



# Negotiating Credit Card Processing Agreements

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# **Part I: Negotiating Processing Agreements for Card and Merchant Portfolios**

# Definitions and Process

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## **Types of Card Processing Agreements**

- Issuing Agreements: Processing for issuers that require processing for payment card portfolios
- Merchant Portfolio Agreements: Processing for banks, ISOs, PSP / aggregators and other entities that have merchant portfolios

## **Negotiation Process**

- Objectives and requirements
- Potential processors
- RFP and evaluation
- Term sheet negotiations
- Contract negotiations

## **Contract Documents**

- Customer or processor paper
- Content and structure

# What's Important?

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## **Customer Priorities**

- Scope definition
- Performance
- Pricing
- Flexibility and leverage
- Compliance
- Fair allocation of risk

## **Processor Priorities**

- Same priorities as customer, but with different perspective
- Standard processes
- Flow-through of network requirements
- Expand relationships with customer (and merchants)

# Scope

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## **Implementation and Conversion**

- Requirements definition
- Gap analyses
- Contract documents
- Change management
- Acceptance testing

## **Recurring Services**

- Scope descriptions
- “Sweep” clauses
- Retained responsibilities
- Service evolution
- Enhancements
- New services
- Business continuity

# Performance - Generally

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## **Performance Standards**

- Service descriptions and documentation
- Warranties
- Customer policies and procedures
- Processor policies and procedures
- Industry standards
- Service Levels

## **Service Level Methodology**

- Metrics – objective and quantifiable
- Measurement tools and process
- Measurement period (typically monthly)
- Reporting
- Baselineing

# Performance - Sample Metrics

Category	Sample Metric
Availability of each key system	99.xxx% availability during scheduled uptime
Processing timeliness	Structure depends on function – e.g.,: <ul style="list-style-type: none"> <li>• System update to occur by 7:00 am each day</li> <li>• If input is in by x time, output must be delivered by y time.</li> </ul>
System Response	Response time for authorization transaction < 1 second
Processing accuracy	Accuracy of key processing and reporting functions - measured through incident reporting and/or sample audits
Service Desk	ASA and Abandonment Rates
Incident Management	Response within ___ and resolution within ___ for x% of incidents
Merchant Metrics	Dispute Management - Retrieval request fulfillment and resolution times
Merchant Services (as applicable)	<ul style="list-style-type: none"> <li>• X% boarded and set-up within ____</li> <li>• Timely and accurate statements</li> <li>• Service desk</li> <li>• Online response times</li> </ul>
Compliance	Timely / successful completion of compliance requirements (e.g., SSAE audits, DR testing)
Customer satisfaction	Surveys, call monitoring

# Performance - Service Level Credits

Issue	Customer	Processor
Credit calculation	- Fixed amount - X% (Weighting Factor) * Y (% of fees)	
Amount at Risk	10 – 15%	0 – 10%
SLA Weighting	150 - 250 points (dynamic)	100 points (fixed)
Applicable Fees	% * Total Monthly Fees	% * Fees for Specific Service
Escalating \$	Yes	Depends
Other Remedies	Non-exclusive remedy	Sole and exclusive remedy
Earn-back	No	Yes
Improvement	Automatic	Negotiated
Termination	Specific SLA threshold	Only if material breach
Excuses	Specific and limited	General and broad
Bonuses	Depends	Yes



# Pricing – Implementation and Conversion

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## **Implementation**

- Pricing methodology
  - Fixed fee or T&M
  - Payments terms – monthly, milestones and/or hold-back
- Allocation of risk
  - Budget overruns
  - Delay
  - Scope changes
- Processor Bonuses

## **Conversion**

- Initial conversion
- New portfolios

# Pricing – Recurring Fees

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## **Metrics**

- Bundled vs. a la carte fees
- Card Processing Metrics – active vs. inactive accounts
- Merchant Processing Metrics – typically transaction-based
- Tiers

## **Baselines or “fence posts”**

- Volumes assumed in bundled fee
- Variable fees
- Pre- or post-contract validation

## **Productivity Commitments**

- Self-executing
- Cumulative

# Pricing – COLA and MRC

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## COLA

- In limited circumstances
- Linkage to renewal terms
- Mechanics: Timing, index, collars, and inflation factor

## Minimum Revenue Commitments

- Commitment
  - Fixed commitment – annual or term
  - Variable commitment – x% of prior year
- Aggregate commitment or by service category
- What fees count?
- Exclusions and adjustments (divestiture, downturn, SLA failure, discontinued service, regulatory guidance)
- Remedy for shortfall

# Pricing - Enhancements

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- Classification and allocation of cost

Classification	Definition	Cost Allocation
Mandatory	Regulatory or card rules	Processor
Roadmap	Processor priorities	Processor
Custom	Customer requirements	Customer (or shared)

- Input into roadmap
- Development pools
- Rate structure
  - Onshore / offshore
  - Dedicated or variable
  - COLA
- IP Rights

# Pricing – New Services and Other Issues

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## **New Services**

- Pre-negotiated – options
- Non-exclusivity
- Controls
  - Commercially reasonable price
  - MFC
  - Margin cap
- Accelerated arbitration

## **Other Issues**

- Most Favored Customer
- Volume discounts
- Pass-through expenses – administration fees and mark-ups
- Invoicing and payment terms
- No back-billing

# Flexibility and Leverage

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## **Term**

- 3 to 7 years
- Renewal options

## **Non-Exclusivity**

- Use of other processors for any services / portfolios
- Cooperation and compliance issues
- Often subject to minimum commitments

## **Permitted Users / Reselling**

- Account types
- Affiliates
- Partners
- Sub-processors
- Geography

# Flexibility and Leverage

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## **Termination rights**

- Convenience
- Cause
- Financial instability
- Regulatory change
- Other material change

## **Termination for Convenience Fees**

- Fixed (declining) fee schedule
- Balance of MRC
- x% of remaining baseline fees
- x% of prior average monthly fees \* y months
- Wind-down costs

# Flexibility and Leverage

## Negotiated deconversion terms

- Scope
  - Continued right to receive services
  - Knowledge transfer
  - Return of Data
- Other issues

Issue	Customer	Processor
Time Period	6 - 24 months	0 – 12 months
Triggers	Expiration or termination for any reason	N/A if customer is in breach
Fees and rates	Negotiated rates continue	Then-current standard rates or existing plus premium
Impact on Exclusivity/MRC	Exclusivity / MRC cease to apply	MRC continues
Extension Rights	Yes (with reasonable notice)	No
Non-solicit	Merchants	Employees



# Flexibility and Leverage

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## **Divestitures**

- Right to continue processing
- Impact on minimum commitments, fixed fees and termination fees

## **Other sources of flexibility / leverage**

- Threat of damages – requires clear performance obligations
  - Service level credits
  - References / Publicity
  - New business
  - Benchmarking
  - Disputed fees
  - Controls
    - Approval of key people
    - Delivery Centers
    - Subcontractors
    - Policies and procedures
    - Change control
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# Flexibility and Leverage – License Option

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## **Option**

- Source code license to a processor's system
- Any time if trigger event occurs
- After x years for any reason

## **Pricing**

- Recurring license fee
- Declines over time

## **Other Considerations**

- Knowledge transfer – during and after term
- Custom instance
- Third party software
- Escrow
- Ongoing support and IP issues

# Compliance

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## **Compliance**

- Laws and regulations
  - Laws applicable to processor
  - Laws applicable to customer
- Industry rules and standards – PCI, NACHA
- Network rules Applicable laws / regulations
- Customer policies and procedures
- Processor policies and procedures

## **Controls and Monitoring**

- SSAE 16 – SOC 1, 2, 3 audits
- Data security and financial audits
- Service locations
- Subcontracting
- Background checks

# Allocation of Risk - Data Security and Fraud

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## **Cost of a Data Breach (US)**

- \$188 / record (increases to \$277 when breach is malicious or criminal)
- Average size of breach: 28,765 records
- \$5.4m / incident
- Data excludes mega breaches (>100,000 records)
- Actual costs vary significantly by industry

## **Type of Costs**

- Direct costs include (i) engaging forensic experts, (ii) outsourcing hotline support, (iii) providing free credit monitoring subscriptions and discounts for future products and services.
- Indirect costs include (i) in-house investigations and communications, (ii) value of customer loss resulting from turnover or diminished acquisition rates.

## **Causes (roughly 1/3 each)**

- Malicious or criminal attack
- Human error system glitch
- Process failure

*Data on this slide is from the Ponemon Institute 2013 Cost of Data Breach Study: Global Analysis, May 2013*

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# Allocation of Risk

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## **Data Privacy**

- Types of Data
  - Cardholder data
  - Merchant data
  - Transaction data
- “Big data” implications
- Liability – caps and breach or strict liability standard
- Cyber-insurance

## **Business continuity**

- Increased focus from regulators
- Process DR plan and testing
- Additional risk mitigation
  - Step-in rights
  - Direct relationship with DR provider
  - License option

# Allocation of Risk

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## **Key indemnities**

- IP infringement
- Compliance with laws, PCI, card brand rules
- Claims by subcontractors
- Breach of confidentiality
- Data security – breach or strict liability standard
- (Gross) negligence or willful misconduct

## **Liability**

- Direct damage cap + exclusion of consequential damages, with exceptions:
  - Exclusions generally mirror indemnities
  - Improper termination / abandonment
  - Employee fraud, criminal activity, misconduct
  - Misdirection of payments
  - Customer payment obligations
- “Super caps”
- Definition of direct damages

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# **Part II: Negotiating Card Processing Agreements for Merchants**

# Definitions and Process

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## Overview

- Agreement between a merchant and a Acquirer/Processor.
- Terms vary significantly depending on context
  - Deal size (processing volume)
  - Acquirer/Processor
  - Business model

## Business models

- Traditional channels - banks, processors, ISOs, (some) networks
- New channels - PSPs / aggregators and other software solutions
- Convergence of models
  - Software companies have full-featured, mobile, integrated POS products
  - Large Acquirer/Processors investing in software (e.g., TSYS/Pro-Pay, FDMS/Clover, Heartland/Leaf, PayPal/Braintree).
- >150 digital wallets



# Definitions and Process

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## **Practical considerations**

- Is the contract negotiable – yes with exceptions
- Negotiation process
- Form of contract

## **Contract Structure**

- Terms and conditions
- Addendums for ancillary services (direct or with third parties)
  - E-check
  - Gateways
  - Fraud mitigation
  - Consulting/analytics
  - Tokenization
- Separate card acceptance agreements for AXP and Discover (sometimes), PayPal

# What's important?

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## **Merchant priorities**

- Pricing
- Scope (and value-add) and Performance
- Flexibility and leverage
- Fair allocation of risk

## **Acquirer/Processor Priorities**

- Same as merchant priorities, but with different perspective
- Standard processes and flexibility to change them
- Flexibility to change policies and pricing
- Flow-down rights
- Right to use data
- Limiting liability
- Credit risk policies / reserves
- Long-term commitment / exclusivity
- Auto-renewal
- Ancillary services

# Pricing

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## Overview

- Primary factor in processor selection
- Increasing number of pricing models
- Components of price: (Interchange + Assessments) + Processing fees

## Tiered Pricing

- Opaque – blends ~ 300 interchange rates (0.05% to >1.65% into 3 categories)
- “Inconsistent buckets”

## Interchange +

- Pass-through without mark-up
- Processor fee is incremental

## “Fixed” Fee Models

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# Pricing

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## **Minimum Volume Commitments / Assumptions**

- Deadbands
- Pricing adjustments (+ / -)
- Exit rights

## **Regulatory / Card Brand change**

- Pass-through or allocation
- Notice and documentation

## **Additional Fees**

- Bundled or variable
- Pass-through – “third party provider” fees

## **Price protection and renewal rights**

# Scope and Performance

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## **Scope**

- Standard descriptions
- Documentation
- Business continuity
- Ancillary services

## **Performance Standards**

- Implementation commitments
- Compliance with network and acquire/processor rules
- Performance warranties
- Service levels

# Flexibility and Leverage

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## **Term:**

- 30 days to 5 years
- Renewal options

## **Non-exclusivity / Preferred Provider**

## **Multi-provider environment?**

## **Termination rights**

- Convenience (for a fee?)
- Cause
- Material change

## **Transition assistance**

## **Acquisitions and divestitures**

## **Notice requirements**

## **Ancillary services**

# Allocation of Risk

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## **Key Indemnities**

- IP infringement
- Breach of confidentiality
- Breach of data security
- Violation of law, PCI or network rules
- (Gross) negligence or willful misconduct

## **Liability limits**

- Direct damages cap
- Consequential damages exclusion
- Exceptions to limitations or “super-caps”
- Definition of direct damages

# Data Security and Fraud

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## **Acquirer/Processor Services**

- Basic protections – e.g., address verification system (AVS) and credit card ID (CVV2 or CVC)
- Tokenization - eliminates need to store sensitive card data by sending back minimal information (e.g., transaction ID, reference ID and authorization code)
- Fraud monitoring

## **Allocation of Risk**

- Breach or strict liability standard
- Caps and “super” caps
- Definition of direct damages

## **Rights in Data**

- Merchant data
- Cardholder data
- Transaction data



# EMV

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## **Overview**

- EMV = Europay, MasterCard, Visa
- Global standard for chip-based credit and debit card processing – established to enhance security and global interoperability
- Merchant terminals can use contact and/or contactless acceptance
- Cardholders use “chip-and-PIN” or “smartcards” with embedded microchips that store and encrypt information
- > 1.5B EMV cards in circulation by mid-2012

## **Visa Technology Innovation Program**

- Goal is to accelerate EMV implementation
- Eliminates PCI validation requirement if 75% of a merchant’s VISA transactions originate from chip-enabled terminals. Terminals must enable contact and contactless chip acceptable
- Acquirer/Processors required to support EMV
- Liability shift
  - Most POS fraud liability is currently absorbed by issuers
  - Liability will shift to acquirer / processors for merchants that do not have an EMV terminal when presented with an EMV card
  - Effective 10/1/15 for most merchants (10/1/17 for gas stations)

# Durbin Amendment

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## **July 2010: Durbin Amendment to the Dodd-Frank Act**

- “Reasonable fees and limits” to debit interchange rates
- Provide debit network exclusivity (for in-scope networks)
- Applies to transactions on debit cards issued by banks with over \$10 billion assets

## **June 2011: Federal Reserve Board issues rules to implement Durbin**

- Average cost pre-Durbin averaged \$0.44/transactions.
- Debit interchange is set at 0.05% + \$0.21 / transaction (+ \$0.01 per transaction for issuers with fraud prevention programs).
- Issuers must use two unaffiliated networks for debit authorization and processing – e.g., one network for PIN debit, one network for signature debit.

## **July 2013: DC District Court (Judge Leon) decision**

- Overturns cap on interchange rates –Congress intended to cover only incremental costs incurred by an issuer in authorization, clearing and settlement (and not other processing fees and fraud losses).
- Overturns network exclusivity rules – Congress intended for merchants to have routing choices between at least two unaffiliated PIN networks and two unaffiliated signature networks at the transaction level – not at the card level.
- Ordered a stay of the current regulation to the Fed rules (Reg II) remain in effect, pending appeal (12-18 months).

# Contact Information

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