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The Trusted Advisor To The Payments Industry

All in a Name?

Commentary on Operation Chokepoint by Kurt Strawhecker, Managing Partner TSG

OMAHA, NE, August 06, 2014: The owner of a small online art boutique was surprised when she was denied a merchant account, not once - but twice, by two major national merchant acquirers. Later, she learned the actual reason for not being allowed to accept credit cards for her beautiful and unique woven and needlepoint items and patterns - it was due to the unfortunate fact that her name is "Gun" and part of the name of the boutique business includes her name.

This is just one example of the effect of Operation Chokepoint (OCP) which has been using the blunt force of branding entire merchant categories that are legal businesses as "high risk" by government regulators.

OCP has been well documented throughout the industry, and has been receiving additional national mainstream press attention of late. In addition, several developments in recent weeks indicate that some of the concerns about the initiative are being heard in Washington.

We believe that the entire industry agrees with the ultimate objective of OCP – detecting and terminating the "bad actors" in the payments industry. In this case we are defining bad actors as: merchants that sell their products and services typically in a non-face-to-face sales environment, that generate a high degree of customer dissatisfaction, and in many cases are selling a service that is non-existent or lead to an excessive number of chargebacks by consumers.

Bad actors need to be removed from the electronic payments system, and we share those concerns. Our industry spends huge resources on a daily basis to not allow bad actors and deceitful merchants enter and use the payments system.

However, we have two major concerns in the way OCP has been implemented:

- First, it attempts to deputize all members of the payments eco-system who may or may not be in a position to affect the actions of the bad actors. Holding processors, banks, payment gateways and ISOs potentially criminally liable for the actions of some merchants is a slippery and dangerous slope. The industry has always self-regulated itself to effectively minimize these detriments to the overall industry.
- Second, is the collateral damage done to perfectly legal merchants when broad swaths of industry descriptions are used due to a concern that bad actors may be in those merchant types. Underwriting and risk management requires a targeted approach. We're concerned that blameless merchants are being swept up by using this blunt force approach. This action is somewhat unprecedented for the payments industry – in the past the industry has not provided payments services to illegal businesses such as illegal gambling, illicit drugs and illegal porn. Since card acceptance is in many cases critical to the success of a business, this can be a crippling action which can severely impact the business.

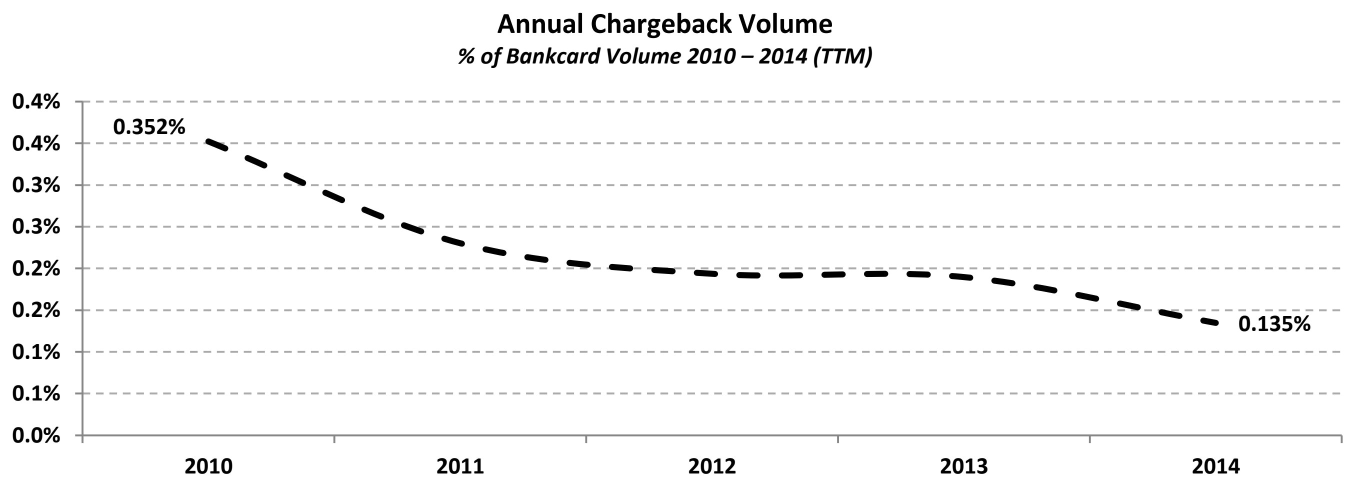
But Washington may finally be heeding the appeals from the payments industry. As noted by The Washington Times on July 28:

“Gun retailers are no longer on a hit list deemed ‘high risk’ by the Federal Deposit Insurance Corp. after the banking regulator formally withdrew Monday the list it put together that outlined what merchants may be considered risky for banks to do business with as part of the Obama administration’s ‘Operation Choke Point’. The agency said its explanatory warning list ‘led to misunderstandings’ about how it’s supervising banks’ ties to third-party payment providers, according to Bloomberg News. The regulator said it never meant to prevent banks from doing financial transactions with the types of businesses on the list…

…Richard Osterman, the agency’s acting general counsel, admitted to the American Banker newspaper Monday that the list had been ‘misinterpreted’ by financial institutions.”

The leadership on the issue by the Electronic Transactions Association (ETA) – especially through its personal outreach to lawmakers by its proactive Government Affairs staff - have helped tremendously on this issue.

Let’s hope the action last week is the first by the FDIC in Washington’s retreat from this blunt force approach to the payments industry. As evidenced by the chargeback rate among the SMB market shown in the chart below, the payments industry has been successful in bad actor merchant oversight. Washington should allow the industry to continue its self-regulated and governed approach to risk and fraud which has worked well in the past.



Source: TSG proprietary database of more than two million U.S. card accepting merchants

About TSG

The Strawhecker Group (TSG) is a management consulting company focused on the payments industry. The company specializes in providing financial institutions, merchant acquirers, card associations, ISOs, processing companies, large merchants, and the investment community with advisory services to maximize their growth and profitability. TSG is also a resource of merchant acquiring industry research, benchmark studies and developing trends. For more information please visit www.TheStrawGroup.com.