

DIGITAL TRANSACTIONS

Trends in the Electronic Exchange of Value

A FIELD GUIDE TO ALTERNATIVE PAYMENTS

Do you know your Obopay from your PayPal? Here's a guide to sorting out some 21 alternative-payment players.

ALSO IN THIS ISSUE:

- Merger Mania in Processing
- Transit Takes Cards
- Real-Time Health Care Networks
- The Rise of Tokenization

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DIGITAL TRANSACTIONS

Trends in the Electronic Exchange of Value

C O N T E N T S

May 2009 ■ Volume 6, Number 5

"Online payments are the focus of furious entrepreneurial activity. A few new systems have deep-pocketed backers, while many others are being proffered by small companies hopeful that their platform will become the next PayPal."
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Digital Transactions takes you on a tour through the natural habitat of alternative payment systems, where new ways to pay without a major credit or debit card are on the prowl. But what exactly is an "alternative" payment system, anyway?

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In the midst of an economy racked by restricted consumer credit, online merchants must embrace new payment solutions that let customers pay with cash, says Paul Phillipson.

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The Inevitability of Alternative Payments

Scarcely do bankers convene at a payments conference without casting a wary eye on some non-bank company or another trying, in their view, to horn in on their turf. More often than not they bemoan the interloper and its potential to drain traffic and profits out of the payments business. This has been going on at least since PayPal became a serious player by cornering the online auction trade, and the sentiment is less productive now than ever.

That's because there are a lot of potential PayPals out there these days, with yet more only in their larval stage. We've documented 21 of them in our cover story starting on page 28. Bankers who view electronic payments—and especially the consumer's demand-deposit account, which forms the basis for so many of the newer alternative models—as their private preserve have much to bemoan now. But just as making PayPal Public Enemy No. 1 didn't stop that online juggernaut, meeting in conference to figure out how to stop the Revolution Cards and the Mazoomas won't have much effect either.

To begin with, banks have themselves to blame, largely, for this pickle they're in. Their insistence as card issuers on propping up interchange rates on credit and signature debit cards, and on promoting the more lucrative signature debit card over the PIN debit card, has flung open a world of hurt. Not only has it brought down the wrath of merchants and possibly regulators, but it has also given entrée to a host of non-bank entrepreneurs who think they can relieve merchants' pain by processing payments on the cheap.

Perhaps some can. The more important point, though, is that banks can gain more from getting on top of this trend than from simply demonizing the entrepreneurs. Some of the alternative-payment players are openly inviting banks to partner with them. Steve Case, who helped popularize the Internet by founding America Online, told an audience of mostly bankers last month at NACHA Payments that his Revolution Card will shake up payments. But he also said he's looking for bank partners to issue the card.

Meanwhile, NACHA itself has a pilot running for Secure Vault Payments, a system by which consumers can pay online merchants by accessing their online-banking programs. SVP by definition is bank-controlled, and offers bank participants interchange income, to boot. And Moneta, though a non-bank company, is seeking bank partners and offering to share transaction revenues with them.

Not all such propositions will make sense. Case, for example, was curiously silent about how banks will benefit financially from issuing Revolution Cards. But openness to alternative payments makes more sense than knee-jerk hostility.

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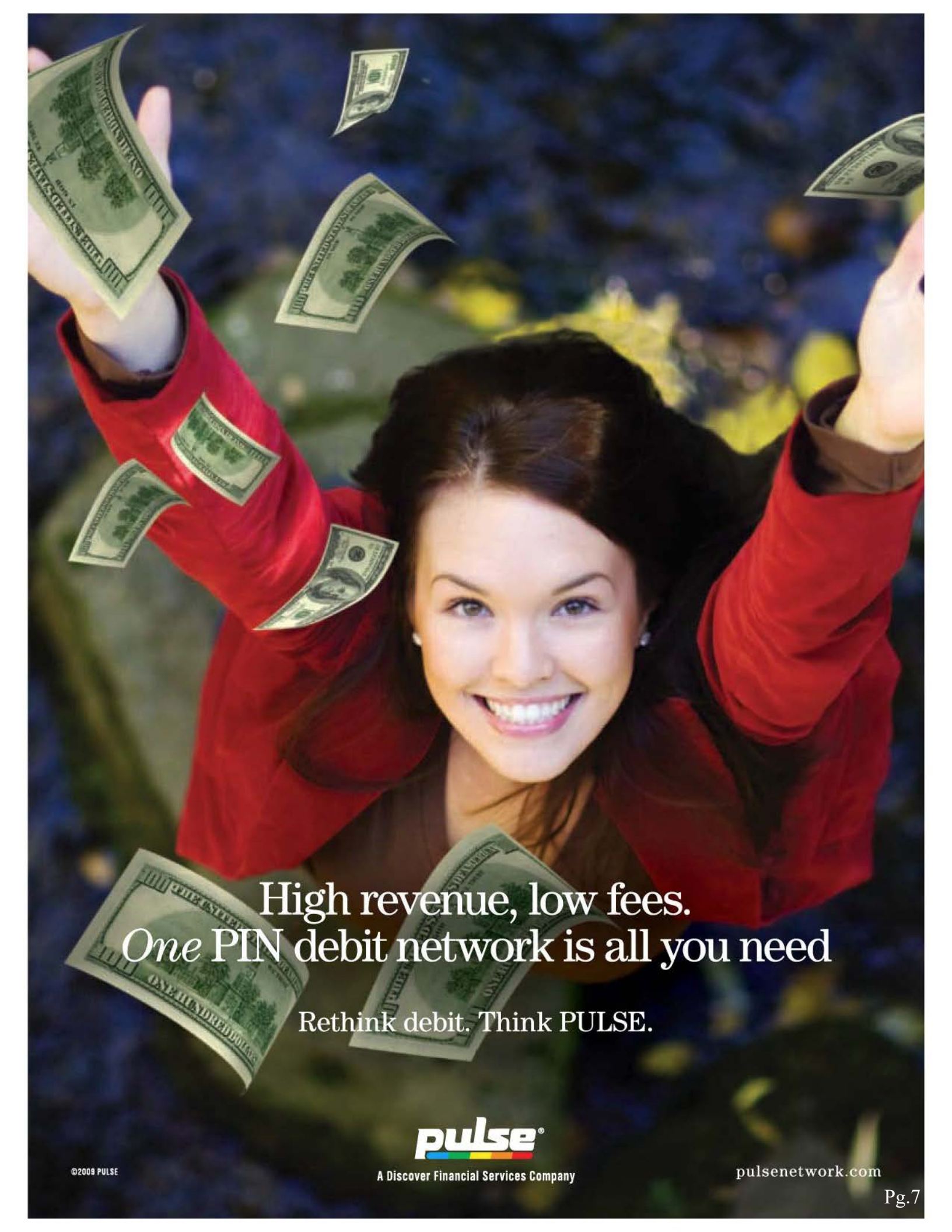
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A woman with dark hair, wearing a bright red jacket, is smiling broadly at the camera. She is surrounded by numerous US dollar bills, including \$100 and \$50 bills, which appear to be falling or floating around her. The background is a blurred outdoor setting with green foliage.

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TRENDS & TACTICS

Merger Fever Rises in Processing

Banks to processors: "There are just too many of you guys."

That's the distilled thinking about the planned, \$2.94 billion acquisition by Fidelity National Information Services Inc. (FIS) of Metavante Technologies Inc. The stock deal will create a bank- and payments-processing giant with \$5 billion in combined revenue and a vast array of products in everything from core banking services to credit, debit, and prepaid card processing, electronic bill payment, check imaging, and emerging technologies such as mobile payments.

To simplify their operations, the banks and credit unions that are the chief customers of FIS, Metavante and many other processors want to deal with fewer providers, according to an analyst who closely follows the processing industry, Gwenn Bézard. "Banks are asking ... for greater consolidation of vendors," says Bézard, research director at Boston-based Aite Group LLC.

At an April 1 conference call announcing the deal, executives of both FIS and Metavante seemed to acknowledge that market signal. While both have bought other companies,

FIS has been especially acquisitive, having bought such prominent processors as eFunds Corp. in 2007 and Certegy Inc. in 2006. Lee A. Kennedy, president and chief executive, said that with Metavante, his bulked-

processors and another company that has expanded through acquisitions. Fiserv bought bill-pay leader Check-Free Corp. in 2007.

"It's a great deal," says Steve Mott, a payments researcher and consultant based in Stamford, Conn. "Now you have somebody who has the bulk to compete against Fiserv."

A Powerful Processing Combo

	FIS	Metavante
Revenues (2008)	\$3.4 billion	\$1.7 billion
Core processing customers	1,400	850
Cards processed	164 million	80 million
Other	Owns the former Certegy and eFunds processors.	Processes 259 million bill payments annually; owns the NYCE EFT network and the Endpoint image network used by 6,000 financial institutions.

Source: Fidelity National Information Services, Metavante

up firm would be better able to compete with the likes of tech giants IBM Corp., Hewlett-Packard Co., and Oracle Corp., which he said may have their eyes on financial processing.

Many observers also see the merger placing the combined companies in a stronger position to compete with Brookfield, Wis.-based Fiserv Inc., the biggest of the core

Jacksonville, Fla.-based FIS and Metavante, which is based in Milwaukee, apparently had been talking for months. In Metavante, FIS is getting a processor with 850 core processing customers, that processes more than 80 million debit and prepaid cards, and that owns the NYCE EFT network. It's also a major provider of bill-payment and

check-imaging services. "Metavante was clearly our number-one target," Kennedy said.

Milwaukee bank holding company Marshall & Ilsley Corp. founded and grew Metavante but spun it off in late 2007, with private-equity firm Warburg Pincus LLC taking a 25% stake. That same year, Metavante formed Monitise Americas LLC, a mobile-banking firm, as a joint venture with Britain's Monitise PLC.

Driving the deal were the possibilities of one processor offering a long list of complementary products attractive to financial institutions as they emerge from the recession, and the ability to take out an estimated \$260 million in annual costs through elimination of redundant products and facilities, combinations of processing platforms in some cases, and a whittling of suppliers. "A major portion of the benefit, before the revenue synergies kick in, is all driven by expense take-out," Kennedy said.

The risk is flubbing the complex integration task after the deal's expected third-quarter close, a risk Kennedy said both companies are prepared to take because of their successful integration of previously acquired companies. "It's a matter of getting the organization committed and focused on this," Kennedy said.

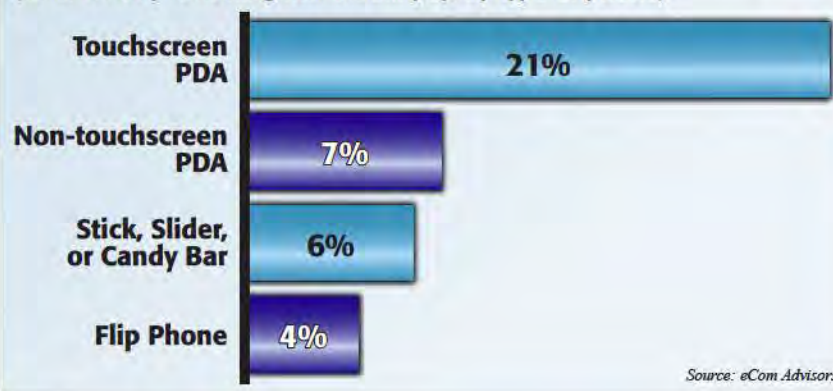
The combined company will be headquartered in Jacksonville but headed by Metavante's chairman and chief executive, Frank R. Martire, who will have the titles of president and chief executive. Kennedy will become executive chairman and spend most of his time overseeing the cost-cutting efforts. About 20% of the company's revenues will come from international operations, most from the FIS side.

Technology—Not Age—Drives Mobile Banking

As with any new technology, the young are presumed to lead the way with mobile banking and payments. And the younger you are, the more likely you are to use your mobile phone to move money around. So goes the conventional wisdom.

How Handset Technology Influences Usage

(% of users performing mobile bill pay, by type of phone)



Not so, says some recent research. It turns out consumers' propensity to use mobile devices to conduct banking functions depends on the sophistication of the device, not on the consumer's age, the research says. More specifically, mobile users equipped with iPhones or other touchscreen-enabled smart phones are far more likely to use the devices for mobile financial services than are users with ordinary cell phones or even devices with full keyboards. Age, it seems, doesn't matter. Technology does.

Surprised? So are the researchers. "It was not our mental model coming into this how much this tied out by device," Fred Brothers, managing partner at payments consultancy eCom Advisors, said in a presentation of eCom's research at the

NACHA Payments conference last month in Orlando, Fla. "Nothing correlated by age at all."

So surprised were Brothers and his team that they re-ran their cross-tabulation programs three times, only to arrive at the same result. "Everything correlated by device—it didn't have anything to do with age," Brothers said.

In the firm's survey, a group of 279 consumers were broken down by

four age groups, mature (born between 1930 and 1945), Baby Boomers, Gen X, and Gen Y. The groups were shown photos of four types of handset: flip phones, so-called candy-bar or stick phones, non-touchscreen PDAs and smart phones, and touchscreen PDAs and smart phones. With this definition of devices, each respondent was asked about the type of phone he or she owned and his or her likelihood to use the device to perform mobile banking.

Though Brothers and his colleagues expected results showing a far stronger interest among Gen Y respondents, the results indicated that mobile-banking adoption is far more likely to be driven by the availability of sophisticated handsets with touchscreens.

For the entire group, 14% said they had used mobile banking in the past 30

days, with 7% doing mobile bill payments. For the group using touchscreen smart phones, however, those percentages soared to 41% and 21%, Brothers said. "The device is clearly the enabling technology [for mobile banking]," Brothers told his audience, referring to iPhones and other such devices.

Some smart phones are "smarter" than others when it comes to inducing mobile-banking usage. Indeed, smart phones like the iPhone are about twice as likely to stimulate mobile-banking usage than other smart phones that rely on full keyboards rather than touchscreens, Brothers told *Digital Transactions News*, a sister publication of *Digital Transactions*.

Some banks are apparently already seeing the effects of this correlation to device. Of the 2 million customers using Bank of America Corp.'s mobile-

banking service, some 41% log into the service from an iPhone, Brothers reported, even though Apple Inc. only introduced the product in June 2007.

The implication, said Brothers, is that as the price of touchscreen phones—and the cost of associated data plans—declines, the greater availability of the devices will drive rapid mobile-banking adoption. "This is going to happen faster than a lot of folks believe," Brothers noted.

Stirrings in the Decoupled Debit Business

You say you haven't heard much about decoupled debit lately? You're not alone. The idea of issuing a debit card that can access funds at another bank, a

notion that rocked the payments industry nearly two years ago, has been eerily silent for about a year.

Fans of decoupled debit needn't fret, though. It may soon be making waves again. An executive with Tempo Payments Inc., a non-bank processor with the only consumer-oriented, network-branded product on the market currently, said last month the company plans to launch a new product soon.

"We've been in stealth over the past year, but we'll issue a new product in July with decoupled debit at the core of it," said Anthony Ruebner, vice president of business development at the San Mateo, Calif.-based company, in a presentation at NACHA Payments.

Speaking to *Digital Transactions News*, Ruebner said he is unable to

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give any details about the product. But it would represent the first major development in the decoupled-debit market since the credit crisis that erupted last year forced bank executives across the country to rewrite business plans and shelve pilots and projects across the board.

Capital One Financial Corp., which stunned bankers by introducing a MasterCard-branded decoupled product in 2007, has quietly shuttered its once-ambitious operation. "We decided to discontinue our decoupled debit product late last year," a Cap One spokesperson says via e-mail. "The decoupled debit pilot was one of many tests that Capital One conducts to analyze product and consumer interests. While we saw a number of positive test results that could be the basis for a product in the future, we

do not believe the results merit further testing in today's market."

Cap One's entry in the market excited substantial interest not only because of its marketing prowess but also because its new product was widely seen among banks as a threat to their bread-and-butter demand-deposit accounts. A decoupled debit card links to a checking account held at a bank other than the entity issuing the card. Transactions clear through the automated clearing house.

So now, with Cap One's exit, have the banks put decoupled debit out of their misery? Some observers argue it's a big setback. "That's not good," says Gwenn Bézard, research director at Aite Group LLC, Boston. "Capital One pulling out is not great news for that space."

But he cautions against writing any obituaries yet. For one thing, the

concept is still so new that very few consumers have had a chance to try it out. "When so few people have tried, it's hard to know if it's an execution issue or a strategy issue or an operation issue," notes Bézard. "It is too early to say if the product is flawed."

And there are signs of success in certain niches, such as PayPal Inc.'s decoupled debit card for small businesses, issued by JPMorgan Chase & Co. "In regard to that, you could say decoupled debit is a success," Bézard says.

Now Tempo, whose roots in decoupled debit go back to its Debitman days, says it is seeing encouraging results with so-called open-loop products. These are cards that Tempo either issues on its own or with a bank partner and that bear the MasterCard logo. Tempo data indicate merchants

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operating an open-loop system issue 50% more cards than like businesses using closed-loop cards. Monthly transactions, meanwhile, jump from 3.7 to 13.3 on the same comparison.

The cards, which can be cobranded by merchants, typically carry rewards that encourage usage by cardholders. The reward rate on a Tempo card is 0.5% per transaction, compared to no more than 0.1% on a traditional, signature-based debit card, according to Ruebner. That has helped drive transaction volume up to 161 transactions per active card per year, according to Tempo data.

Tempo's bank partner is HSBC Retail Services, which issues a Tempo-supported card under its OptiPay brand for merchants like CVS Caremark Corp. Ruebner refuses to break out Tempo's volume between the HSBC-related activity and that which is Tempo-direct. The company is seeking

more bank partners, but current conditions in banking have made that job a tough one. "What with the economy being what it is, innovative new products are not top of mind," he told the conference audience. "That's why you've seen decoupled debit go quiet."

More Than One Path to Faster ACH Clearing

Back in March, the Federal Reserve Banks said it was time for faster settlement of certain automated clearing house transactions, and it set in motion a plan that in about a year would allow banks to clear these payments on the same day they're entered.

Not all payments experts, though, are enamored of the Fed's plan. And now at least one has offered an alternative proposal that he says

will accelerate clearing times without the threat to banks he sees in the Fed's idea.

Danne Buchanan, chief executive of NetDeposit Inc., a Salt Lake City-based payments-software vendor and unit of Zions Bancorporation, says ACH debits should be posted on the same day by financial institutions if they are received by 8 p.m. Actual settlement would occur by 10 a.m. the next day.

This schedule, which Buchanan says simply follows the practice used in check clearing, contrasts with current ACH practice, which calls for next-day posting and clearing. But it also contrasts with the Fed proposal, under which debits would clear the same day if received by 2 p.m.. The Fed plan, which is voluntary for banks, is set to be implemented by the second quarter of 2010.

Buchanan argues the Fed proposal would deprive banks that receive ACH debits of a day's worth of interest income on the cleared funds. His plan, he says, would allow banks to hold on to that income by posting on the same day but not clearing until the next morning.

Meanwhile, under the Fed plan the originating banks get the benefit of the accelerated float, Buchanan argues, which they will promptly negotiate away in bidding for the business of corporate clients. "It will destroy the value within the payment system," he charges.

Richard Oliver, executive vice president at the Federal Reserve Bank of Atlanta and the Fed's product manager for retail payments, counters that the Fed proposal will let receiving banks save a day's worth of interest by posting debits earlier to their customers' accounts.

The Fed might offer pricing as part of its plan that would compensate

Letter to the editor

Hi John:

I read your piece ["What good is PCI?" March] with interest.

I am glad you too recognize the [Payment Card Industry] data-security standard as the strongest defense against attacks on our payment systems. The PCI Security Standards Council continues to assert that maintaining a security program that incorporates ongoing compliance, with the DSS at its foundation, remains the best line of defense against potential data breaches.

This is supported by the fact that to date, card brands report that no entity that has been breached has been compliant with the PCI DSS. Your assertions about Hannaford and Heartland are premature. While forensic investigations are still under way at some of the latest breaches, it is fair to say that this fact continues to hold true.

The "checkbox" mentality you point out remains a problem. IT organizations must approach their security strategies holistically. It is not good enough to seek certification, then let your compliance report gather dust for another year. Securing customers' payment data is a round-the-clock, all-year-long job.

Regards

Bob Russo

General Manager

PCI Security Standards Council

receiving banks for the interest income they would give up, though Oliver stops short of confirming this. "We are examining what type of pricing approach will do the most to further the service," he says.

Both Buchanan's plan and the Fed proposal address growing concern in the ACH network with so-called direct-send arrangements between banks. Under these agreements, banks handle ACH items directly in bilateral exchanges, bypassing the ACH network and any risk controls the network might have offered.

The arrangements also have the potential to drain revenue out of the network, critics say, as the trading partners avoid network fees. Meanwhile, they say, transaction costs rise as fewer payments flow across the fixed-cost network. "When you bypass the ACH, transactions become invisible to the world," says Buchanan. "You can't get a network view any more."

No one knows just how much direct-send traffic there is. "It's hard to estimate that," says Oliver. "But it's a substantial number, and there could be more to come." Many view Pariter

Solutions LLC, the common processing platform announced last year by Wells Fargo & Co. and Bank of America Corp., as the latest and most prominent outgrowth of the trend toward bilateral exchanges.

The idea of speeding up settlement on the ACH network, if even just for debits, is attracting increasing interest. At a recent conference sponsored by NACHA, the regulatory body for the ACH, Buchanan and Oliver presented their rival proposals—and debated their merits—in front of a standing-room-only crowd. **DT**

Credit Card And E-Banking Web Transaction Indexes

Following are the Keynote Credit Card Web Transaction Performance Index and the Keynote E-Banking Web Transaction Performance Index.

The Keynote Credit Card Web Transaction Performance Index measures the performance and availability of going to a selected credit card site and logging in to conduct the appropriate intended actions and checking in or signing out. All measurements are taken from the 10 largest U.S. metropolitan areas (Boston, Chicago, Dallas, Detroit, Houston, Los Angeles, New York, Philadelphia, San Francisco, and Washington, D.C.) on high-speed links attached to key points on the largest U.S. Internet Service Protocol (ISP) backbones.

The Keynote E-Banking Web Transaction Performance Index shows the total execution time and success rate for logging into an account and checking the account balance on selected Internet banking sites. The sites included in the index were selected based on publicly

available market-share information published in The Wall Street Journal and other reliable industry sources.

Data for these indexes, supplied each week by Keynote Systems Inc., San Mateo, Calif., reflect performance for the most recent week available before the production deadline for this issue, as well as rankings for the three previous weeks. Sites from these lists may be removed from weekly published results due to insufficient data points for a particular week. For other weeks the site was removed, its ranking will be indicated as "DNR"—did not rank. For more information on the methodology behind the indexes, visit www.keynote.com. For more complete statistics for the weeks indicated, go to www.digitaltransactions.net, click on "Web Transaction Performance Indexes," and click on the hyperlink for the week you're interested in at the bottom of the page.

Credit Card Web Transaction Performance Index Week starting April 6, 2009

Rank by Speed (seconds)				
Rank	Target	Response Time (sec.)	Rank week of 3/30	Rank week of 3/23
1	Diners Club	4.74	1	1
2	US Bank	6.66	2	2
3	Chase	7.62	3	3
4	Citibank	8.2	4	5
5	Wells Fargo	8.47	5	
	Credit Card Index	11.76		
6	HSBC	11.76	6	7
7	Capital One	12.47	7	6
8	American Express	12.66	8	8
9	National City	15.63	9	11
10	Bank of America	15.87	10	9
11	Discover Card	18.72	11	10

Rank by Success Rate (percentage)					
Rank	Target	Success Rate (%)	Outage Hours	Rank week of 3/30	Rank week of 3/23
1	HSBC	100	0	1	2
2	Capital One	99.87	0	10	2
2	US Bank	99.87	0	3	4
4	Bank of America	99.75	0	8	8
4	Diners Club	99.75	0	11	11
6	National City	99.62	0	4	1
7	Chase	99.49	0	5	10
8	Wells Fargo	99.11	1	5	6
	Credit Card Index	99.11	0		
9	Discover Card	98.47	0	7	9
10	Citibank	97.54	2	2	5
11	American Express	96.65	3	9	7

E-Banking Web Transaction Performance Index Week starting April 6, 2009

Rank by Speed (seconds)				
Rank	Target	Response Time (sec.)	Rank week of 3/30	Rank week of 3/23
1	Etrade	3.78	1	1
2	WAMU	5.61	2	2
3	US Bank	6.29	3	4
4	Wachovia	6.73	4	4
5	PNC	7.27	5	5
	eBanking Index	7.92		
6	Chase	7.92	6	6
7	Wells Fargo	8	7	7
8	Citizens Bank	8.85	8	8
9	Bank of America	11.33	9	9
10	Citibank	12.2	10	10
11	National City	15.04	11	11

Rank by Success Rate (percentage)					
Rank	Target	Success Rate (%)	Outage Hours	Rank week of 3/30	Rank week of 3/23
1	Etrade	100	0	1	4
1	PNC	100	0	1	4
1	WAMU	100	0	4	2
1	Wachovia	100	0	1	8
5	Citibank	99.75	0	5	7
5	National City	99.75	0	11	4
7	Bank of America	99.62	0	6	1
	eBanking Index	99.61	0		
8	Chase	99.49	0	7	11
9	Wells Fargo	99.37	0	9	10
10	US Bank	99.23	0	8	9
11	Citizens Bank	98.48	0	10	3

Security Notes

Why Payments Must Shore up Its Defenses



Gideon Samid • Gideon@AGSgo.com

In numerous hiding places around the world, some very smart and wily people are asking themselves: "How can we exploit America's digital vulnerability?" The answer could well be: attack its payment systems. The U.S. Navy, Air Force, and Marines

are powerless to protect our payment dynamics. More and more of our goods and services are powered by a counter flow of electronic currency. If an enemy paralyzes our payment system, he paralyzes our shipments of necessary merchandise.

Our digital payment system is superficial in the sense that it is close to the surface of the Internet. Efficiency concerns dictate that merchants, processors, and banks all keep their valued databases just a query away from a stray surfer latching on to the system from anywhere in the world. A typical transaction quickly queues up in one central place for authentication. Knock out this node, and everything piles up waiting, choking the system.

Incremental contamination of our databases is another looming threat. I have seen secret, alarming estimates of how many people there are in various databases with credit scores, payment histories, and character dossiers—only these "people" don't exist!

Size efficiency creates centralization, which in turn engenders vulnerability. A greater and greater ratio of our digital transactions are punched in through fewer and fewer large merchants. The processor community has also consolidated to a few giants, and the few major credit card companies have had no serious competition for years.

What is worrisome is that these big disaster scenarios are dealt with in think tanks and academic institutions, and there they stay. The major players in the digital-transactions realm are too busy with their daily affairs, with yesterday's bit-player hacking scandal. We are not cognizant of those thousands of ambitious, determined, well-funded, and very clever enemies who think day and night about how to spot our vulnerabilities and exploit them.

What every player in the payment networks should do is to allocate time and attention to thinking about this strategic

threat. It is this attention and focus that would allow us to spot vulnerabilities and understand how they can be exploited by our adversaries. It should be directed from management. The payoff would be profound. Anyone who thinks deeply about strategic threats ends up with greater insight into his own system. Insight leads to innovation, efficiency, and profits.

We need to think about prevention and to contemplate counter action and damage control. In some cases that I have been involved in, two transaction partners exchanged a secret one-time pad large key to be invoked in case the prevailing ciphersystem is suddenly compromised. And yes, this always happens suddenly and without warning. The ready-key will allow the partners to use preset communication protocols without any fear of exposing their transactions to a third party. In other cases supplier and customer established an emergency credit to allow for supplies to flow without interruption even if the transaction network breaks down.

In yet other cases, procedures for ad hoc paper currency marked with cryptographic stamps have been devised to allow payment to happen even if an electromagnetic super-shock disables all the computer chips in town. Strategic emergency planning led one merchant to think about what a well-connected malcontent insider could do. This led him to see a structural vulnerability, which he has cured by a protocol that required multiple individuals to effect certain critical changes.

Strategic emergency planning is an excellent exercise for your own people to do. In my experience, outsiders are liable to be too superficial because they can always point to some weak points without really delving into your system. Their compensation is independent of how many weak spots they find, so why bother? Also, consultants will tend to find vulnerabilities for which they have a remedy to sell you, meaning they will overlook or de-emphasize serious problems for which they don't have a solution. We find that strategic emergency planning is a perfect work item for your recently retired professionals on a consulting basis.

There are a lot of disadvantaged people around the world who resent the advantaged life they see in America. Some of these envious people are very smart. They adapt. They are innovative. And they are dangerous. We can't afford to be caught asleep at the switch. ■



Electronic Payments Aim for Critical Mass in Transit

Karen Epper Hoffman

The growing adoption of electronic payments for fare collection on buses, trains, and taxis means new opportunities for acquirers and card networks, but technology and pricing still present hurdles.

Contactless payment is on the move, in more ways than one. Not only is the number of contactless cards growing rapidly—MasterCard Inc. announced in March that 50 million MasterCard PayPass cards were in issue worldwide at the end of 2008, double the number outstanding in 2007—but also transit agencies are increasingly adopting the payment technology.

Further, public transportation agencies are starting to look beyond the closed-loop, transit-only cards or tokens that they have issued for years. Some transit agencies are embracing the use of general-purpose payment cards and even near-field communication (NFC) cell phones for payment on their buses, trains, and subways.

“More and more agencies are implementing fare collection with smart cards; that’s been the big trend in fare collection,” says Sandy Thaw, head of the transit initiative for Visa Inc. “And they’re realizing they don’t need a whole separate service.”

‘Long-Term Vision’

Indeed, transit authorities in cities such as New York, Boston, Atlanta, Los Angeles, Salt Lake City, and San Francisco have either implemented

or piloted the use of mainstream contactless payment cards or fobs for their riders. And many more cities, including Cincinnati, have issued requests for proposals to develop an electronic fare-collection system, according to Thaw.

The financial underpinnings of this new sector have yet to be clarified—and may indeed drive card networks and acquirers to adjust their expectations in terms of interchange fees and co-developing infrastructure. But eventually, proponents say, transit may become the market that boosts contactless payment from an underutilized component of the bank card to one that’s used daily. That could make a transit-enabled payment card the favorite one in a rider’s wallet.

Craig Roberts, manager of technology program development for the Utah Transit Authority, began contemplating the use of electronic fare collection nearly four years ago. At the time, he was aware of various transit agencies, many outside the States in London or Hong Kong, for example, using contactless payment.

“It seemed the advantage was speed and accuracy, and we wanted to explore it,” Roberts says. “Plus, we didn’t have a legacy system for

fare collection that we would have to replace.”

In recent years, buoyed by the availability of contactless card readers and PayPass and Visa payWave bank cards, Roberts led the UTA to develop a fare system that accepts major-brand contactless cards, as well as two of its own electronic passes, Eco Pass and Ed Pass. The proprietary cards, Roberts says, are mainly issued to promote the use of mass transit among Salt Lake City-area ski visitors and college students, and offer steep discounts. The UTA manages and settles these transactions.

Currently, UTA has 520 buses outfitted with card readers in the front and back entries. Utah’s light-rail line, Trax, which runs commuter train services, also takes contactless payment.

Visa has worked with the UTA. And, according to Thaw, the development here, as in other cities, is two-fold: getting transit agencies to accept contactless payment, and then encouraging more issuers in the local market to offer these tap-and-go cards. “Our long-term vision is that instead of developing their own closed system, these [agencies] become merchants on the VisaNet system,” Thaw says.

‘Killer App’

That’s a common desire among card networks, issuers, and acquirers alike, given that mass transit is a wide-open market dominated by cash

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payment. First Annapolis Consulting Inc. pegs the annual U.S. transit market—including parking, taxis and limousines, and tolls, along with mass transit—at \$40 billion. Transit thus represents a large, steady, and growing stream of transactions.

Earlier this year, the American Public Transportation Association (APTA) announced that public transportation ridership in 2008 had risen to its highest level in 52 years. Despite decreasing gas prices and increasing job losses toward the later half of the year, Americans took 10.7 billion trips on mass transit—a 4% increase over the number of trips taken in 2007.

And perhaps it's not surprising that two markets where light-rail ridership increased by double-digits were

Salt Lake City (12.3%) and the state of New Jersey (10.9%), where mainstream contactless payment is already afoot or under development.

Pradip Mistry, vice president for engineering at Cubic Corp., the San Diego-based developer of fare-collection systems, sees terrific future opportunities for transit agencies to let riders use their cards on transit systems outside their home cities. Alongside transit agencies leveraging the contactless systems put in place by banks, he sees more systems adopting the contactless fare media standard (CFMS), as Los Angeles and Miami are doing, with Cubic technology that eventually will let transit users in one city or state use the same application to pay fares on other systems.

Nonetheless, Mistry believes that while more agencies are moving toward the adoption of contactless bank cards for payments, there will be a combination of bank card and proprietary systems developed here for at least the next two years. Cubic helped pioneer the use of closed-loop contactless transit payments in Washington, D.C. more than a decade ago. The company currently has 60,000 of its readers installed worldwide in at least 17 markets.

And, in some cases, transit authorities are leapfrogging past contactless cards and jumping right into what some experts believe will be the ultimate way to pay in transit: mobile. Early last year, some 230 riders on the Bay Area Rapid Transit (BART) rail in San Francisco participated in a four-month pilot. In the test, which ended last May 30, riders were encouraged to use their NFC-outfitted Samsung cell phones to tap-and-pay their way into any one of BART's 43 stations. Test participants included processor First Data Corp. and contactless reader and software vendor ViVotech Inc.

NFC-enabled handsets contain a special chip that can communicate over a very short range—typically about 4 centimeters—to establish a link with another NFC device, such as a point-of-sale reader. The chip interacts with the phone's operating system and with an electronic wallet in the phone containing card-account details.

The project's sponsors learned valuable lessons about riders using mobile payment, and also about using a contactless transit application alongside other payment applications. Participants not only used their devices to pay for 9,000 rides on BART, they also used their handsets to pay for meals at Jack in the Box fast-food restaurants via a proprietary prepaid application embedded in the phone.

Tom Savage, vice president of business development for Mobile

Card Payments Go Airborne

The skies are becoming much friendlier to the payment card industry.

While mass transit chugs forward into electronic payment, the airline industry also is expanding its acceptance of cards for onboard purchases. So far, Southwest, Frontier, JetBlue, AirTran, Midwest, Virgin America, and Alaska airlines have all nixed cash payment on flights, requiring passengers to pay by credit or debit card for their food, beverages, entertainment, and extras.

The so-called "cashless cabin" trend is catching on with more and larger carriers. Since late 2008, US Airways has tested card payments on about 600 flights, though it still accepts cash. American Airlines, which had tested the use of card-only payment, announced that this summer it would go cashless on domestic flights and flights between the U.S. and Canada. United Airlines has also said it would replace cash with card payments on all of its domestic and several of its foreign routes.

Why are card payments taking off? Airlines like cards because they save their over-taxed crew members from having to make change or manage cash, which has to be stored in hotel rooms in the case of layover flights. Also, card payment tends to boost the amount travelers spend. In a typical transaction, the flight attendant swipes the card in a portable terminal; transactions are submitted into the card networks after the plane lands.

Alison Croyle, spokeswoman for New York City-based JetBlue Airways Corp., which has been accepting card payments in its cabins since October 2007, describes the move as going "extremely well. It's such a hassle-free way to purchase alcoholic beverages, headsets, pillow and blanket sets. It's just a better experience."

Croyle adds that the revenue from on-board purchases doubled in one week after launching card acceptance, which initially was limited to the purchase of alcoholic beverages.

Commerce Solutions at First Data, says that the pilot provided “a lot of learning about enhancing the prepaid platform. We all agree that mobile payments are coming, and the feedback is that the product is durable. I think this is going to be the killer app on the mobile side.”

Even in the taxi and limousine market, which has been adopting contactless in markets such as New York City and Las Vegas, mobile payment is also being tested. About 35 cab companies in 31 locales, including Los Angeles, San Diego, San Francisco, and the Silicon Valley, are offering passengers the option of paying via BlackBerry or iPhone smart phones with an application from RideCharge Inc.

Using the application, passengers can book and pre-pay a taxi ride using their BlackBerry or iPhone. Sanders Partee, president of Alexandria, Va.-based RideCharge, would not say how many taxi rides are paid through RideCharge, but says the number is doubling month over month.

Writing off Investments

Cubic’s Mistry sees several advantages ultimately weighing in favor of mobile payment for transit, particularly the security that is already inherent in mobile applications and the ability to add value to prepaid accounts wirelessly without having to visit a point-of-sale device to top up. While adoption may be slow in the short term, since so few phones in the U.S. are NFC-compatible, once a majority of cell phones are enabled in a few years, this form of payment will be used more frequently for transit, he predicts.

Whether by phone or by card, payments pundits agree that mass transit likely will be a tremendous sector for contactless payment growth. But bank card acquirers and issuers will reap more benefits if they are willing to support the transit agencies, some observers say.

In a March blog, Bruce Cundiff, senior analyst at Javelin Strategy & Research, cited ViVOtech’s announcement of integration with Cubic, the transit-systems developer, as a significant step forward for contactless acceptance, issuance, and for transit itself.

‘We all agree that mobile payments are coming, and the feedback is that the product is durable.’

“Card acceptance at transit is a big motivator for issuers,” Cundiff said in his blog post. “It’s a market that is both high profile and also potentially lucrative for transaction volume. This could definitely serve to motivate issuers to ramp up contactless issuance.”

But for many transit agencies, the decision to begin accepting

electronic payments may be complicated by variables involving cost and control. “Are [transit agencies] hesitant about how to go forward? Yes,” says Martin Schroeder, APTA’s senior program manager of rail and energy programs. “They’re afraid of being locked into a system.”

Long before contactless bank cards had entered the market, big-city transit agencies implemented their own closed-loop payment systems using magnetic-stripe cards or transit-only contactless cards, such as New York City’s MetroCard and Los Angeles’s Transit Access Pass (TAP). These systems, experts say, likely cost in the tens of millions of dollars to build and support.



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Now that there are more contactless cards in the market, and a bevy of technology providers and processors to support them, agencies can more easily offload the development and management of these payment systems to outside parties. But for many, that choice means giving up some control.

And for some, it also means potentially writing off recent investments in proprietary systems. Los Angeles, for example, developed its own fare-collection system several years ago with TAP. The city “invested a lot of money in that service,” according to Visa’s Thaw. But this year, the city will begin piloting a year-long program where it adds Visa’s payWave contactless chip to the card. “They’re looking for ways to increase the value to their riders, to get more riders to use it,” Thaw says.

Still, Thaw says, “I suspect we’ll see a lot more of the smaller [transit agencies] opting to go with a contactless bank card, since they don’t have other investments to worry about.”

Rethinking Fees

For the agencies that did not choose to build their own, there is still the issue of ceding some control of their payments system to the card networks, and also of discount rates, the largest component of which is the acquirer-to-issuer transaction fee

contactless payment was much less than the proprietary route. “Our intention is to piggyback on their infrastructure and standards,” he says.

First Data’s Savage believes the metrics of adopting open contactless

In late March, for example, an Illinois state senator introduced a bill that would require Chicago’s vast Metra rail system to accept card payments for tickets. But according to local press reports, Metra



A contactless card reader at a Utah Transit Authority light-rail station.

payments systems will vary greatly, based on the investments the agency has already made as well as the size of the service area. “What works for the New York MTA is going to be very different for Cincinnati or smaller properties,” he says.

And penetrating transit agencies, whether they’re large or small, may also require acquirers and card

doesn’t take cards because of the processing fees.

Thaw argues that, when compared to the cost of establishing and running an independent network, paying a discount rate would likely be much less. As Todd Ablowitz of Denver’s Double Diamond Consulting sees it, “If I am spending 8% of every dollar to run my own system, it’s much better to pay interchange.”

“The interchange issue is there,” Roberts admits, “but we also need to see that in the context of other fees [in a closed system]. But it seemed to us that the business case [of an open system] made more sense to us.” Still, he adds that “both Visa and MasterCard will have to take a hard look at how they charge fees.”

Summing up, Roberts says, “We’ve tried to position ourselves to take advantage of a huge investment in a broader industry ... but getting folks to agree on how to split up the money is going to take a while.” **DT**

‘What works for the New York MTA is going to be very different for Cincinnati or smaller properties.’

called interchange. Acquirers pass that fee on to their merchants.

Roberts of UTA chose to go the open bank card route because contactless payment cards were beginning to emerge, because it offered the agency opportunities for cross-promotion with banks, and also because the cost to build and support mainstream

networks to rethink their fee structures if they want to gain traction in a new market with such a regular and growing base of transactions. Interchange, which is set by Visa and MasterCard and continues to stir controversy among merchants, likely will be in the sights of this new card-acceptor class.



If Only Health-Care Payments Could Be Like Retail Payments

Lauri Giesen

Health care is moving, finally, toward systems that tell patients exactly what they owe—and process their payment—before they leave the doctor's office. Still, despite a flurry of recent developments, progress has been agonizingly slow.

Most patients would not want the quality of their health care to resemble a retail experience. But they might want the health-care payment to be treated in a more retail-like manner. And health-care providers certainly would like to see that happen.

In the processing of health care claims and payments, one of the big buzz words these days is “retailization.” What that means is that patients know immediately after receiving a medical procedure how much they owe and can pay on the spot—often in an electronic form involving a credit, debit, or prepaid card.

Bringing health-care payments to a level closer to the retail world “provides one of the biggest opportunities for improvement in health-care payments processing,” according to John Reynolds, president of Milwaukee-based Metavante Health Care Payment Solutions.

In a retail environment, point-of-sale terminals can automatically read the price tag and tell a customer exactly how much purchased items cost and then charge that amount to a credit or debit card if the customer requests. Even if there is an additional markdown

not reflected on the price tag, the system should know the correct price.

But that's not the case in health care. Rarely is it known if the patient's insurance will pay part of the cost of the treatment, and if so, how much. As a result, doctors' offices and hospitals have to make educated guesses at how much the patient should pay or bill the patient later—the latter being a very costly alternative.

“In a Nirvana state, there would be real-time adjudication,” says Red Gilen, analyst with Celent LLC. “Leaving a doctor's office would be just like a checkout at a retail store. A claim would be sent to the payer and there would be a response within 10 seconds telling the health care provider what the patient owes.” Then a payment for that amount could be completed immediately.

While such a world is far from reality today, there have been strides toward that level. At the minimum, an estimate of what the patient owes can be determined and the patient can approve a payment up to a specified amount. When the final amount owed is determined, settlement could automatically be made without sending the patient a bill or a payment schedule could be established.

Prompting this desire for real-time adjudication of patient payments is the fact that patients are paying more of their total health-care bills, making it more important for health-care providers to get payments quickly from patients.

“In the old world, where everyone had a \$20 copay, it was not difficult. The \$20 would be charged to a credit card,” says Ed McLaughlin, senior vice president of bill payment and health care for MasterCard Worldwide.

That's why payment companies, including MasterCard and Visa Inc. and their member banks, spent a lot of time in the past working to get health-care providers simply to accept credit cards to handle what were generally small, but certainly well-defined, payments at the time of service.

Now, though, that emphasis has changed. “In the mid 1990s we focused on broad acceptance of our card,” says Stacy Pourfallah, senior business leader for Visa. “But over the last two to three years, we've been focusing on working toward real-time payments.”

An example of that new focus is an alliance announced recently between Visa and Carrollton, Texas-based Preferred Health Technology Inc. (PHT), a provider of electronic payment and transaction-processing services for the health-care industry. The alliance will use PHT's A-Claim technology system, which enables health-care providers to verify insurance eligibility,

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