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IMPACT NOTE

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MPE 2019: Collaborating to Realize Next-Generation Payments

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TABLE OF CONTENTS

LIST OF FIGURES

FOREWORD

By Paul Adams, Barclaycard Director of Acquiring, Ireland

The rapid pace of change in payment technology is bringing about a fundamental shift in the way merchants, issuers and acquirers interact to ensure the ideal purchaser experience.

As David Birch, MPE event moderator and renowned commentator on digital financial services, said: "We have no idea what could happen from month to month – which is why MPE has steadily become more valuable over the years. We're living in a time of change."

This year's conference was another great success, with industry leaders sharing their thoughts and insights about how payments are evolving. Here are some of my key takeaways:

1.REMOVING PAYMENT FRICTION

There are unprecedented challenges faced by stakeholders right across the payments ecosystem, which are disrupting the very nature of transactions. Barriers such as 2-factor authentication and payments failure make for a sub-optimal experience that can deter people from making a purchase – it is estimated that up to 25% of customers will abandon the process, according to Mastercard's Rigo Van den Broeck.

The solution for him, at least, lies in the increased flexibility allowed to merchants through 3DS2, which reduces the authentication barriers – and thus false declines – for the most trusted users.

2. BIOMETRICS WILL BE PIVOTAL

Steve Cook of Biometrics for eCommerce outlined the increasing role that biometrics is playing in innovating the secure payment experience. Not only is it the default entry technique for many digital-only banks – whether face capture or fingerprint recognition – but biometrics is the natural direction of travel for the millennial customer of today, who is driving the industry as a digital native.

The banking industry also shows significant support for the use of biometrics to improve security – in part because it sees an opportunity for increased customer engagement, better goodwill towards their brand, and a longer-term reduction in costs.

3. THE SMARTPHONE REIGNS… FOR NOW

Moderator David Birch's scenario of the seamless retail store experience – where Internet of Things technology gives the merchant enough data to know who the customer is as soon as they walk in – presented an attractive picture of the near future.

In my opinion, however, the industry needs to agree on the problem it is trying to solve first before trying to stitch these technologies together. Are we looking to capture data on consumers to make the offering more relevant? Are we looking to strip down cost? Or seriously re-engineer the customer journey?

What's clear is that mobile will be at the centre. Customers might still make the transaction using a different method, but the smartphone is the device that the consumer will return to to register, to authenticate, and to activate their preferences.

4. STAY CUSTOMER-CENTRIC – ALWAYS

Three days and more than 35 sessions later, one common theme across the event became clear: the smartest response to such a changeable payments climate in the face of new regulations, new technology and multiple challenges to security, lies in keeping the customer experience at the front and centre of all decisions.

Customers' expectations are changing rapidly, and we have to use new technologies intelligently to meet those aspirations.

INTRODUCTION

The Merchant Payment Ecosystem (MPE) has become the largest conference in Europe focused on merchant acquiring and payments. In 2019, it was organized in Berlin, from February 19 to 21. Situated in the capital city of Germany, for years its habitual residence, the conference attracted more than 1,000 participants.

The MPE covers the latest technologies, trends, and business models of merchant payment acceptance, checkout and conversion, fraud and security, and the changing customer shopping experience. The audience mainly consists of merchants, acquirers, and payment service providers (PSPs) as well as vendors of technology solutions. The strong presence of the demand side—i.e., the merchant community—underscores the value of the MPE for the business. Discussions that Aite Group held with delegates during the conference confirmed that the MPE organization has been successful in reaching the right mix of delegates. One main reason given for this achievement was the focus on business content for practitioners.

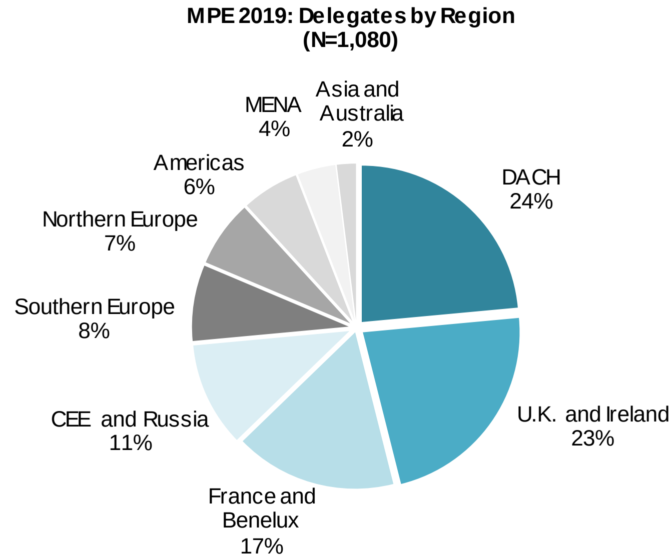
This Impact Note summarizes the key themes from MPE 2019. Therewith, it provides an overview of the top trends and issues in European acquiring and payments.

METHODOLOGY

This Aite Group report has been produced in cooperation with Empiria Group, the organizers of the MPE. It is based on the content provided at the MPE conference through presentations, panel discussions, and discussions with conference participants. This report also leverages existing Aite Group research and market intelligence. The report was sponsored by BarclayCard.

The MPE's audience mainly came from Europe (88% of delegates). The largest delegation originated from German-speaking countries—Germany, Austria, and Switzerland (DACH region, 24%)—with the U.K. and Ireland (23%) as the second-largest delegation. France and Benelux represented 17% of participants, while 11% of delegates came from Russia and Central and Eastern Europe (CEE). The non-European delegation (12%) consisted of people from the Americas (6%), the Middle East and North Africa (MENA; 4%), and Asia and Australia (2%; Figure 1).

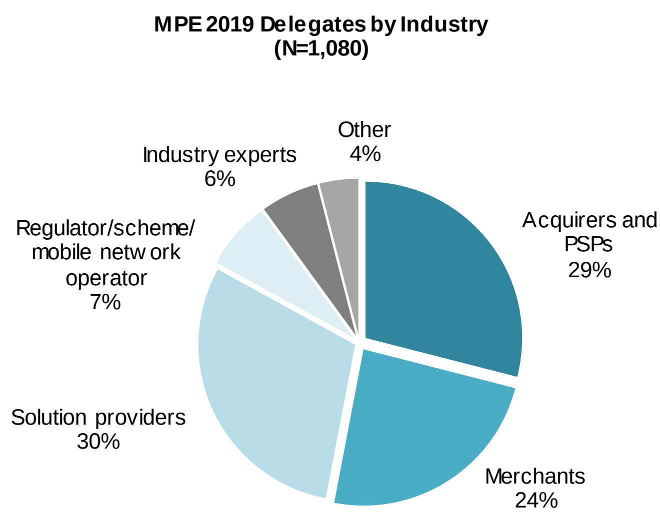
Figure 1: MPE 2019 Delegates by Region



Source: Empiria Group

More than half of the MPE's audience consisted of representatives from acquirers and PSPs (29%) and merchants (24%; Figure 2).

Figure 2: MPE 2019 Delegates by Industry



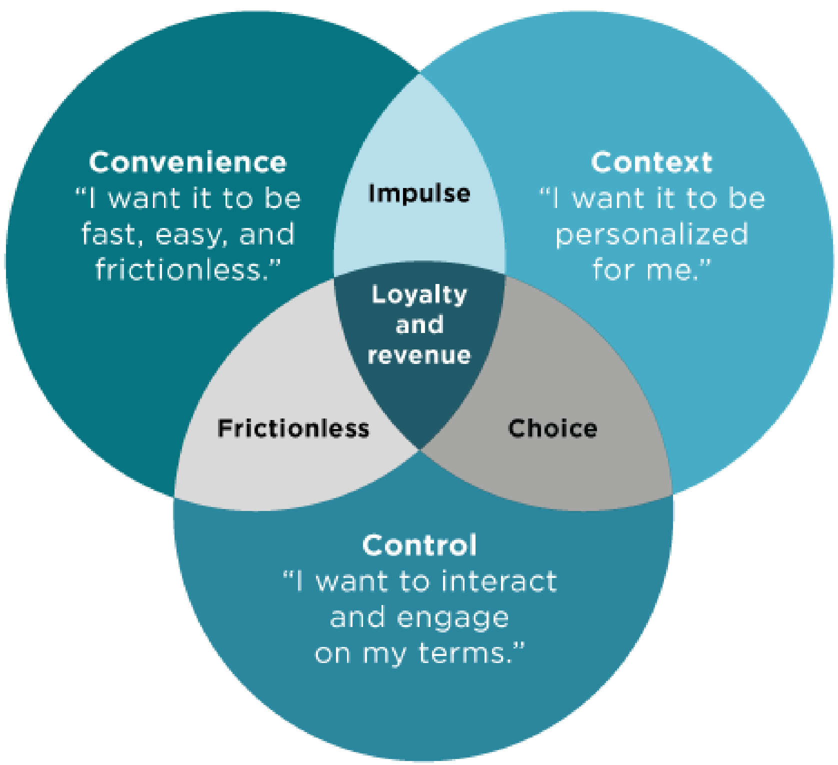
Source: Empiria Group

MAJOR THEMES AT MPE 2019

If we had to select one overarching theme for the MPE, it would be the digitization of global commerce and how that drives merchant demand for payment innovation to deliver superior customer experiences.

By 2021, retail e-commerce sales turnover is expected to grow to US$4.9 trillion, representing 17.5% of total retail sales. The lion's share of this volume (73%) will be transacted over mobile devices, aggravating customer demand for convenient and frictionless payments.[1] The digital checkout experience is, therefore, critical for merchants to drive conversion. As explained by Discover, 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 (Figure 3).

Figure 3: Digital Experiences Are Becoming the Basis of Competition



Source: Discover at MPE 2019, Adyen

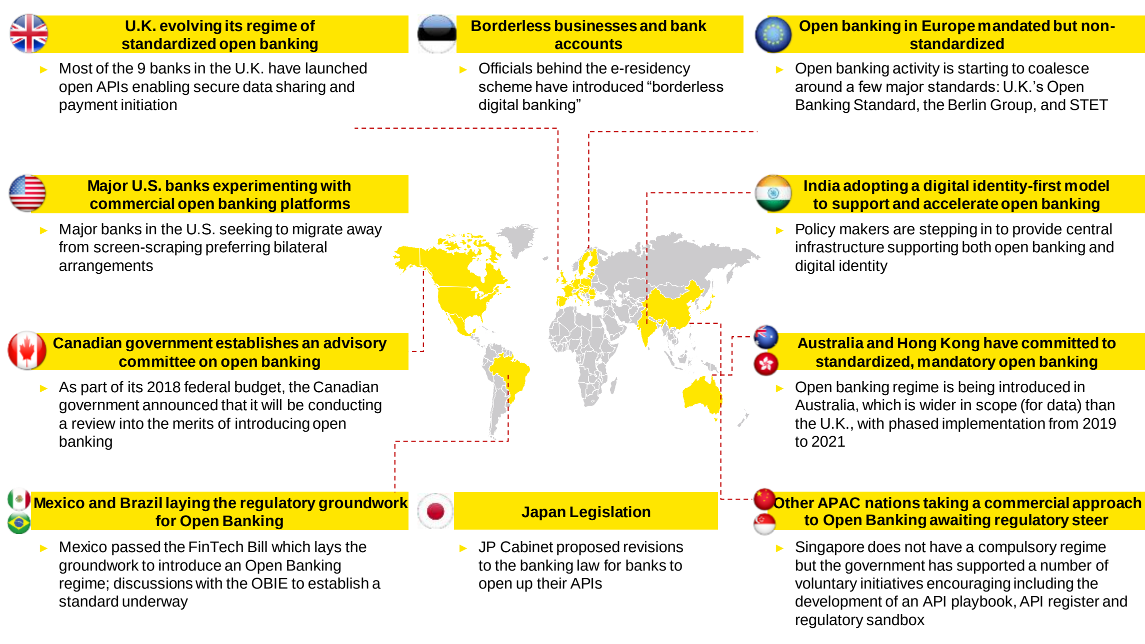
1. "Worldwide Retail and Ecommerce Sales: eMarketer's Updated Forecast and New M-Commerce Estimates for 2016 to 2021," eMarketer, January 2018, accessed March 26, 2019, https://www.emarketer.com/Report/Worldwide-Retail-Ecommerce-Sales-eMarketers-Updated-Forecast-New-Mcommerce-Estimates-20162021/2002182.

To succeed, businesses must remove friction for online consumers at every touch point. ACI mentioned that retailers are losing US$10 billion every year due to poor customer experiences. The payments industry has responded with a wide range of innovations to improve the customer journey. The challenge is to balance the requirement for frictionless payments with the need to combat fraud and comply with regulatory obligations. The industry is collaborating to address these issues, and the work of the W3C, EMV with Secure Remote Commerce, and the FIDO Alliance are all seeking to simplify the payment experience from a browser or mobile device.

While e-commerce is commanding an increasing share of retail sales, most transactions are still happening offline. Digitization is also transforming the payment experience at the point of sale (POS), replacing cash with digital payments. The surge of contactless payments is the most prominent example: According to Visa, outside the U.S., more than 40% of in-store Visa transactions are contactless.[2] At the same time, merchant requirements for mobility and customer service at the POS have started a revolution in payment acceptance solutions. The traditional payment terminal is gradually being replaced by the next generation of smart POS solutions.

It should be no surprise that the theme of open banking took center stage at MPE 2019. With the deadline of the revised Payment Service Directive (PSD2) looming this year, Europe is ahead of the game in making banking and payments "programmable" through application programming interfaces (APIs). But open banking is by no means limited to Europe (Figure 4).

Figure 4: Global Open Banking Initiatives



Source: EY at MPE 2019

2. "Tapping to Pay With Visa Around the World," Visa, December 2018, accessed March 26, 2019, https://usa.visa.com/dam/VCOM/global/pay-with-visa/documents/vsa215-02-contactless.pdf.

While still in initial stages, open banking will lead to the next wave of digitization in payments, reconfiguring age-old value chains and changing business models. All this means that payments are more dynamic than ever. The scale and complexity of the changes can be daunting to merchants and payment companies alike. At the same time, the market has to comply with myriad new regulations and industry standards. This is fertile ground for a payment-focused conference such as the MPE, which can provide education, networking, and inspiration.

The following sections highlight a few of the major themes that were presented at MPE 2019:

- Next-generation POS
- The new world of PSD2 and open banking
- Alternative payment methods
- Combating fraud and friction at the checkout
- Acquiring 2.0

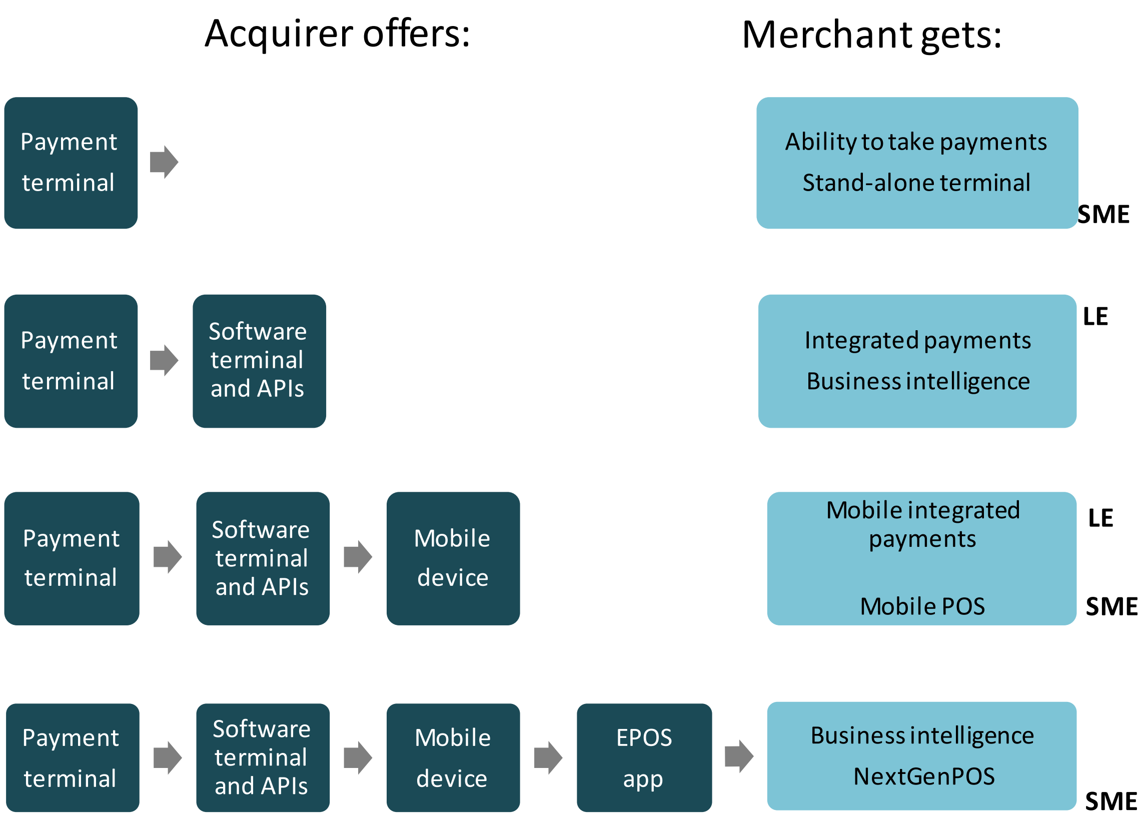
NEXT-GENERATION POS

The days of the cash register and the stand-alone payment terminal may be counted. The arrival of cloud-based electronic POS (EPOS) applications have brought enterprise-level business intelligence and integrated payments within reach of small and midsize enterprises (SMEs). Independent software vendors (ISVs) provide tablet-based applications tailored to specific merchant verticals, with payments pre-integrated as part of the solution. That means that the choice of ISVs will sit at the top of the merchant's priority list, while the acquirer as the provider of the payment solution will just be an option that the merchant will select mainly based on cost.

THE EVOLUTION OF POS

The evolution of POS for SMEs and large enterprises (LEs) was nicely presented by Handpoint, a payment platform provider headquartered in Iceland. This is presented in Figure 5 with some minor changes to the original image.

Figure 5: Evolution of POS for SMEs and LEs



Source: Handpoint at MPE 2019, with minor changes by Aite Group

This picture assumes that the acquirer is providing the full solution to the merchant, although in practice, there are many different distribution channels through which merchants buy POS solutions. For instance, there are specialized resellers that advise merchants about EPOS applications, hardware, and payments, and package those together as full solutions.

Many SMEs still use the stand-alone payment terminal, just providing the ability to take card payments. Enterprise merchants can integrate payment software through APIs into their business applications, but such integration used to be out of reach for SMEs.

That changed with the arrival of mobile POS (MPOS). MPOS provides a card reader connected to a basic EPOS app running on a tablet or smartphone. Merchant onboarding is simple and fast, and the service is delivered on a "pay-as-you-go" model. MPOS was initially targeted at micromerchants, but it has been quickly adopted by larger SMEs for its convenience, competitive pricing, and value to the business. Large enterprises are also integrating MPOS into their business for new store concepts (think of the Apple Store) or applications that require mobile solutions, such as deliveries.

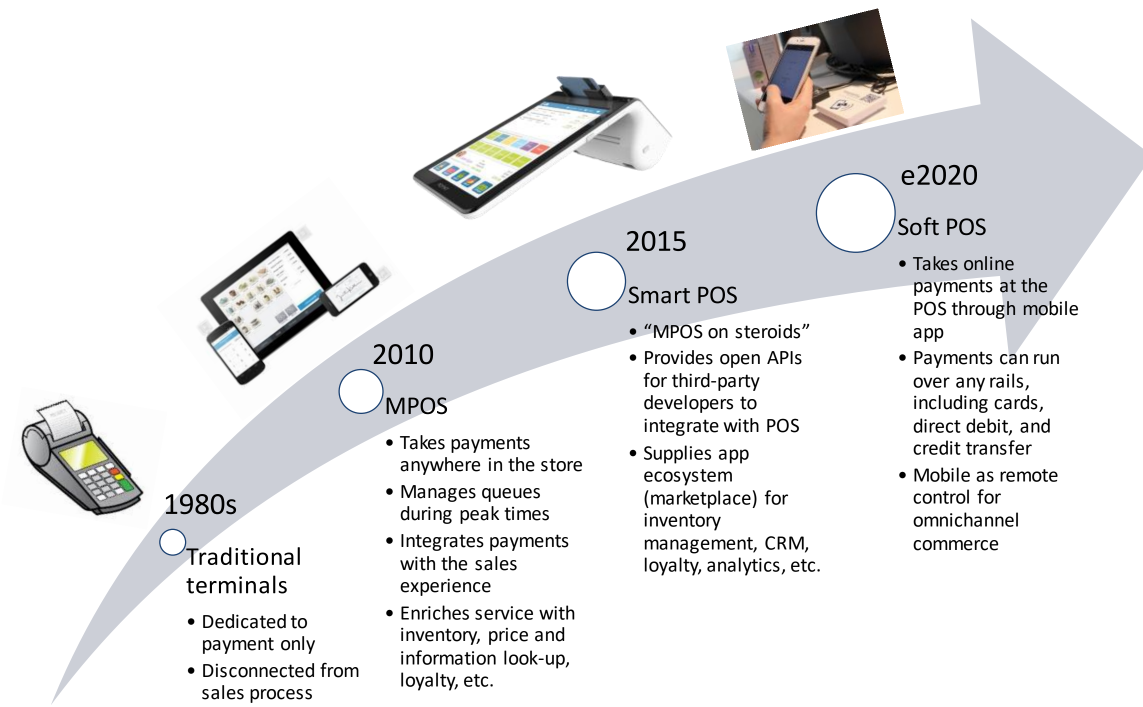
The next stage in this evolution is the availability of dedicated tablet-based EPOS software for SMEs, provided in the cloud on a subscription model. This development empowers SMEs with access to business intelligence similar to that of large enterprises, with payments integrated as just one of the many functions that the business needs. MPOS providers, such as Square and iZettle, are now offering more advanced EPOS apps, but they also provide integrations with popular EPOS systems.

IS THERE A FUTURE FOR THE HARDWARE TERMINAL?

In 2018, the PCI Security Standards Council published the specifications for PIN entry on commercial off-the shelf devices (PIN on COTS). This standard enables EMV card transactions with PIN entry on the merchant's consumer device, using a secure PIN entry application in combination with a secure card reader. Before the development of the PIN on COTS standard, only dedicated devices approved by PCI allowed PIN entry "on glass." Such Smart POS solutions consist of a purpose-built, tablet-style device with an integrated card reader. Providers offer an app store or marketplace to merchants, allowing them to compose their own POS environment and business applications. Examples of Smart POS providers are First Data Clover, Poynt, and Verifone Carbon. Smaller Smart POS solutions come to market as well, integrating a payment terminal, a cash register, and a printer into a portable device. Examples are EVO Payments' PosPay, and Yello.

The question is if, or when, the final step can be made and the hardware terminal will disappear. Payment acceptance will then become as easy as downloading an app, with all functionality and security programmed in software. This could be called "Soft POS" as the next step in the evolution of the payment terminal (Figure 6).

Figure 6: (R)evolution of the POS Terminal



Source: Aite Group

The first steps to make that possible have been made already. PCI is working on a new standard for contactless payments on COTS, which is due for publication by the end of 2019 and will be shared with stakeholders for comments in April 2019. This standard will allow the acceptance of contactless card payments on the merchant's device, using near-field communication (NFC), without the need for a separate card reader. The solution is already piloted by a few acquirers, such as WorldPay in the U.K. and Elavon in Poland.

The jury is still out on whether the hardware terminal can be replaced altogether. But fact is that the value chain and distribution model of traditional acquirers and independent sales organizations is already challenged by fintech providers of MPOS solutions, particularly for the SME segment. Acquirers must focus on the business needs of their customers, offering solutions that center around business intelligence, not payments alone.

THE NEW WORLD OF PSD2 AND OPEN BANKING

By September 2019, all companies providing payment services in the European Economic Area have to be ready to support the PSD2's requirements for third-party access to the bank account.[3] This led to a great emphasis on open banking during the conference, particularly the potential of new payment initiation services that will be enabled by PSD2. This is a sizable market. According to EY, the card and existing bank transfer e-commerce volume with high average transaction value are the most relevant. EY estimates this segment to reach US$315 billion by 2021. Assuming a flat pricing of 0.5%, this implies a total addressable revenue of US$1.6 billion by 2021 for providers of payment initiation services.

THE PROMISE OF PAYMENT INITIATION SERVICES

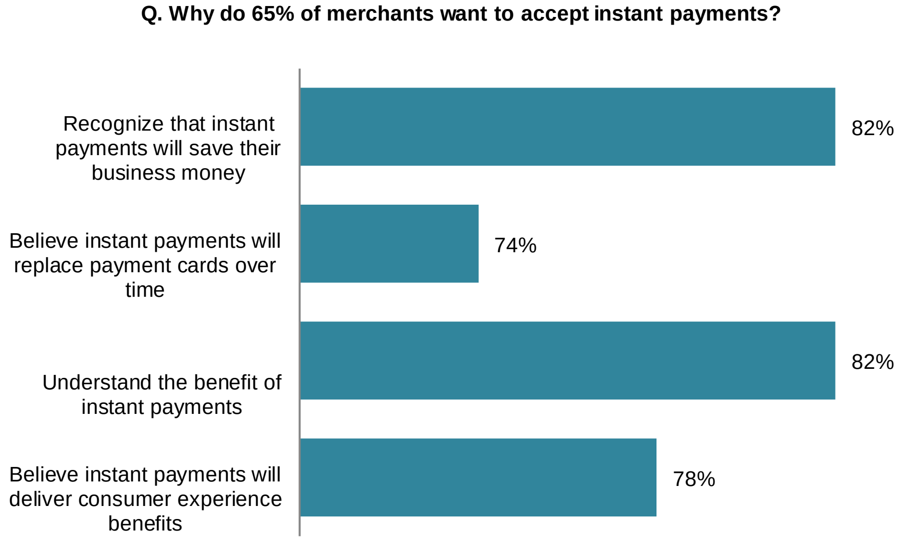
Bank account holders (consumers and companies alike) can allow any regulated PSP to access their bank account(s) and initiate payments directly from that account. These models hold a lot of promise for merchants to offer alternative payment methods that compete with cards. The advantages of payment initiation services for merchants are threefold:

- **Faster settlement of funds**: The merchant's PSP can initiate payments directly from the consumer's account and expect these payments to clear immediately using the real-time or instant payment rails that are rolled out all over Europe. Although merchants would not require (or even wish) to receive each individual payment, the funds could be received at the end of the same business day, or even multiple times per day. This provides the merchant with improved liquidity and working capital.
- **Irrevocable payments**: All payments will be fully authenticated by the customer and authorized by the bank, making payments irrevocable (no chargebacks for unauthorized payments). Merchants could still offer buyer protection and dispute resolution to give consumers peace of mind when shopping online.
- **Lower fees**: As the new payment models do not use the card rails, they save on interchange costs and card scheme fees. And given the low risk of such transactions, PSPs can offer competitive pricing to merchants.

According to research presented by ACI, merchants fully understand the benefits of instant payments (Figure 7).

3. "Commission Delegated Regulation (EU) 2018/389 of 27 November 2017 Supplementing Directive (EU) 2015/2366 of the European Parliament and of the Council With Regard to Regulatory Technical Standards for Strong Customer Authentication and Common and Secure Open Standards of Communication," EUR-Lex, January 13, 2018, accessed March 28, 2019, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2018.069.01.0023.01.ENG&toc=OJ:L:2018:069:TOC.

Figure 7: Merchants' View on Instant Payments



Source: ACI at MPE 2019

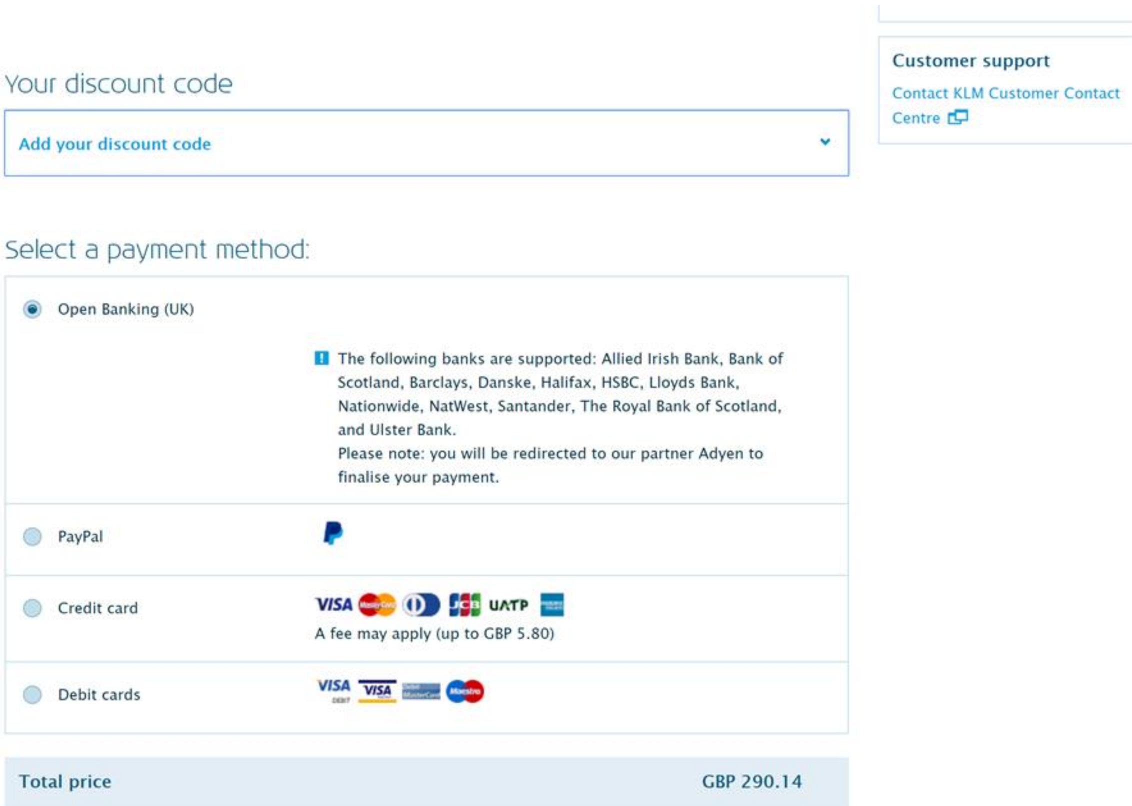
The first initiatives are coming to the market. IATA and Deutsche Bank co-presented the IATA Pay initiative. IATA Pay is a program to develop a prototype for an industry form of payment based on account-to-account bank transfers. The drivers for IATA and the airline industry to develop this new service were formulated as follows:

1. **Empower**: IATA Pay empowers airlines by protecting their direct sales channels.
2. **Savings**: When compared with traditional forms of payment, IATA Pay will help airlines save costs and improve working capital with faster settlements.
3. **Take back control:** IATA Pay represents an opportunity for airlines to take back control of their payments and obtain and manage customers' financial data.
4. **Loyalty:** IATA Pay gives the airlines control of their loyalty and incentives programs.

Deutsche Bank will act as the payment initiation service provider enabling IATA Pay, starting in Germany and rolling out to other markets in the future.

In the meantime, Air France-KLM has launched a new payment method in the U.K. that connects to the open banking infrastructure in the country. Customers who want to buy a ticket on Air France-KLM's website will see the option to pay with open banking (Figure 8). They can then select their account from a list of banks that are live with open banking.

Figure 8: Live Implementation of Open Banking Payments in the U.K.



Source: Air France-KLM U.K. website

OPEN BANKING CHALLENGES

Delegates acknowledged the benefits of open banking, but they also pointed out several challenges that the industry has to deal with to bring the new payment initiation services to market.

From the supply side, these challenges have to do with the lack of standardization and central governance. For payment methods to function effectively, there is a clear need for a scheme management entity that sets business rules and standards for all participants. One example is the European Payments Council, which develops and maintains the rulebooks for European direct debits and credit transfers. And the card schemes have demonstrated the importance of this function for decades. Unfortunately, there is no centrally governed program to implement the PSD2 requirements across Europe.

This means, for instance, that there is no single standard for the APIs that banks are using to provide access to the bank account. At least five standards initiatives exist, and banks may also choose to develop their own proprietary APIs. Further complexity is added with the realization that bank implementations of the same standard will differ as well, as demonstrated in the U.K. This will raise the bar for PSPs that aim to provide a Pan-European service, having to invest in, and operationally manage, thousands of different APIs.

Compare this, for instance, to the situation in India. The unified payment interface (UPI) enables bank clients in India to send and receive money instantly from their smartphones without the need to enter bank account information. UPI enables instant person-to-person (P2P) payments and bill payments (via a request-to-pay message sent by the biller to the payer). The infrastructure is built on a set of standard APIs that provide access to the RTP rails in India (called IMPS), as well as other payment rails, such as RuPay (domestic card scheme) and the national ACH system. There are 139 banks live on UPI, and volume is ramping up quickly.[4]

In contrast, Europe is starting from different conditions. Multiple initiatives will go to market, each offering a different user experience, potentially creating confusion and slowing down adoption. Providers will also be challenged to provide a consistent user experience to their customers, as they have to deal with API specifications, interpretations of the PSD2 requirements, and service levels that are different for each bank.

The other challenge, from the demand side, is how to incentivize customers to adopt the new payment methods. The latter must provide clear benefits, in terms of convenience, speed, or rewards, to make customers change their payment behavior. Much will also depend on local payment culture. Consumers in countries that are used to account-based payments may adopt open banking more easily than consumers in countries that use cards almost exclusively.

In summary, the payments industry is just starting to get its arms around the PSD2 requirements. While central governance is missing, the market has to find its own way to monetize the potential of open banking in payments and deal with the challenges. Partnerships will be essential to deliver on the promise of open banking. MPE 2020 will be a great opportunity to take stock of what can be achieved in this area.

4. "UPI Product Statistics," National Payment Corporation of India, accessed March 28, 2019, https://www.npci.org.in/product-statistics/upi-product-statistics.

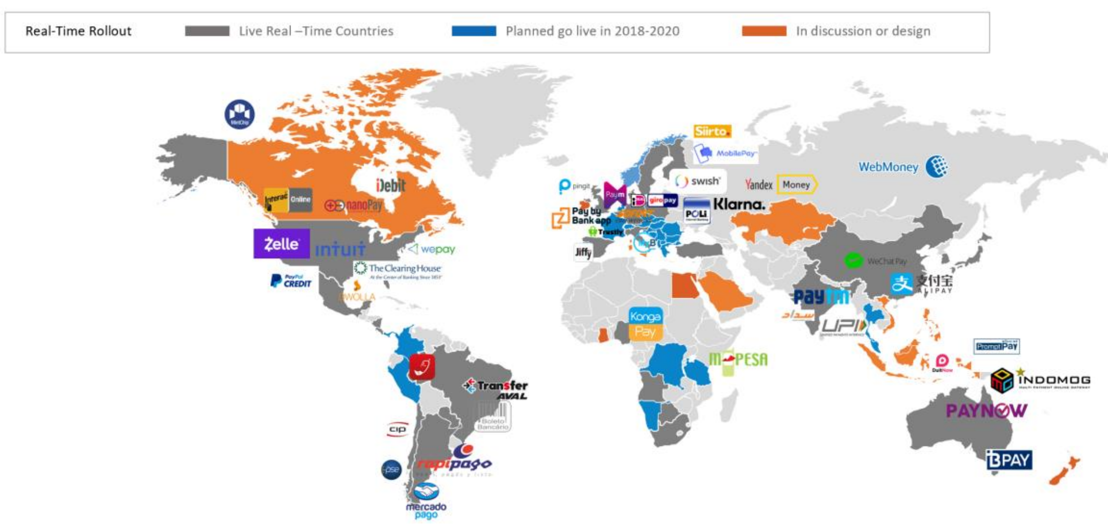
ALTERNATIVE PAYMENT METHODS

Cards are losing their dominant position as a means of payment on the internet. Alternative (noncard) payment methods account for more than 50% of e-commerce transaction volume, and more than 140 online payment methods are in use today.[5] This trend away from cards to alternative payment methods is driven by consumer demand for convenience, trust, and speed, and the needs of online merchants to drive conversion and reduce risk.

ALTERNATIVE PAYMENTS METHODS TAKE OVER ONLINE

The innovative force of the payments industry has delivered a plethora of new payment methods, including digital wallets, P2P payments, and overlay services that enable e-commerce payments through the existing e-banking infrastructure (Figure 9).

Figure 9: Evolution to the Digital Payments Ecosystem—Rollout of Digital, Noncard, and Overlay Services

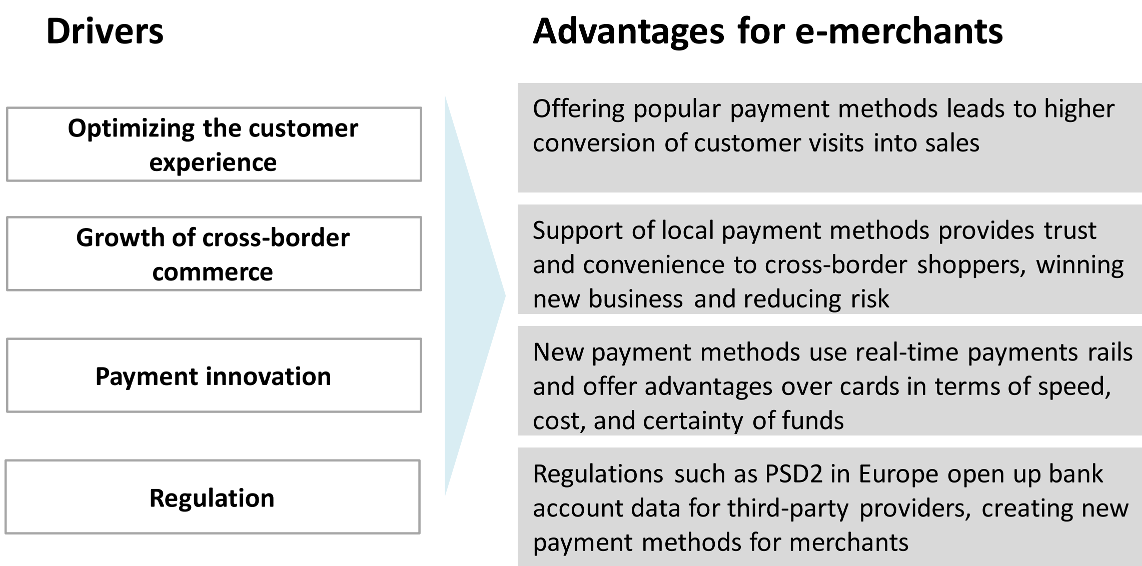


Source: ACI at MPE 2019

Most of these alternative payment methods are made account to account, using ACH rails and bypassing the cards infrastructure. With the global rollout of real-time/instant ACH rails, alternative payment methods are becoming even more attractive to merchants. Figure 10 summarizes the main drivers for the adoption of alternative payment methods by online merchants.

5. "Global Payments Report," Worldpay, November 2018, accessed March 15, 2019, https://worldpay.globalpaymentsreport.com.

Figure 10: Drivers for Alternative Payment Method Adoption in E-Commerce



Source: Aite Group

Consumers expect their preferred payment method to be offered, or they will shop somewhere else. According to PPRO, almost 50% of consumers will end a transaction if their preferred payment option is not available. Consumers increasingly shop outside their home market, searching for better deals or for products not available at home. With cross-border commerce, it becomes even more important for online merchants to support local payment methods that are popular with consumers in their different markets. Accepting only cards is not enough. Their new customers may not have a credit card, or they may prefer to shop with a merchant that offers their trusted payment method used at home.

Acquirers and PSPs must support alternative payment methods if they want to stay competitive. Specialized providers such as ACI Pay.On, Modo, and PPRO can help them deal with the complexities of alternative payments in the online space.

ALTERNATIVES IN THE PHYSICAL WORLD

The growth of alternative payment methods is not restricted to online commerce. Payment providers are using bridging technology such as QR codes to connect consumers and merchant payment devices, effectively creating an online payment experience at the POS. China is the prime example, with Alipay and WeChat Pay, but similar networks are being developed around the world. EMVCo has published standards for QR code payments, and the card networks are rolling out pilots in developing markets where terminal penetration is low.

The next wave of innovation may take place at the POS, and a US$16.8 trillion opportunity is waiting to be monetized by converting cash and checks into digital payments (Figure 11).

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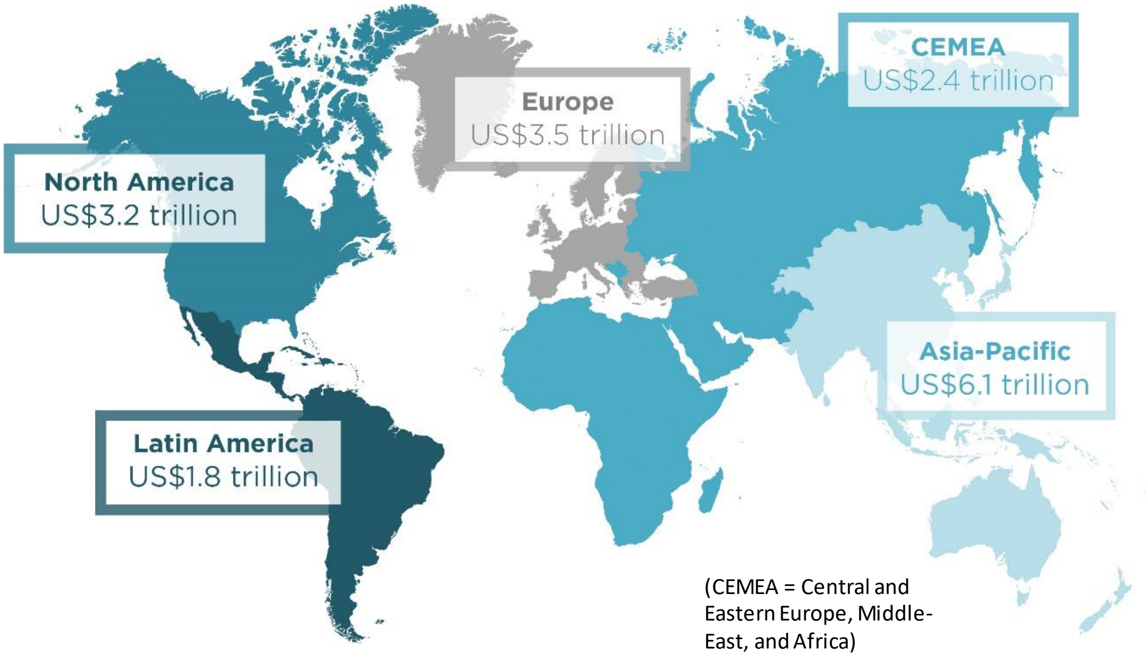
Figure 11: Value of Cash and Check Payments per Region



Source: Visa

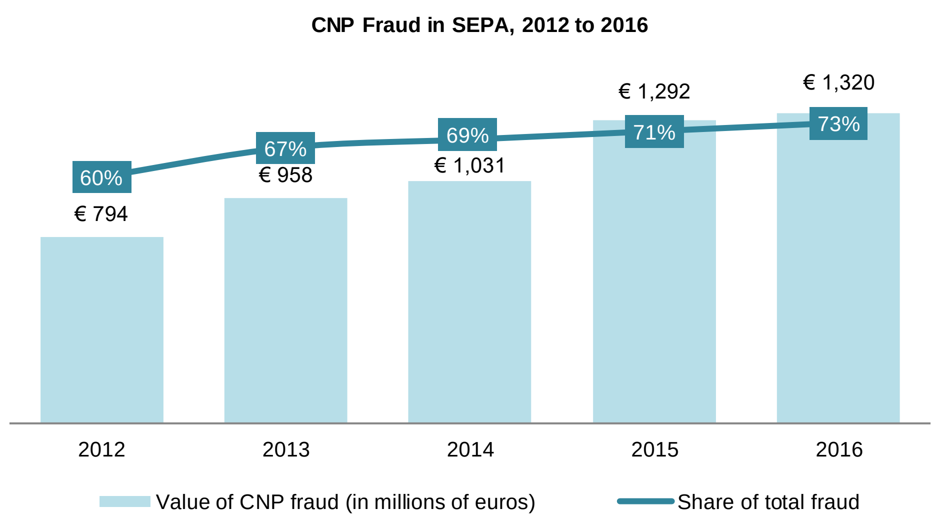
An interesting case was presented by Amazon Pay with its strategy in India to replace cash. This applies to both the online and physical worlds, as over 70% of e-commerce orders are paid in cash on delivery. The biggest opportunity lies with the 59 million micromerchants in the country, of which only 10% accept digital payments. Using QR codes and mobile devices for payments rather than card terminals greatly reduces the cost of acquisition for these merchants.

The growing use of alternative payment methods is expected to continue and even accelerate in the coming years. In the online space, this trend has already reached maturity. With the demarcation lines between online and offline gradually disappearing, the POS environment will also become a hot focus of payment innovation.

COMBATING FRAUD AND FRICTION AT CHECKOUT

The combat against fraud is an important and recurring topic at MPE, and not without reason. Card-not-present (CNP) fraud remains a focal point of attention for merchants and PSPs. For instance, in the single euro payments area (SEPA), CNP fraud is claiming an increasing share of total fraud (Figure 12).[6]

Figure 12: Share of CNP Fraud as a Percentage of Total Fraud in SEPA



Source: European Central Bank (ECB)

The market has responded with a number of innovations in fraud detection and prevention, such as 3-D Secure, biometrics, risk-based authentication, tokenization of sensitive data, and advanced risk analysis systems using artificial intelligence. These developments have successfully contributed to containing fraud. According to the ECB, the data suggest that CNP fraud grew at a lower rate than CNP transactions as a whole within SEPA.

Nevertheless, the share of CNP fraud in the total value of fraud amounted to 73% of total card fraud losses in 2016. In that year, the total value of CNP fraud increased by 2.1% compared to the previous year, reaching 1.32 billion euros.[7]

6. SEPA covers payments in euros and consists of 38 countries and territories. See “Map of SEPA Scheme Countries and Territories,” European Payments Council, February 12, 2016, accessed January 19, 2019, https://www.europeanpaymentscouncil.eu/document-library/other/map-sepa-scheme-countries-and-territories.

7. “Fifth Report on Card Fraud,” European Central Bank, September 26, 2018, accessed January 14, 2019, https://www.ecb.europa.eu/pub/cardfraud/html/ecb.cardfraudreport201809.en.html#toc5.

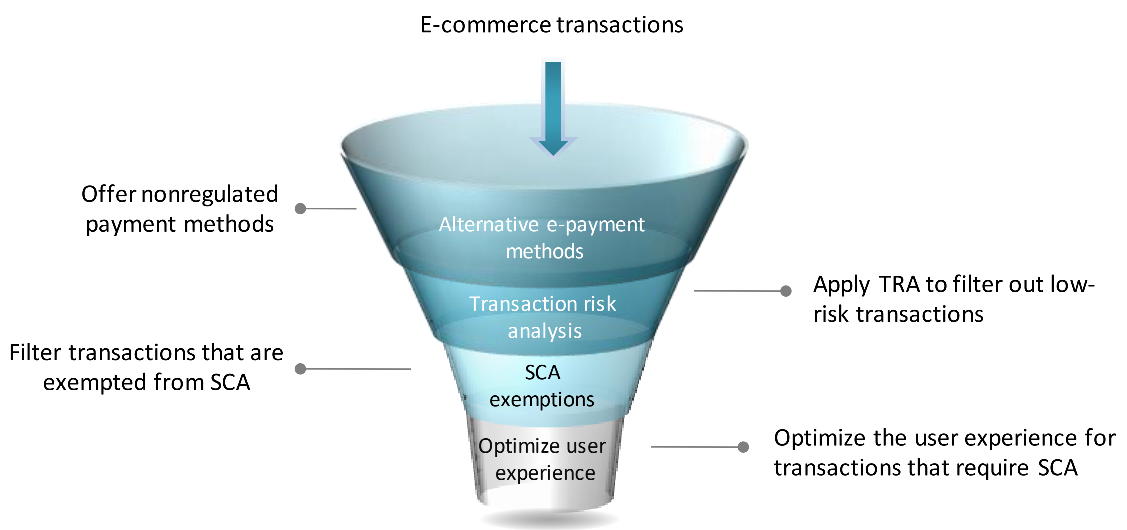
To combat fraud more effectively, the European Commission decided to strengthen the security requirements for electronic payments with the SCA requirements under PSD2. SCA requires two-factor authentication of all electronic transactions, unless these can be considered “low risk,” and exemptions apply. SCA will add more friction to the payment process, particularly for e-commerce. Merchants and their PSPs need to define their strategy to implement the SCA requirements while maintaining a superior user experience for their clients.

SCA: HOW TO MINIMIZE CONVERSION RISK

The SCA requirements mean that buyers will experience many more stepped-up authentications than they do today. Aite Group estimates that, on average, the number of stepped-up authentications will double.[8] This may expose merchants to the risk of cart abandonment and loss of sales if the new process is not properly managed.

Merchants and acquirers have several tools available to reduce conversion risk as much as possible. This will involve a multilayered approach with the dual purpose to reduce the number of transactions that require SCA and offer the best user experience for the remaining transactions that require SCA (Figure 13).

Figure 13: Measures to Minimize Conversion Risk as a Result of SCA



Source: Aite Group

8. See Aite Group’s report *PSD2: Advent of the New Payments Market in Europe*, March 2019.

Merchants can do the following to minimize conversion risk:

- **Offer nonregulated payment methods**: The SCA requirements only apply to electronic payments that are initiated by the payer. Merchants can offer their clients payment options that do not fall under the SCA requirements because they are initiated by the payee (merchant), such as direct debits.
- **Apply transaction risk analysis and other SCA exemptions to filter out low-risk transactions:** PSD2 allows for several exemptions to filter out low-risk transactions that do not require SCA. One of these exemptions is transaction risk analysis (TRA), which was discussed at length during the conference. TRA can be used to spot abnormal spending or behavioral patterns, changes in the user's device, suspected location of the payer and/or the payee, and other criteria. The application of the TRA exemption depends on the average fraud rate of the acquirer and, ultimately, the issuer. This means that the average fraud rate of the PSP can become a competitive differentiator.

  Other exemptions are allowed as well—e.g., for low-value transactions, recurrent transactions for the same amount to the same beneficiary, or the option to whitelist a merchant as a trusted beneficiary. The issue is that the PSPs involved in the transaction choose if and how these exemptions are implemented. The expectation is that many banks will not support some or all of the exemptions by the September deadline, as these are not a mandatory part of the SCA requirements. The new normal post-SCA reality is that merchants will not be able to fully guarantee or control their customers' checkout experience.
- **Optimize the user experience for transactions that require SCA:** Even after applying the filters mentioned before, many transactions will still require stepped-up authentication. Fortunately, new tools have become available to offer a smooth user experience, at least for card transactions. EMVCo's redesign of the 3-D Secure protocol, called 3DS 2.0, will be the primary method to comply with SCA requirements for card payments. It enables issuers to make more informed decisions based on data provided by merchants and acquirers.

  A liability shift for 3DS 2.0 comes into force in April, whereby any member that does not support 3DS 2.0 will automatically have liability for that transaction. A central feature of 3DS 2.0 is the ability for merchants to share far more data with issuers, allowing issuers to make more informed authentication decisions. 3DS 2.0 is also capable of seamlessly integrating with mobile apps as well as browser-based environments. This allows for integration with mobile authentication solutions, including issuer-provided solutions and third-party-provided solutions such as Apple Pay.

IS THE MARKET READY FOR SCA?

Major concerns were raised about the ecosystem's readiness for SCA. Mastercard recently conducted a quantitative survey among European merchants to understand to what extent small and midsize e-commerce merchants are aware of and prepared for PSD2's SCA requirements. The results indicate that awareness is low, particularly among small merchants. Only 25% of European online merchants say they are aware of SCA requirements under PSD2. Only 14% of European online merchants already support SCA, and another 28% mention that SCA will be ready in September 2019. The survey also found that 24% of European online merchants interviewed have no plans (yet) to support it.

Issuer support of 3DS 2.0 may also be limited by September 2019. Participants feel that there is a real risk that customers may have completely different checkout experiences with the same merchant depending on the issuer. They feel that consumers may quickly work out which of their cards supports the best experience and will thus incentivize issuers to move to 3DS 2.0.

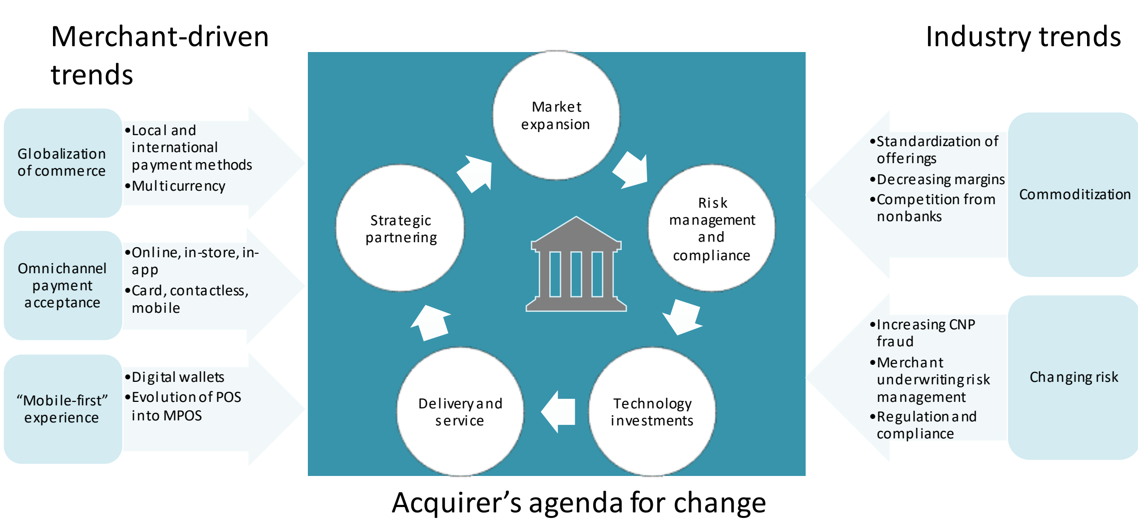
It will be interesting to witness the impact at next year's MPE, by which time SCA will have taken effect.

ACQUIRING 2.0

Acquiring has become a service business. Merchants are looking for acquirers to do more than just process payments. They want their acquirer to help them increase sales, contain costs in an increasingly complex environment, and provide best-in-class solutions—e.g., for fraud management and data analytics. An acquirer should, therefore, position itself as a merchant services provider rather than as a payments company. This requires the provider's transition to acquiring 2.0.

Acquirers must deal with changing customer requirements in a competitive and regulatory environment that is increasingly challenging (Figure 14).

Figure 14: The Acquirer's Agenda for Change



Source: Aite Group

Merchants require their payment provider(s) to support multiple payment methods and currencies, to manage payments over all channels, and to provide superior "mobile-first" experiences for both their consumer clients and their own needs. And all that must be delivered domestically and cross-border, as well as online and offline. According to multinational company Ikea, few acquirers can provide a true omnichannel solution on a multicountry basis.

Increasing competition, from peers and from new entrants, has led to strong margin pressure, with many services becoming commodities—with price as the only distinguishing factor. This commoditization makes acquirers look for new markets and merchant segments, increasing profitability but also raising the risk profile of their merchant portfolio. Acquirers will have to manage due diligence and monitor merchant operations within an ever-more-demanding regulatory framework, a reality that acquirers find increasingly challenging. Investment in the right technology will be critical, as the increasing complexity of the business can no longer be sustained through legacy infrastructure and manual intervention.

This is why MPE 2019 had so much focus on cooperation and partnerships. Acquirers should review their value chain and find strategic partners for offerings that are not considered core business. Acquirers should partner with fintech companies and get quick and easy access to the latest technology through APIs. Token.io, a fintech company that specializes in open banking solutions, provides a fitting quote by Charles Darwin: “In the long history of humankind, those who learned to collaborate and improvise most effectively have prevailed.” The central theme of the MPE couldn’t be better phrased.

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CONCLUSION

The digitization of global commerce continues to drive merchant demand for payment innovation to deliver superior customer experiences. MPE 2019 discussed how acquirers and PSPs should prepare for the next generation of payment solutions, with cross-industry collaboration and partnerships as a common theme.

The following are highlights from themes that were discussed during the conference:

- The days of the cash register and the stand-alone payment terminal may be counted. The arrival of cloud-based EPOS applications has brought enterprise-level business intelligence and integrated payments within reach of SMEs. That means that the choice of EPOS vendor will sit at the top of the merchant's priority list, while the acquirer as the provider of the payment solution will just be an option that the merchant will select mainly based on cost. Acquirers must, therefore, focus on the business needs of their customers, offering solutions that center around business intelligence, not payments alone.
- With the deadline of the PSD2 looming this year, Europe is ahead of the game in making banking and payments "programmable" through APIs. The payments industry is just starting to get its arms around the PSD2 requirements. While central governance is missing, the market has to find its own way to monetize the potential of open banking in payments and deal with the challenges. Partnerships will be essential to deliver on the promise of open banking.
- The growing use of alternative payment methods is expected to continue and even accelerate in the coming years. In the online space, this trend has already reached maturity. With the demarcation lines between online and offline gradually disappearing, the POS environment will also become a hot focus of payment innovation.
- The PSD2 SCA requirements mean that buyers will experience many more stepped-up authentications than they do today. This may expose merchants to the risk of cart abandonment and loss of sales if the new process is not properly managed. Merchants and acquirers have several tools available to reduce conversion risk as much as possible. This will involve a multilayered approach with the dual purpose of reducing the number of transactions that require SCA and offering the best user experience for the remaining transactions that require SCA. Nevertheless, merchants will not be able to fully guarantee or control their customers' checkout experience due to the differences in issuer SCA implementation.
- Acquirers should position themselves as merchant services providers rather than payment companies. This is why MPE 2019 had so much focus on cooperation and partnerships. Acquirers should review their value chain and find strategic partners for offerings that are not considered core business.

RELATED AITE GROUP RESEARCH

PSD2: Advent of the New Payments Market in Europe, March 2019.

European Acquiring: Opportunities and Challenges, September 2018.

The Changing Dynamics of Merchant Acquiring, July 2018.

Global Consumers' Authentication Preferences: Have Your Cake and Eat It Too, September 2018.

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