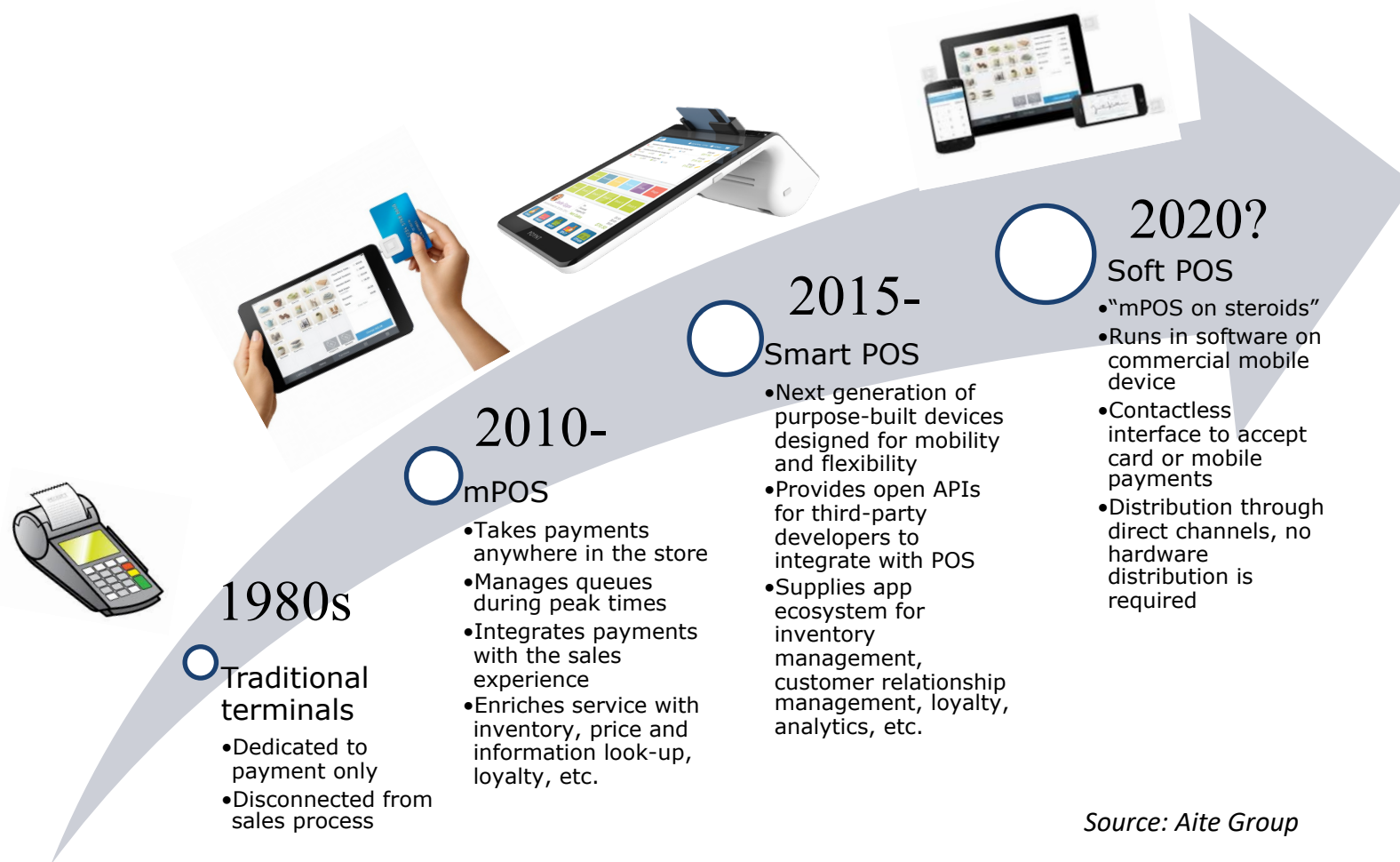
- According to Visa, there is a U.S. \$ 16.8 trillion opportunity globally to convert cash and check. Contactless payments offer a significant opportunity to digitalize cash and to a lesser extent check payments.
- EMV contactless payment has reached mass adoption in markets around the world
- Merchants benefit from reduced check-out time (10 seconds faster on average than an EMV contact payment for low value payments). Contactless increases spending per active card by 14-16%.
- Alternative networks use bridging technology such as QR codes to enable digital payments at the point-of-sale.
- China is the prime example with Alipay and WeChat Pay, but similar networks are developed around the world.
- EMVCo has published standards for QR code payments, and the card networks are now rolling out pilots in developing markets where terminal penetration is low.

Value of Cash and Check Payments Per Region



Source: Visa

The (R)evolution of the POS payment terminal

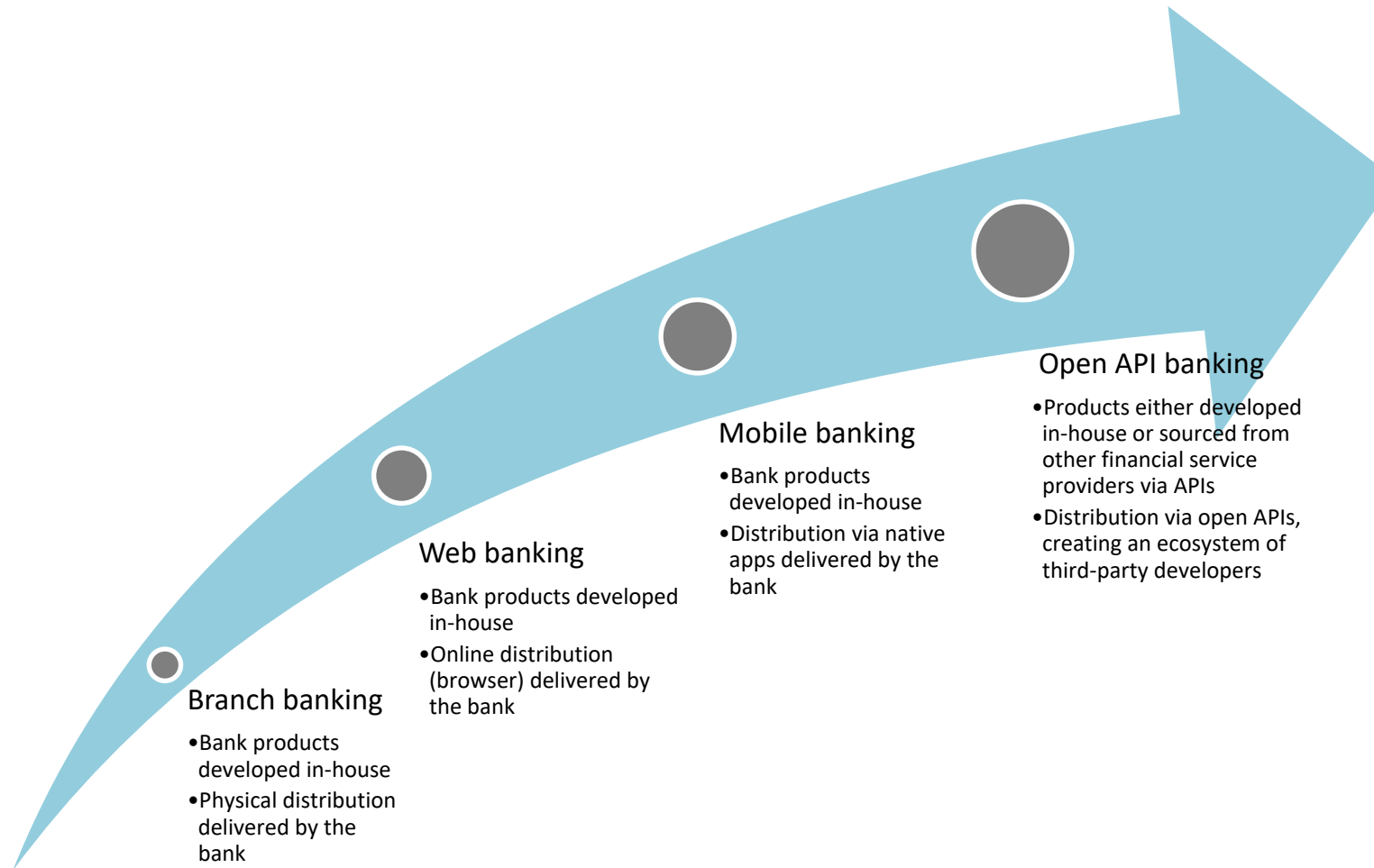


Source: Aite Group

The global trend to APIs and open banking

- **Macro-trend driving the movement to open banking:** consumers own their data and can use it as they see fit, regardless of source.
 - Radical shift from the traditional 'fiduciary' model of financial services
- **Development of the programmable web through APIs:** "banking-as-a-service", open banking architecture that is "programmable" by third-party developers.
- **The fintech revolution:** traditional, vertically integrated banks transform into more agile organizations that cooperate with fintech companies to optimize value for customers.
- **Regulation:** regulators require banks to open access to the account to third party PSPs (TPPs). This is accelerating the trend to open banking.

Evolution of bank product/service distribution



Global open banking initiatives

U.K. evolving its regime of standardized open banking

Banks in the U.K. have launched open APIs enabling secure data sharing and payment initiation

Open banking is reaching MEA

Bahrein has issued open banking regulation. UAE and Israel are considering. Nigeria is working on open banking standards.

Open banking in Europe mandated but non-standardized

Open banking activity is starting to coalesce around a few major standards: U.K.'s Open Banking Standard, the Berlin Group, and STET

Major U.S. banks experimenting with commercial open banking platforms

Major banks in the U.S. seeking to migrate away from screen-scraping preferring bilateral arrangements

Canadian government establishes an advisory committee on open banking

As part of its 2018 federal budget, the Canadian government announced that it will be conducting a review into the merits of introducing open banking

Mexico and Brazil laying the regulatory groundwork for Open Banking

Mexico passed the FinTech Bill which lays the groundwork to introduce an Open Banking regime; discussions with the OBIE to establish a standard underway

Japan Legislation

JP Cabinet proposed revisions to the banking law for banks to open up their APIs

India adopting a digital identity-first model to support and accelerate open banking

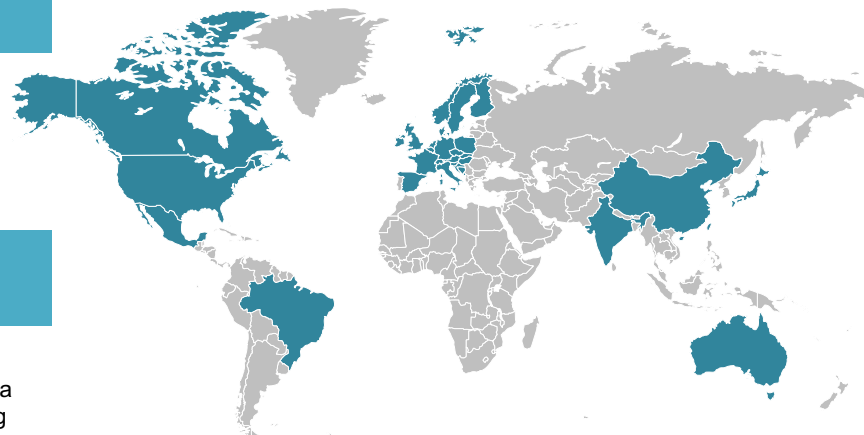
Policy makers are stepping in to provide central infrastructure supporting both open banking and digital identity

Australia and Hong Kong have committed to standardized, mandatory open banking

Open banking regime is being introduced in Australia, which is wider in scope (for data) than the U.K., with phased implementation from 2019 to 2021

Other APAC nations taking a commercial approach to Open Banking waiting regulatory steer

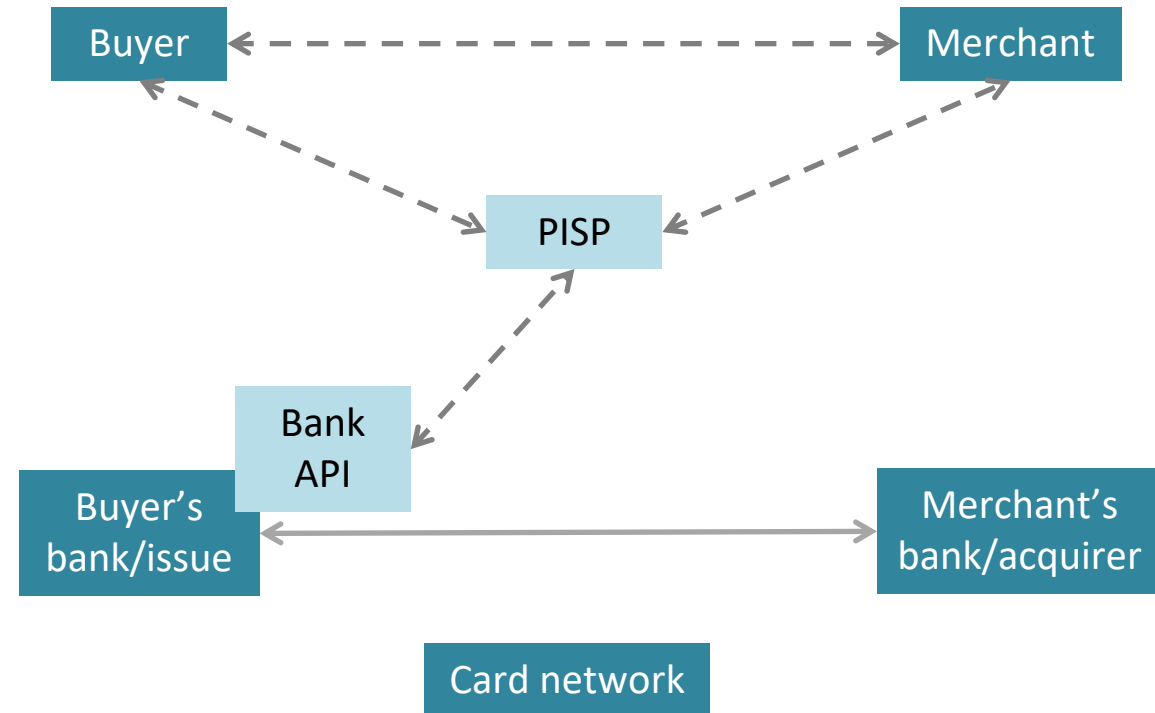
Singapore does not have a compulsory regime but the government has supported a number of voluntary initiatives encouraging including the development of an API playbook, API register and regulatory sandbox



Source: EY, Aite Group

How the PSD2 PIS payments model may disrupt the traditional cards model in Europe

- PISPs will be able to offer merchants a service to receive money from sales instantly, using the new RTP rails to collect money from every bank account in Europe.
- The fees for such transactions could be expected to be lower than the fees charged for card payments. There would be no interchange, no scheme fees, no risk reserve requirements and typically a fixed per-transaction fee rather than an ad valorem fee.



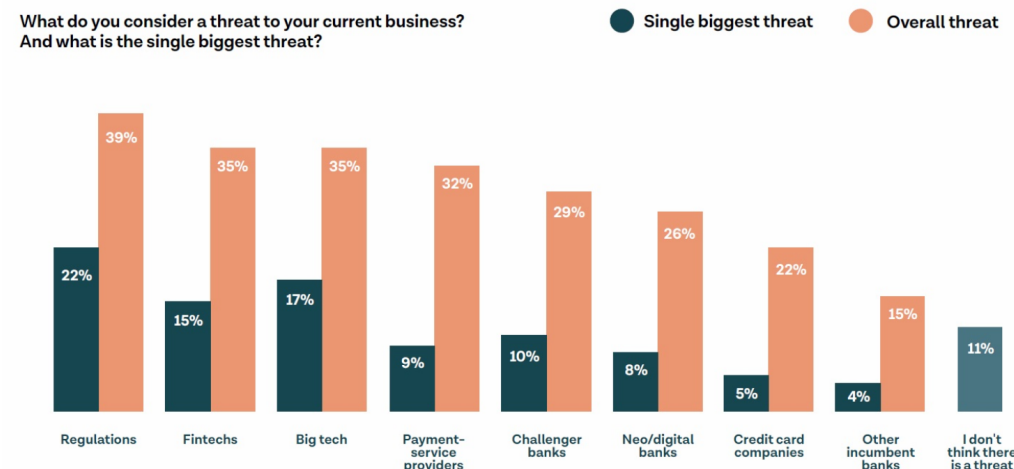
Source: Aite Group

Authorization
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Settlement
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Open banking is challenging the status quo...

Research among 269 senior decision makers in Europe:

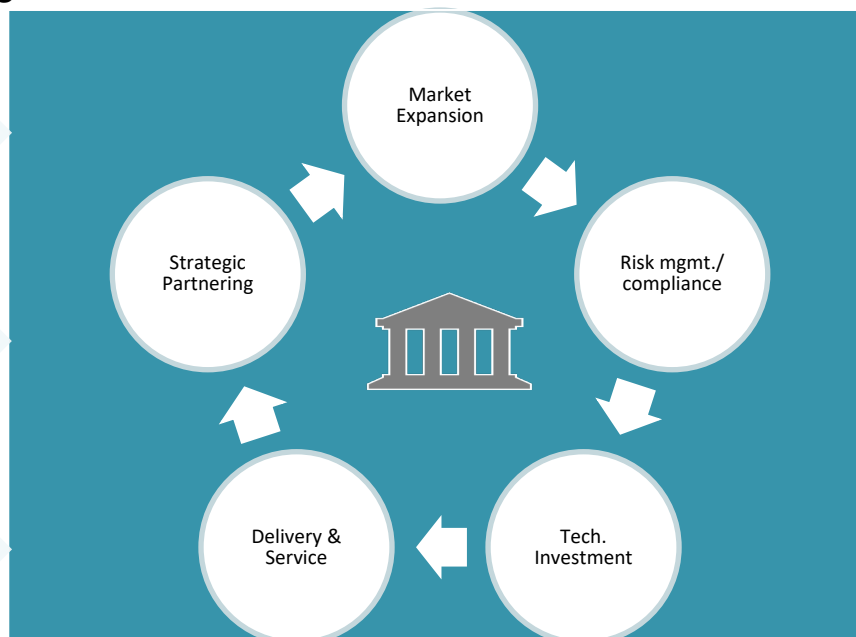
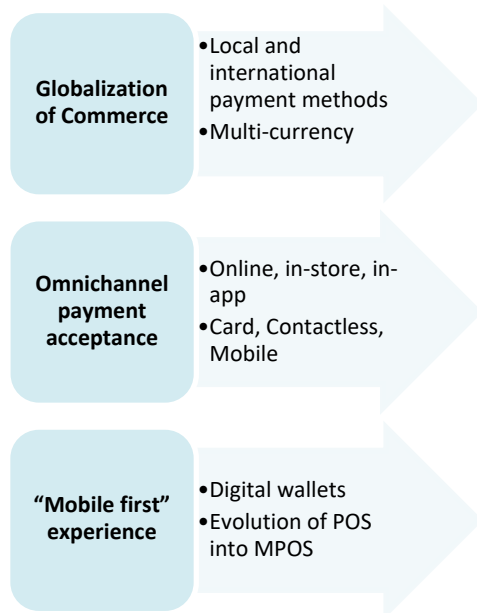
- Two fifths (39%) see open banking regulation as the biggest current threat to their business model
- 56% fear that consumer loyalty towards banks will be significantly reduced as a result of open banking.



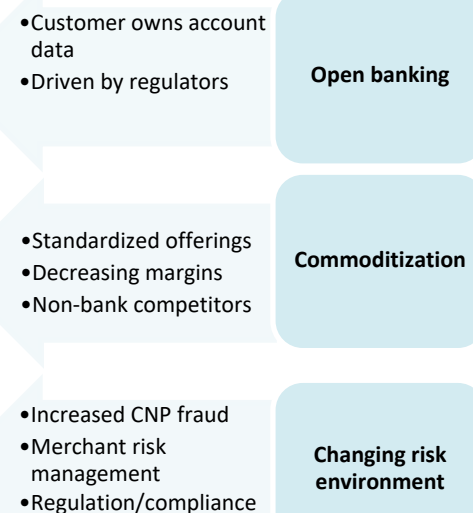
Source: Tink

Major trends driving the acquirer's agenda

Merchant driven trends



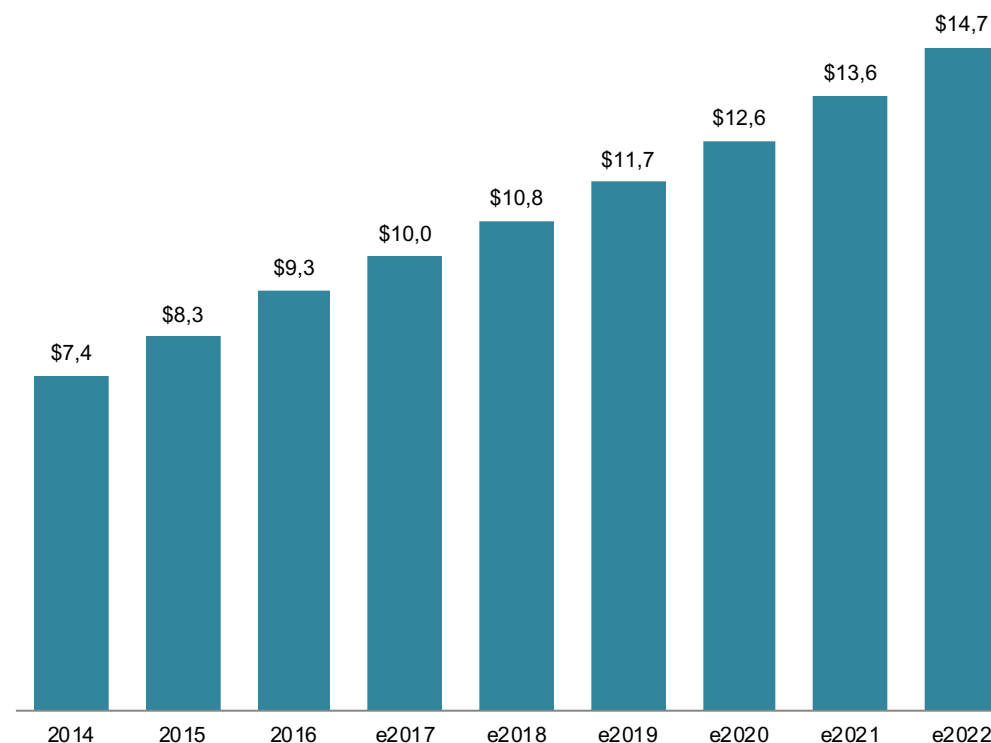
Industry trends



European acquiring: 3 year outlook

- Aite Group estimates that by 2022, the EU card acquiring market will be worth US\$14.7 billion in net revenue.
- Continuing consolidation as acquirers become European (and global) players.
- Acquirers that serve multinational merchants will have to meet their clients' requirements for Pan-European omnichannel acquiring solutions.
- Acquirers must manage an increasingly complex payment ecosystem on behalf of their customers. Merchants expect new functionality to be only one API call away.

EU Card-Acquiring Net Revenue, 2014 to e2022
(Net of interchange and card scheme fees and in US\$ billions)





SCA: how to minimize conversion risk

Charles Damen

SVP Payment Strategy at Worldpay

PSD2 mandates SCA for all electronic transactions

Except if an exemption applies

PSD2 SCA requires at least 2 of 3 factors of authentication...



Something only the user knows

Password
Pin
Signature



Something only the user has

Card
Mobile phone
Wearable device



Something the user is (biometrics)

Facial recognition
Fingerprint
Iris scan

Extra element for Remote Transactions (Internet, Mobile): each SCA must be linked dynamically to a specific amount and a specific Payee

Some transactions are Out of Scope or can be Exempt from SCA

Out of scope for SCA (excluded)

Some transactions are completely out of scope of SCA

One leg out transactions

- Payments where the issuer or the acquirer are based outside of the EEA are not required to perform SCA

Merchant Initiated Transactions

- Transactions initiated by the payee such as mobile phone payments and fixed and variable amount subscriptions or instalments
- SCA needs to apply on first transaction/mandate

MOTO

- No need for SCA to be performed

SCA exemptions

Some transactions can be exempted from SCA to help reduce friction and minimise conversion risk

Low risk transactions

- Transactions that have been assessed as low risk in real time (TRA) and where PSP is below the fraud threshold

Low value transactions

- Remote electronic payment transactions ≤ 30 EUR
- Applies up to 5 consecutive payments or cumulative amount since last SCA is \leq EUR 100

Whitelists of beneficiaries

- No SCA unless when payer adds a merchant to a whitelist of the issuer

Corporate Payments

- SCA is not required for B2B payments using a secure dedicated process
- Corporate cards not used by persons e.g. lodged cards, virtual cards are exempted from SCA

A 'managed rollout' of SCA is being introduced, softening the 14th September 2019 enforcement deadline

- **EBA opinion published in June acknowledging more time is needed for SCA**
 - National Competent Authorities (NCAs) may “provide limited additional time” for issuers, acquirers and merchants to become fully SCA ready, as long as PSPs have an agreed migration plan
 - Extra time is expected to be between 12-18 months - exact details have been left up to each National Authority to determine
 - Potential implementation divergence between European countries, which could add complexity
- **Financial Conduct Authority (FCA) in UK has confirmed an 18 month enforcement extension to 14 March 2021**
 - Other markets that have announced non-enforcement of 14 September deadline without specific timelines
 - Austria
 - Germany
 - Ireland
 - Italy
 - Malta
 - Netherlands
 - Poland
 - Details on delays in other EEA markets are expected to be announced by early September

Low risk exemption is based on Transaction Risk Analysis (TRA)

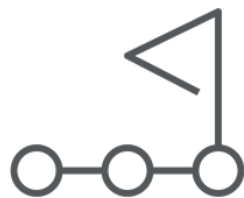
Fraud rates that allow SCA exemption – applied on PSP (issuer / acquirer level)

Transaction value (EUR)	0-100	100-250	250-500	500+
Reference fraud rate (%) Card Not Present based payments	0.13	0.06	0.01	N/A SCA on all transactions unless other exemption applies

Implications:

- Merchants can request to exempt a transaction from SCA and assume liability
- Exemption can only apply to Low Risk transactions based on real time TRA assessment
- Worldpay provides multiple solutions for merchants to request the exemption and provide a frictionless experience

What risk factors do we have to look at to perform TRA?



Is the spending pattern /
behaviour normal?



Is the payer's device
/ software known?



Is there any suggestion of
malware infection?



Does the transaction match any
known fraud scenarios?

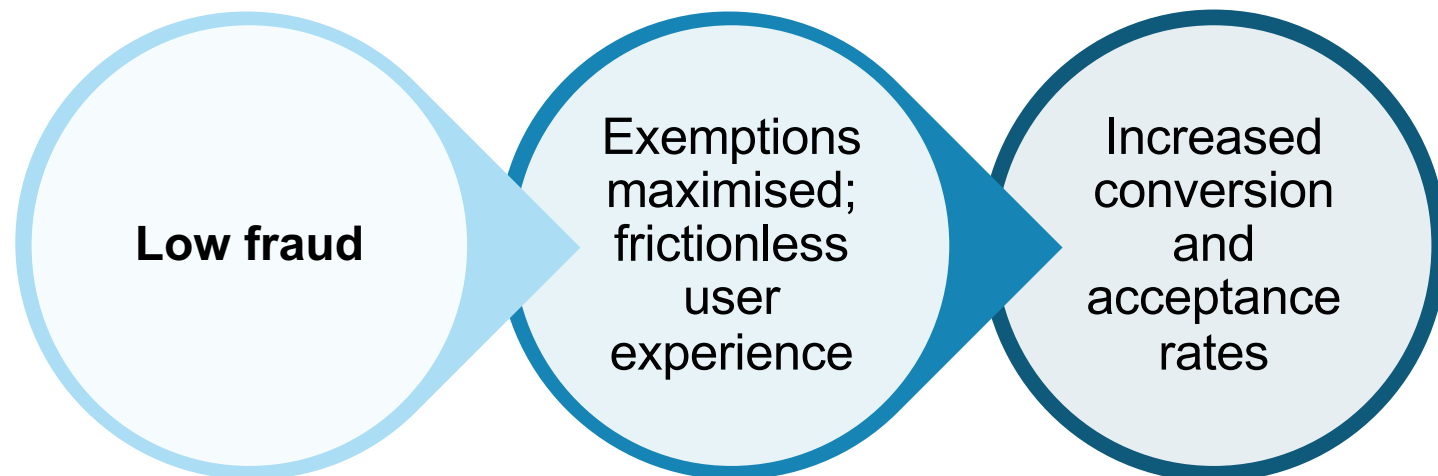
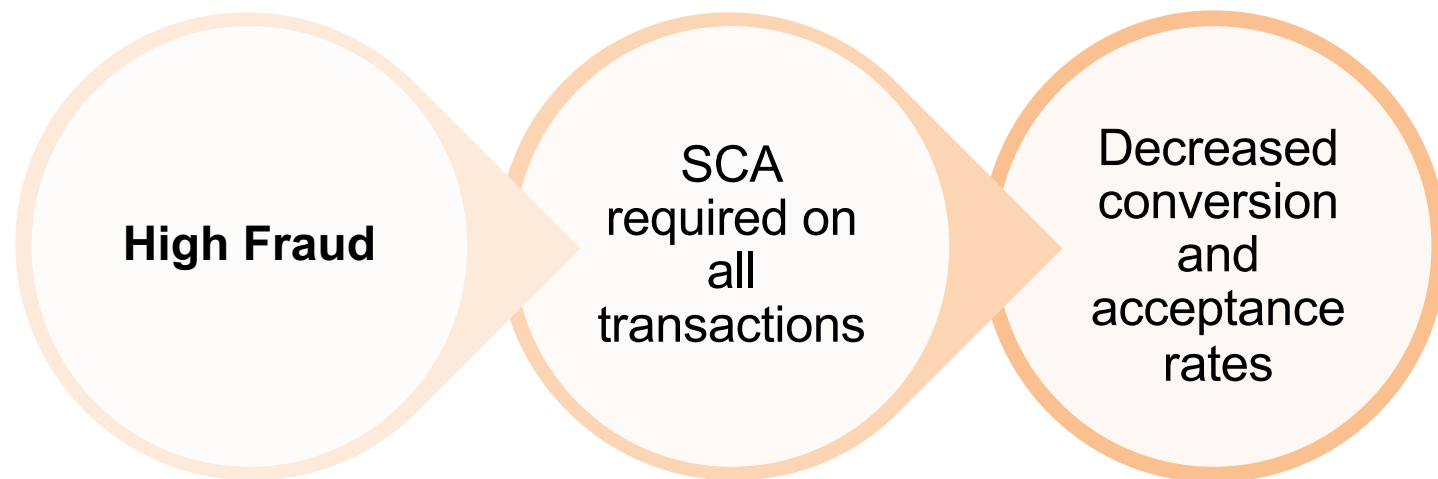


Is the payee location
high risk?



Is the payer location
abnormal?

Fraud rates will have a major impact on acceptance rates



The requirement for SCA will impact you in a number of ways

Increased friction

- While 3DS2 is a significant improvement on 3DS1, SCA rollout will still **increase the number of steps** that customers have to follow to complete a payment. This could create a **poorer payment experience**
- **Drop-out rates could increase**, reducing your revenue and lowering customer loyalty

Increased cost

- Undertaking 3DS2 will incur **additional processing costs**
- Some card schemes are already charging **authentication fees** or have announced introduction of additional fees authenticated transactions

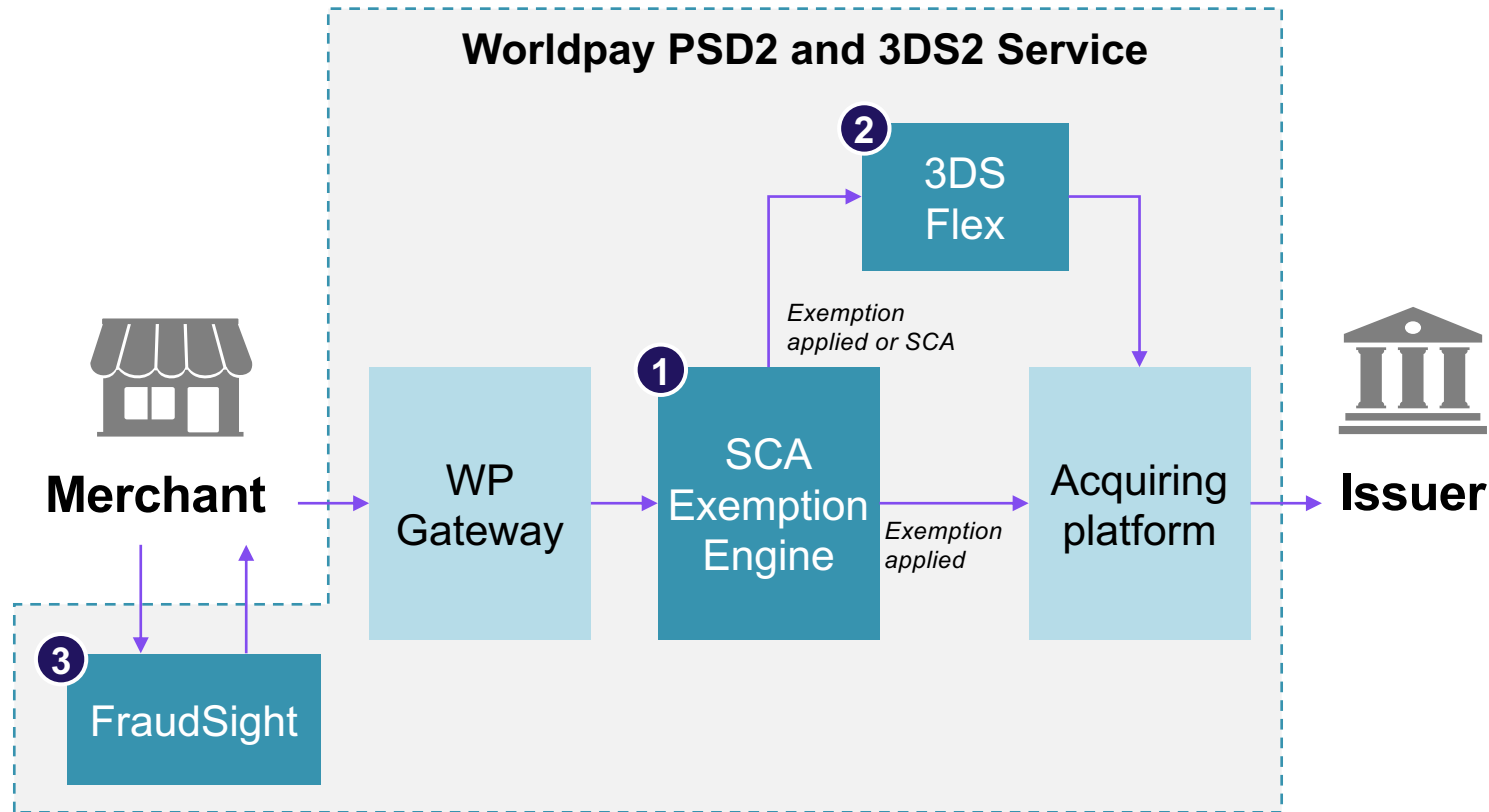
Fraud rate scrutiny

- Acquirers and issuers will now have to be **below certain fraud thresholds** in order to apply the low-risk SCA exemption
- Therefore, there will be much more **scrutiny of merchant fraud rates**, and protections may be put in place to negate the impact of high-fraud merchants

Dev work

- While Worldpay will help merchants to hold this to a minimum, **some development work will be required** to implement 3DS2 and gather additional data to complete TRA, and supply it to Worldpay (or any acquirer) via extended APIs

Worldpay will provide a full suite of products to help merchants manage SCA



3 key components:

- 1 SCA Exemption Engine** to exempt as many transactions as possible from SCA/3DS2 – reducing friction and cutting cost
- 2 3DS2 Merchant Plug In (MPI)** to ensure you can perform SCA whenever it is required
- 3 New industry-leading fraud tool** to help you lower your fraud and maximise which SCA exemptions can be used

What are the benefits of the exemption engine?



Maximise a frictionless checkout

Offer a frictionless checkout by exempting in authentication or authorisation



Reduce costs

Save authentication costs by exempting



Integration friendly

Minimise integration and boarding effort

Summary: what does this mean for you?

Fraud management

- Manage **your fraud rates** to make sure that you can utilise low-risk SCA exemption

SCA

- Add **3DS2 to your development roadmap to provide the best SCA experience**, in advance of the expected scheme mandates and SCA migration plans
- Consider adding SCA compliant payment options such as **Apple Pay, Google Pay and Samsung Pay**

User Experience

- Prepare yourself to maximise the use of **SCA exemptions** to enable a frictionless user experience and minimise conversion risk



Q&A



Thank you



<https://www.aitegroup.com>



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