Payments Disruptors, Innovations and Trends
9 Technologies to Watch
Almost 70 years ago in 1949, a businessman named Frank McNamara was hosting a dinner in New York when he realized he had forgotten his wallet. That experience prompted Mr. McNamara and his business partner, Ralph Schneider, to launch the Diners Club Card in 1950. This new payment form, known as a charge card, was used primarily for travel and entertainment purposes, and required cardholders to pay off balances in full each month.

The concept of accessing a credit line by a plastic card was so simple, yet so brilliant, that adoption spread quickly. MasterCard® reports that in 1959 card issuers began offering cardholders the option to maintain a revolving balance. The modern credit card was born.

And, according to creditcards.com, 1959 was also the year when “open-loop” systems were introduced. In contrast to the industry’s existing “closed-loop” systems that required each issuer to authorize and handle all aspects of their respective transactions, open systems called for “interbank cooperation and funds transfers.”

This move set the stage for a major industry advancement in 1966. That year, Bank of America established the BankAmerica Service Corporation that franchised the BankAmericard brand (later to become Visa). This was also the year the Interbank Card Association was formed by a group of credit-issuing banks that pledged “membership” in this nationwide association.

Initially called MasterCharge, the ICA was eventually renamed MasterCard – and today the MasterCard network remains Visa’s number one competitor. According to PBS, during the 1980s the number of credit cards more than doubled, credit card spending increased more than five-fold, and the average household credit card balance rose from $518 to nearly $2,700.

And in 1983, another new innovation changed the face of payments forever: the debit card. For the first time, consumers could access funds directly from their checking accounts without the hassle of writing a check.

Fast forward to today. While credit and debit cards remain the foundation of the payments industry, advances in fintech have since expanded their utility in ways Mr. McNamara never could have imagined.

From digital wallets and P2P platforms to prepaid debit cards and mobile security apps, a new generation of payments disruptors is quickly emerging today, and is poised to transform the industry all over again.
THE HISTORY OF CREDIT AND DEBIT CARDS

New York businessmen Frank McNamara and Ralph Schneider founded Diners Club International with $1.5 million in capital.

THE WORLD’S FIRST CHARGE CARD initially served 27 participating restaurants and 200 members.

American Express introduced the first plastic card. Banks that offered their own charge cards began allowing customers to revolve balances.

**THE MODERN CREDIT CARD WAS BORN**

American Express and Bank of America **ISSUED FIRST CHARGE CARDS.** “Open loop” systems were introduced as well. And banks that offered their own cards began allowing customers to revolve balances.

Bank of America franchised the BankAmericard brand (later to be known as Visa). Four California banks joined forces to create the **INTERBANK CARD ASSOCIATION,** which later became MasterCard.

Banks began **ISSUING DEBIT CARDS** (Federal Reserve Bank of St. Louis)

Consumers conducted MORE TRANSACTIONS WITH DEBIT CARDS than checks. (Brighthub)

**THE CREDIT CARD ACT** restricted some rate and fee practices, required new disclosures, and limited marketing to young people.

The Durbin amendment, a last-minute addition to Dodd-Frank, **LIMITED DEBIT INTERCHANGE FEES**

The number of **DEBIT CARD PAYMENTS** (including pre-paid cards) grew to 69.5 billion with a value of $2.56 trillion. The number of **CREDIT CARD PAYMENTS** reached 33.8 billion, with a value of $3.16 trillion. (Fed’s 2016 payments study)

Technology marches on, sometimes a bit too quickly. While many advances in card payments may appear challenging – or even burdensome – at first, embracing innovations with sound strategies and investments can greatly enhance cardholder engagement, security and convenience.

Here is what you need to know about today’s market disruptors...
Typically purchased at retail outlets or online, prepaid cards are utilized by the underbanked and unbanked, and are also popular with millennials. In addition to generating fee income, prepaid debit cards are exempt from interchange caps.

If a credit union’s field of membership consists of unbanked or underbanked consumers, or if a credit union aims to target that market, prepaid cards are an excellent way to provide electronic access. Additionally, prepaid cards can generate noninterest income and interchange income at a higher rate than standard (non-reward) debit cards.

**CO-OP** offers client credit unions a turnkey, affordable prepaid card product that includes card production and packaging, web apps, reporting, chargebacks, escrow, risk and member servicing.

**Bottom Line:** Credit unions are advised to bring prepaid cards into their portfolio to capitalize on their revenue potential and the unique market niches they serve.
Despite the risks, ACH has potential

Online shopping volume has exploded with the proliferation of smartphone apps. While cards are still the primary digital payment method, ACH or pay by checking account is increasingly being used online, especially at top merchant sites such as Amazon and Target.

While ACH processing is growing in popularity, the payment platform is not without its drawbacks. The automated clearinghouse does not preauthorize transactions today, exposing issuers to fraud and collectability issues.

**Bottom Line:** Should better fraud and loss mitigation capabilities become available, ACH processing could take off.
More than 25 percent of U.S. smartphone owners use mobile payment apps at least once a month, according to 2016 research from Parks Associates. And increasing merchant adoption of "wave and pay" near-field-communication (NFC) technology is laying the foundation for more widespread usage. Which means, if you are not in this market already, it is time to get on board.

Many experts project that 2017 will be the year mobile payment apps and digital wallets like Apple Pay®, Android Pay™ and Samsung Pay gain mainstream adoption – unless retailer wallets and mobile apps like Walmart Pay and Kohl’s Pay take the wind out of their sails. Apple Pay is currently reporting significant growth – with one million new users per week.

Hundreds of credit unions already integrate directly with Apple Pay and other mobile provider payment apps. Others leverage the cooperative nature of credit unions by using CO-OP to enable mainstream payment apps like Apple Pay, Android Pay and Samsung Pay.

According to Mercator, consumers who use mobile payment apps are using credit cards as preferred payment sources, rather than debit cards. Even when consumers enter a debit card into a mobile app or wallet, it is not likely to be the default card. However, mobile apps are often used for small-dollar, routine transactions like grocery purchases, making debit cards a better choice.

Mercator has found that consumers are less likely to switch cards once they enter credentials into their mobile payment apps. Because of this dynamic, it is critical that your cards, both credit and debit, are entered first. Incentivizing debit and credit cardholders to load your cards into digital wallets and use them at the point of sale could significantly increase revenues and help build cardholder engagement.

**Bottom Line:** If they aren’t already, your members will very soon be using a digital wallet to pay at the point of sale. Offering Apple, Samsung and Android Pay will ensure that you can provide this tool of convenience for all the phones your members use. You might also consider offering your own credit union–branded wallet.

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**CREDIT UNIONS HAVE THREE OPTIONS WHEN IT COMES TO MOBILE PAYMENTS:**

1. **BUILD A SEPARATE APP**
2. **INTEGRATE A SOLUTION INTO THEIR MOBILE BANKING APP**
3. **OR DO BOTH**

Building a proprietary payment app is currently only feasible for the largest financial institutions, like Citibank and Capital One, which have both launched their own payment app.
In a July 2016 *Wall Street Journal* article, former Google and PayPal executive Osama Bedier reported, “Whoever wins the battle for person-to-person payments ultimately has the ability to win all of payments because customers want control over their own money.”

J.P. Morgan Chase & Co., Wells Fargo & Co. and other large banks agree – and joined forces to create a P2P service called clearXchange, a revolutionary new payments platform that allows real-time settlement of person-to-person transactions.

Payments Network Early Warning has since acquired clearXchange and will convert it to its exciting new P2P service, *Zelle™*. In partnership with CO-OP, this financial institution–led digital payments network will enable members of participating credit unions to send money to anyone with a U.S. bank or credit union account – instantaneously – using the RealPay by CO-OP P2P app.

P2P platforms such as *Zelle* are also laying the foundation for the future of bill pay applications, which will leverage the technology to expedite payment processing and enhance the user experience. CO-OP will introduce a new version of RealPay in late 2017 that is fully integrated with the *Zelle* network.

**Bottom Line:** Person-to-person payments must be considered in a credit union’s overall product offering. While P2P platforms don’t typically produce fee income, services such as Venmo are so popular among millennials they have significantly impacted what these tech-savvy consumers expect from payments. Ultimately, a P2P app will serve you well as a sticky product to help nurture member loyalty. But the biggest benefit P2P delivers is its ability to position your credit union for bill payment functionality down the road – an advantage that could drive member growth and cross-selling opportunities exponentially.
EMV is making inroads nationwide finally

EMV is quite simply the global standard for card security – and has virtually eradicated card-present fraud in more than 80 countries that have migrated to the technology. And despite early challenges with adoption in the U.S., EMV migration has made significant progress here over the past two years.

According to Mercator, only 32 percent of credit cards in circulation – approximately 175 million – had an EMV chip as of year-end 2014. That rate has since increased dramatically, and by the end of 2018, nearly all credit cards (Visa, MasterCard, American Express and Discover) are expected to utilize EMV chips.

Retailers have been relatively slow to comply with EMV to date. Mercator estimated that as of year-end 2016, only 68 percent of terminals were EMV capable and 41 percent were actually enabled. Those figures are expected to rise to 84 percent and 65 percent respectively by the end of 2017. Mercator also expects EMV transaction volume to increase, from $890 billion at the end of 2016 to $1.465 trillion in 2017.

It is important to note, however, that adoption so far has been largely driven by big box merchants like Walmart and Target. Because these retail giants capture such a large market share, the percentage of compliant terminals is overstated when compared to the number of compliant merchants – most mom-and-pop retailers across America are not yet compliant, exposing consumers to counterfeit fraud risk.

Bottom Line: Credit unions should provide EMV-compliant debit and credit cards to members and take every step necessary to ensure that their ATMs are EMV-compliant as well. Credit unions should also take measures to address card-not-present fraud, which is on the rise in the wake of EMV adoption. Card controls and alerts are a great complement to the security provided by EMV. Equipping members with these mobile security apps is the best way to protect their data during card-not-present transactions.
Rewards programs boost card usage and spend when well executed

By every measure, rewards programs work. In fact, *CU Times reported in November 2016* that 42 percent of baby boomers participate in credit card rewards programs. The research also found that three-quarters of Americans consider rewards to be one of the most important factors when choosing a credit card. And according to Mercator, millennials are the most motivated demographic to obtain and use debit cards that offer rewards.

While credit union account reward programs use gift cards, cash or merchandise to attract consumers, new credit card account reward programs tend to feature points or statement credits, *CU Times* said.

And as appealing as consumers find rewards programs, card issuers can face challenges with adoption and implementation. In a number of studies, consumers have cited unclear value propositions, lackluster or insufficient program benefits and irrelevant offers as reasons they don’t join or keep loyalty rewards programs.

In order for your rewards program to deliver on its promises, you should ensure that merchant rewards are relevant, inspiring and convenient. Allowing cardholders to combine points across family members and accounts can build excitement for your program as well, as members will accumulate points and reach rewards milestones at a much faster rate. And enabling members to apply points immediately to purchases helps give them the “instant gratification” today’s consumer expects.

The Member Rewards by CO-OP loyalty program can help on all fronts by providing you with several options, including points-based, cash back, merchant funded and relationship rewards – or any combination thereof.

**Bottom Line:** Credit unions need to offer a rewards program to engage member cardholders, and should offer a broad range of redemption options that appeal to a diversity of members. Investing in data analytics tools, such as *CO-OP Revelation*, can provide the critical member data credit unions need.
Instant issue has become an invaluable tool for credit unions, allowing them to ensure uninterrupted card access for members.

Factors driving instant issue adoption include an increase in card data breaches, competitive pressures and EMV. Each of these scenarios presents a situation in which members may find themselves without access to their card, at least temporarily – and feeling terribly inconvenienced as a result.

According to Mercator research, as instant issue becomes more prevalent, cardholders who have simply forgotten their card at home – not lost, forgotten – are more likely to stop at a nearby branch to replace it than return home to get it.

**Bottom Line:** Members who want to use their card that badly should be supported at the expense of a replacement card because it will encourage ongoing usage and loyalty.
PFM tools have tremendous potential to increase card usage and maintain or even grow outstanding credit card balances – especially among millennials.

In fact, according to research from Accenture, 67 percent of millennials “are interested in their bank providing tools and services that help them create and monitor a budget.” A 2016 Novantas survey reported by MX reveals that nearly half of millennials who are looking to switch banks want their new institution to offer PFM, and that interest in PFM grew by 19 percent annually among all consumers looking for a new financial institution. And Forrester Research finds that digital money management is essential to “quash the disruptive threat from digital banks” and “garner the loyalty of younger customers.”

Consider also that PFM technology is quickly advancing. Today developers are creating PFM tools that automatically transfer funds from the checking account to pay credit charges that fall into predetermined categories to maximize rewards benefits. For example, if a credit card offers cash back on grocery or dining charges, PFM tools would recognize those charges and automatically transfer them from the checking account, allowing the member to collect card rewards without increasing their outstanding balance. While this would decrease interest income, more card usage would produce more interchange revenue and cover the cost of the rewards program.

PFM tools could also be used to stretch credit card payments (and interest income) over a longer time frame using skip payment and other options when checking coffers run low. This function would increase interest income and could offset the practice of automatically transferring funds from checking to pay for new charges.

**Bottom Line:** Credit union core software providers and other fintech firms are beginning to roll out a new generation of PFM tools. These off-the-shelf solutions could enable credit unions to offer PFM faster and at a lower price than they otherwise could achieve by building their own proprietary software.
Card controls and alerts give your credit union ongoing mobile access to members for important messages – including those concerning fraud. And, according to industry research, these tools transform payments in two very important ways: they have proven to increase card usage by more than 23 percent while reducing fraud costs by as much as 40 percent.

In fact, card controls and alerts are so effective in the fight against fraud that Visa issued a bulletin in 2015 requiring all credit, debit and prepaid issuers to have a fraud alert service in place by October 2016.

Instead of considering this Visa mandate as a costly undertaking, issuers should leverage these services and market them to their advantage. Not only does alert technology mitigate card fraud and losses, but it also gives the issuer a value-added communications platform to interact with cardholders.

Mercator provided the following suggestions to successfully implement the strategy:

**Avoid alert fatigue**
Make sure messages are meaningful, and allow members to set their own parameters for receiving messages.

**Integrate alerts for online and mobile banking apps**
That way, cardholders won’t receive an alert regarding a transaction and then be alerted again when the transaction clears their account.

**Don’t ever leave members hanging**
When sending an alert, especially concerning potential card fraud, provide a link to card services, member services and/or information regarding the closest branch so members can resolve the situation.

**Add controls that allow members to restrict card usage**
For example, allow members to refuse overseas transactions when they are not traveling to prevent fraudsters from striking abroad. Members can also turn online purchase authority off when they don’t need it to reduce card-not-present fraud. Even better, instruct your members to keep their cards “turned off” whenever they are not in use. Mobile apps, such as CO-OP’s CardNav, allow users to turn cards off – and back on again for transactions - on demand, for optimum security. Having these options puts members in total control of when, where and how much their cards can be used – a benefit that not only enlists them in the fight against fraud, but also engages them in your card products and brand.

**Bottom Line:** Ensure that alerts are provided for all transactions and that they originate from the fraud department. Partnering with cardholders to battle fraud is a highly effective strategy that both reduces their risks and increases their engagement with your card products and brand.
Typically purchased at retail outlets or online, prepaid cards are utilized by the UNDERBANKED AND UNBANKED, and are also popular with MILLENNIALS. Prepaid cards can generate NONINTEREST INCOME AND INTERCHANGE INCOME at a higher rate than standard (non-reward) debit cards.

Prepaid accounts are one of the financial industry’s FASTEST GROWING PRODUCTS.

Because mobile payment apps use card-based funding sources, they can lead to INCREASED CARD USAGE AND INTERCHANGE REVENUE.

More than 25 PERCENT of smartphone owners use mobile payment apps at least once a month.

Because mobile payment apps use card-based funding sources, they can lead to INCREASED CARD USAGE AND INTERCHANGE REVENUE.

Once a default payment card is loaded into a mobile payment app, it typically STAYS ON TOP OF THE PHONE INDEFINITELY – consumers rarely switch out cards.

ACH or pay by checking account is INCREASINGLY BEING USED FOR ONLINE PURCHASES, especially at top merchant sites such as Amazon and Target.

The payment platform is not without risks, as the automated clearinghouse does not preauthorize transactions today.

Should better fraud and loss mitigation capabilities become available, ACH processing could take off.

P2P platforms are laying the foundation for the FUTURE OF BILL PAY APPLICATIONS.

Real-time P2P platforms are quickly emerging and poised for rapid growth.

Millennials and other tech-savvy consumers are embracing P2P apps to TRANSFER FUNDS AND MAKE EVERYDAY PURCHASES.
Consumers today expect their cards to be **replaced on demand, any time and for any reason** – not just when they are lost or stolen.

**Instant issue has proven to increase card usage**.

With so many players in the payments industry, services like instant issue are becoming increasingly important to **attract and retain cardholders**.

EMV has virtually **eradicated card-present fraud** in more than 80 countries that have standardized on it.

**EMV transaction volume is expected to increase from $890 billion at the end of 2016 to $1.465 trillion in 2017**.

**U.S. adoption so far has been driven by big box merchants** like Walmart and Target – most mom-and-pop retailers across America are not yet compliant.

75 percent of U.S. consumers consider rewards to be **one of the most important factors** when selecting a credit card.

The most effective rewards programs offer a **range of redemption options** to appeal to a diverse cardholder base.

**Debit rewards are a market differentiator** for credit unions as most banks overwhelmingly favor – and focus resources on – their credit rewards programs.

An informed cardholder is more likely to **reach for that card more often**.

**Card controls and alerts reduce fraud losses by up to 40 percent**.

**The platform also serves as a value-added communications tool** to interact with cardholders and improve their user experience.

Members who use card controls and alerts increase card usage by more than 23 percent, according to industry research, and tend to be **more engaged with the credit union brand as well**.
True innovation can be disruptive. However, most of the technological challenges presented to credit unions today represent opportunities to grow card portfolios, better serve members and build revenues and profits.