Visa Consulting & Analytics (VCA)

Risk management in the acquiring business

February 2023

Merchant landscape changes bring acquirer risk management strategies to the forefront

Traditionally banks have focused their risk management capabilities and expertise on the card issuing side of the payments ecosystem, which after much investment and innovation, has evolved dramatically in recent years. Unfortunately the acquiring side of the payment ecosystem hasn't received the same level of attention and investment. This has led to relatively weaker acquiring risk management controls and left acquiring banks exposed to potential penalties or/and fines to be imposed by payment networks and regulators.

However, changes in consumer behaviour and new entrants to the market have forced acquiring banks to make changes and revisit their existing business models and interplay with acquiring risk management. Acquiring risk management now needs to be an important strategic priority to enable sustainable acquiring business growth. It is an area that can differentiate acquiring banks, become an enabler of business and market share growth, at a time when margins are being squeezed and acquirers need to differentiate themselves.

We want to help you be at the forefront of these existing and emerging changes. In this paper we will outline the major trends in the acquiring risk management landscape and discuss the strategic implications for each of these trends. We will introduce to you our acquiring risk management framework and share with you ways in which our expertise can help you.

Current trends in acquiring risk management and their strategic implications on acquiring banks

The COVID-19 pandemic forced us to shift our shopping experiences into digital channels. These changes demanded a quick shift in priorities from acquiring merchants to enable them to serve customers digitally. As a result, several key trends have been identified in acquiring risk management:

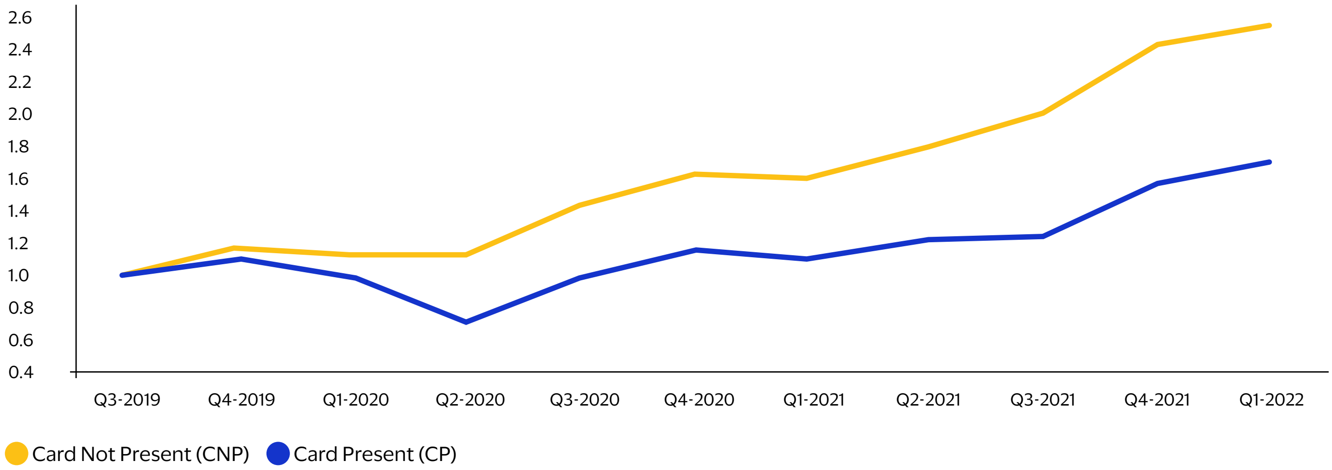
Trend #1:
Unprecedented growth of e-commerce merchants

e-Commerce (e-Com) has grown at a staggering rate. In 2021 e-com sales reached approx. 4.9 trillion dollars worldwide and is predicted to grow over 50% in the next three years to about 7.4 trillion dollars by 2025.[1] These figures are reflected in Visa data which shows us that 78% of consumers have changed their payment method due to security concerns and 45% of consumers state that online shopping is a necessity.[2,] Looking at VisaNet data from Central Europe Middle East and Africa (CEMEA), it is clear that card not present transactions have been grown significantly over the last 2 years and continue to grow in line with predictions.[3] See figure 1 below.

This huge rise in e-com has led to higher risk exposures in the payments ecosystem. Acquiring banks are trying to meet the needs of different merchants at differing levels of digital maturity while remaining relevant and trying to innovate in the space.

1. CNP vs CP Distribution

CEMEA CP vs CNP (Payment Volume Growth $Bn – indexed to Q32019)



Source: VisaNet Data

1. Statista.com, Retail e-commerce sales worldwide from 2014-2025
2. Visa Back to Business Study, June 2020, https://usa.visa.com/dam/VCOM/global/run-your-business/documents/visa-back-to-business-study.pdf
3. VisaNet Data

Trend #2:
Reinventing business and operating models

Acquiring banks are now competing against the tech-savvy Fintechs who have transformed the acquiring value chain, redefined the merchant journey and simplified pricing structures. These new players in the acquiring value chain are pursuing open platforms and rationalizing back office processes which puts additional pressure on the incumbent acquiring banks. This has resulted in the re-evaluation of value propositions for merchant services and introduces new acquiring risks into the payment ecosystem as they try to compete.

In the first half of 2022, Adyen reported a 60% year on year increase in processed volumes and a 97% increase in point of sale volumes year on year across the Middle East.[4] Much of this growth comes from onboarding new online service providers and enabling higher authorization rates. Many of these new players can pivot much more quickly and adapt to new markets in a more agile way than the existing acquiring banks. However, the acquiring banks are also looking at ways to innovate, they are reassessing the silos that exist between the issuing and acquiring businesses and trying to drive synergies and learnings which should result in higher engagement as well as cost savings.

Merchants of all sizes are placing new expectations on acquiring banks, expecting them to process payments (beyond basic authorisation services) in real time, demanding simplicity in pricing structures and frictionless experiences. Both merchants and consumers are putting pressure on acquiring banks to keep up with the omni-channel customer journey that has become the norm. According to research from Salesforce, 73% of shoppers use multiple channels during their checkout journey.[5] All of these changes will require investment in payment technology and risk services to develop robust, forward thinking, risk management capabilities.

Acquiring banks are focusing on advanced real time fraud detection and prevention systems to address the challenges they are facing. As margins compress, these new technologies and capabilities, including tokenization and risk scoring, are allowing the acquiring banks to reposition themselves to be able to capture new revenue streams which are key to their growth. Acquirers like Worldpay are strategically migrating to more secure credentials like Tokens and authentication protocols like EMV3DS, which make transactions safe and secure and subsequently reducing their operational costs.

Acquiring banks need to leverage merchant risk insights from data using Artificial Intelligence (AI) models to add value and offer new services like chargeback protections. Some newer entrants are already doing this work like Riskified who offer full chargeback protection to merchants and "enable frictionless eCommerce with instant decisions."[6]

4. Uaenews247.com, Adyen N.V. ANNOUNCES H1 2022 Financial Results: Middle East expansion driven by new merchant acquisitions
5. Salesforce.com, Omnichannel Retail and Beyond: Delivering Superior Customer Experiences.
6. Riskified.com

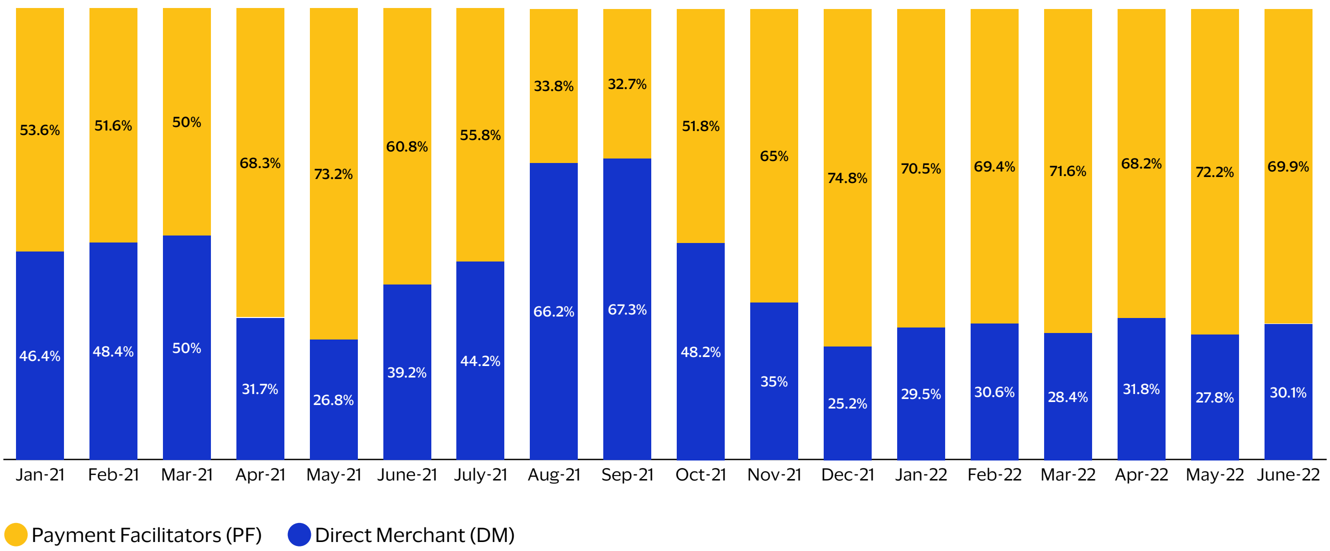
Trend #3:
Payment facilitators are becoming key players

Payments disrupters like PayPal, Square and Stripe have completely changed the relationships between players in the merchant acquiring space. Their growth has been phenomenal, they're on track to process over 4 trillion US dollars worldwide in 2025.[7] To enable growth, some acquiring banks have outsourced certain risk management functions such as merchant underwriting, onboarding and monitoring, to these payment facilitators (PFs) which has introduced additional acquiring risks into the payment ecosystem. By analysing VisaNet data from CEMEA, the levels of dispute and fraud violations (posed because of excessive reported fraud and disputes), by payment faciliators now makes up a majority of excessive dispute and fraud violations.

A balance must be achieved between the necessary merchant services that the PFs provide which is enabling growth for the acquiring banks and the need for acquiring risk management control in order to maintain a reliable, secure and trusted payment ecosystem.

2. Direct Merchant vs Payment Facilitators

CEMEA DM vs PF Excessive Dispute and Fraud Violations (# of Merchants)



Source: VisaNet Data

Trend #4:
Shifts in payment channel preferences

The growth in mobile and contactless payments has left merchants and acquirers struggling to keep up with the pace of change in consumer behaviour and to adopt new technologies to meet consumer demand. This has seen acquiring banks losing out to new market entrants who have more convenient, safer and secure payment methods that meet consumer needs and enable better customer experiences.

7. Insider Interlligence.com, Payment facilitators: How these providers are eating the payments value chain, June 2021

Trend #5:
Change in fraudsters approach

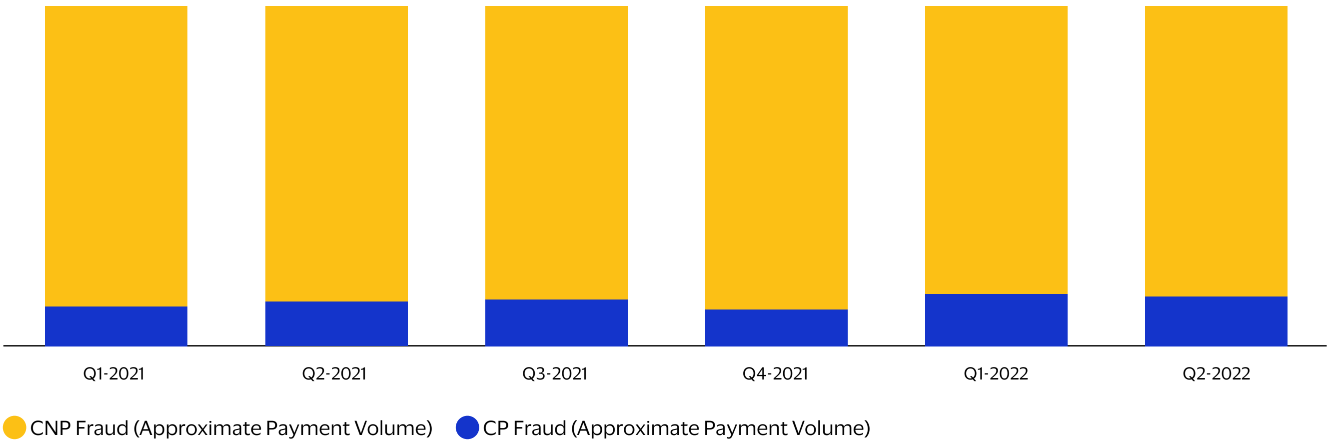
Whilst there is no denying that digital payments has brought a huge number of benefits for both consumers and merchants, it has also resulted in a huge increase in Cybercrime. Fraud has moved to target Card Not Present (CNP) transactions resulting in the acceleration of secure technologies (i.e. EMV3DS and Tokenization) across all payment channels. VisaNet data shows us that across the CEMEA region, fraud levels over the last 18 months have been at least 85% in card not present transactions. See figure 3 below.

We have observed across the CEMEA region that the fraud rate on 3-D Secure-verified transactions is ten times lower than transactions where the protocol was not used.[8]

To combat this acquiring banks should place more emphasis on closing the gaps in near-real time controls and monitoring, as well as having greater control over merchant underwriting, onboarding and monitoring. This will reduce merchant driven fraudulent and illegal activities.

3. CNP vs CP Fraud Distribution

CEMEA CP Vs CNP Fraud (Approximate Payment Volume)



Source: VisaNet Data

8. Arabianbusiness.com, Visa CEMEA: Pioneering advanced technologies to mitigate the risks of e-commerce fraud, July 2022

Building best in class risk management capabilities is key for all acquirers

This post-pandemic context has made a complex and competitive sector even more challenging. However, despite the challenges, significant opportunity remains for acquirers to carve out a differentiating, value-creating role by enhancing their acquiring risk management capabilities. Visa has developed a comprehensive framework based on Global Acquiring Risk Standard (GARS) (complimentary to existing Visa Rules) to work with you to develop the necessary acquiring risk capabilities.

There are some key areas that all acquirers must review in light of best practices:

Acquiring Risk Management: Acquiring Risk Advisory

We offer a comprehensive end-to-end review of acquiring risk policies and processes

1. Acquiring Risk Strategy & Risk Appetite
- Acquiring merchant segments and target setting
- Merchant risk segmentation
- Merchant risk concentration caps

2. Organization & Governance
- Organizational structure and functional statements
- Governance (committees)

7. Third PartyAgent (TPA) Management
- SLA and control policies
- Liability management and monitoring
- Standards compliance review
- KPIs and analytics

3. Merchant Underwriting & Onboarding
- Risk acceptance criteria
- Credit and fraud risk assessment
- Verification and control
- Merchant training and education
- Merchant agreements

6. Terminal & Host Management
- Terminal and gateways maintenance and controls
- Host control management
- Data security management

4. Merchant Activity Monitoring & Management
- Capabilities and systems
- Rules management
- Resource capacity assessment
- Response and investigation policy
- KPIs and analytics

5. Dispute Management
- Dispute processing and performance
- Liability management policy
- KPIs and analytics

1. Acquiring Risk Strategy & Risk Appetite

Acquiring banks require forward thinking strategic plans which takes into account historical data and fraud levels but, are future focused with clear business plans and objectives. Strategic plans should include well-defined acquiring risk metrics to be tracked for the coming 3-5 years and can be further enhanced with global, regional and local research insights highlighting identified existing and emerging acquiring risk trends with clear strategic implications and risk mitigation plans.

2. Organization & Governance

Acquiring banks should also confirm whether their risk management function organizational structures remain fit for purpose with clear roles and responsibilities being well defined. Acquirers should ensure that the personnel in the acquiring risk roles have the necessary skills and competencies aligned to the dynamic and changing acquiring business. Fit for purpose governance structures should be established to ensure that material acquiring risks are being timely identified, reported and acted upon by the people with the right level of authority in the organization.

3. Merchant Underwriting & Onboarding

Policies and standard operating procedures must be in place to ensure that merchant underwriting and onboarding controls are complied with even when carried out by the Third Party Agents (TPAs) such as Payment Facilitators. Merchant credit rating methodologies, merchant agreements with clear protection clauses and independent verification checks should be adopted and conducted to ensure that the financial profiles and legitimacy of merchants being underwritten and onboarded. Last but not least, regular reviews should be conducted with clear and timely escalation processes when issues are being identified.

4. Merchant Activity Monitoring & Management

Daily monitoring of merchant authorization and settlement activity is necessary to help an acquirer recognize any unusual or sudden change in normal merchant activity levels and to prompt mitigating action swiftly. The acquirer should have fit for purpose technology / systems and adequate management information to ensure timely identification of emerging acquiring risks.

5. Dispute Management

To protect profitability and reduce losses, acquirers should develop dispute management policies and standard operating procedures in several areas including: dispute validation, dispute classification, dispute resolution time, liability management and remitting funds to issuers.

6. Terminal and Host Management

Acquiring banks must take measures to safeguard themselves against the potential risk of Face-2-Face POS terminal data being compromised. This can be addressed through clauses in merchant contracts or by more effective POS management and constant education and training. For CNP/eCom transactions, acquirers should also ensure that clauses are in place to safeguard against bypassing 3DS/EMV authentication protocols.

7. Third Party Agent Management

Acquirers can outsource critical risk management functions to TPAs however, acquirers are solely responsible for complying with their own acquiring license requirements and safeguarding the payment ecosystem. Acquirers must ensure that they regularly review the TPAs policies and procedures ensuring that they align with their own. TPA activity must be regularly monitored to ensure compliance.

What lies ahead for acquiring risk management?

Going forward, acquirers must deal with changing customer requirements in a highly competitive, regulated environment, rife with new entrants, rapidly evolving consumer preferences, emerging payment types, increasingly complex value chains and new payment use cases. As such, acquirers are repositioning themselves as merchant service providers (as opposed to only acquiring payment processors) and must provide best-in-class acquiring risk solutions for payments-related needs such as fraud and dispute risk management, technology solutions and data analytics.

As more transactions are shifting online, there is going to be increased card not present (CNP) / eCommerce fraud and disputes as online payments become prime targets for criminal attacks. Regulators have imposed mandates for strong customer authentication (SCA) to manage fraud associated with CNP fraud. The widespread requirement for SCA in Europe is already showing its ability to decrease CNP fraud. Payment networks have also introduced EMV3DS as a payment security protocol to reduce CNP fraud. Price erosion due to heavy competition will call for strategic moves into higher-risk merchant segments to sustain profitability. Commoditization will also continue to make acquirers reposition themselves to target new markets and merchant segments to increase profitability but increasing the risk profiles of their merchant portfolios. Successful acquirers will be required to have best-in-class acquiring risk management policies and processes enabling them to gain market share in these higher-risk higher-margin merchant segments while ensuring that this remains within the risk appetite of their portfolios.

Acquirers will be required to invest heavily in technology solutions and deploy advanced ML/AI tools to combat emerging fraud. Acquirers will need advanced merchant underwriting, onboarding, and monitoring tools to mitigate financial, regulatory, and potential reputational risks. This will be further exacerbated as more merchant payments are being aggregated by new acquiring value chains such as payment facilitators, marketplaces, and other third-party agents. There will be strong demand for acquirers to leverage data analytics, fraud monitoring rules, risk modeling, and other fraud prevention tools and techniques to identify merchant risk factors that may change merchant's original level of risk from when the merchants were underwritten and onboarded irrespective of whether these were directly acquired merchants or indirectly acquired merchants through third party agents.

Our deep knowledge combined with Visa leading data and analytics means we are ideally placed to support and guide you to deliver a gold standard acquiring risk management strategy and to help you grow these capabilities in your organization.

About Visa Consulting & Analytics

We are a global team of hundreds of payments consultants, data scientists and economists across six continents.

- Our consultants are experts in strategy, product, portfolio management, risk, digital and more with decades of experience in the payments industry.
- Our data scientists are experts in statistics, advanced analytics, and machine learning, with exclusive access to insights from VisaNet, one of the largest payment networks in the world.
- Our economists understand economic conditions impacting consumer spending and provide unique and timely insights into global spending trends.

The combination of our deep payments consulting expertise, our economic intelligence and our breadth of data allows us to identify actionable insights and recommendations that drive better business decisions.

For help addressing any of the questions raised in this paper, please contact your Visa Consulting & Analytics representatives via email.

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