

## MONEY GUY

# IS EMV GOOD FOR ISOs?

By Harold Montgomery



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Will EMV happen in the U.S. in the coming years? VISA is beginning the process of implementing it here. EMV (which stands for Europay, MasterCard and VISA) is a security protocol standard in place throughout the world (minus the U.S.) The U.S. market grew up on magnetic stripe cards and has been reasonably happy with that standard. Card processors and Associations have used all conceivable methods to prevent fraud from occurring and clean up when it does. In general, these steps have been very effective. Fraud in the U.S. market has been falling for years.

So it would seem that fraud cost is not really all that much of a problem in the U.S., at least measured in raw dollar cost terms. But what about brand identity and consumer confidence in the payment system? That's a different issue altogether with a completely different value logic behind it. Card Associations have spent tens of billions of dollars on advertising and other means of building consumer confidence in their payment products. There's literally no telling what the historic accumulated cost of building the VISA or MasterCard brand is. Likewise, there's no telling what the cost to the brand is when consumers lose confidence that the payment products are safe and trustworthy. It's simply not acceptable. So, while fraud cost measured on a dollars basis may not be a big deal, persistent, unmeasurable fraud cost on a brand level is a different matter altogether.

What you need at the brand level is total confidence that the system is safe. In short, fraud needs to go away once and for all. It's not a problem that can be thought of as "manageable" but rather a problem that needs to be killed, buried

and forgotten completely. Everyone at VISA and MasterCard wants to wake up tomorrow morning knowing that they will not be featured on the front page of the New York Times in an article about yet another card data breach.

A March 2009 study by Unisys Security Index found that, "Credit and debit card fraud is the No. 1 fear of Americans in the midst of the global financial crisis. Concern about fraud supersedes that of terrorism, computer and health viruses and personal safety." From a brand management point-of-view, that's wrong—really, really wrong.

So, what to do about it? The easy answer is EMV. It works, it's already in use, tested, tried, effective and understood. In addition, it has the happy benefit of making various card types compatible across continents so that big spenders who travel from the U.S. to Europe have a card that's compatible with EMV terminals abroad. What could be better?

So, EMV is real, and it's going to happen. In fact, it already has. Large retailers have been updating POS equipment with EMV compatible terminals as part of the natural equipment refit cycle. Small retailers, who have less of an issue with card compatibility and security, will be laggards.

When it comes to EMV, there are two issues that will affect the ISO business. First, who pays for the POS terminal upgrade? Will merchants be incented to change hardware? At this time, these questions are unanswerable. Someone's going to make money on this, but it remains to be seen if it will be ISOs or whether 'free terminal' programs will rule the day. In any case, it's a one-time profit event, not an ongoing monthly

revenue stream. The only question is how much profit and who gets it. I don't see this as the game changing consequence of EMV.

The second issue is much more important to the ISO business than the POS terminal refit. What happens to PCI fees when EMV comes about? Are the justifiable in an EMV world? I don't think so. PCI fees have become a standard in the industry. What started out as supplemental revenue has become a critical component of total revenue for many. I have seen profit and loss statements with PCI fees making up 40% of total revenues.

Both processors and ISOs have used PCI fees to replace eroding margins for core processing services. But these two revenue streams are not of the same quality – and this case shows exactly why. PCI fees are vulnerable to EMV or other Association rules changes that might make them obsolete. While we can see EMV coming from a few years away, there will be a scramble to find ways of replacing that lost PCI revenue.

Over the last ten years, margins on core processing services have dwindled steadily. As margins fell, the industry got lucky with PCI, since it created an entirely new revenue stream out of thin air. That era may be ending now as EMV approaches. While the industry has been inventive when it comes to ways to maintain revenue, there's only so much that can be done. The amount merchants are paying for processing services is falling over time, and the decline of PCI fees will exaggerate the trend. ■