Knowing the risk liability enables ISOs to offer accounts to businesses of all types.

ISOs and agents should understand, manage and control the risk involved in merchant processing. That requires knowing the rules, regulations and guidelines of the card brands and regulators.

Knowing the in-house risk liability and accountability enables ISOs to offer merchant accounts to businesses of all types and sizes, even in high-risk situations where merchants could not previously secure approval.

Online businesses are usually considered to have high risk exposure. That’s why it’s crucial to set specific guidelines for the category to limit the risk and perform constant monitoring of the risk performance.

The risk department should identify and control merchant risk by thoroughly investigating and evaluating the quality of goods and services the merchants offer their customers.

Depending on the assessed risk, the merchant needs to maintain reserves with the processing bank. The risk department scrutinizes activities daily, weekly and monthly, keeping an eye on key areas of merchants’ sales activities and periodically reviewing the financial status of high-volume merchants.

All risk assessments focus on loss prevention for the merchants’ business activities. When merchants apply for online payment processing services, the applications are approved based on the creditworthiness of the merchant itself and its individual principals, an evaluation of the goods and services the merchant sells and an evaluation of the merchant’s fulfillment process.

High-risk accounts are evaluated based on a site inspection and the execution of all related documentation along with applicable reserves, personal guarantees by the principals, and guarantees by the related entities.

Each online merchant falls into one of three risk categories: high risk, moderate or low.

High-risk merchants provide goods and services before or at the same time the card transaction is authorized and processed or with a certain period from the time the card transaction is authorized and processed.

Some high-risk merchants routinely make sales without the card used to effect the transaction being present. Examples include direct marketing, telephone or mail order, and Internet merchants. Others require full payment or process preauthorized transactions in advance of delivering the goods or services. Examples of that include club membership and travel-related merchants.

High-risk merchants have the potential to generate a significant number of chargebacks. They’re considered for acceptance based upon their financial strength and the quality of goods and services they provide.

Because high-risk merchants usually generate a significant number of chargebacks, the underwriting team at the online payment processing provider may request alternatives to mitigate the risk.

Those alternatives are associated with several factors of risk that affect the global risk calculation such as the monthly discount rate, the credit risk, the chargeback risk, the future delivery risk and the fraud risk. For each merchant, the underwriters also calculate the expected exposure.

Moderate-risk merchants are similar to high-risk ones in that they complete the sale by providing the goods and services requested before or at the same time as the card transaction is authorized and processed or when the sale is completed by providing the goods and services for future deliveries and complete the sale by providing soft goods or services.

However, moderate-risk merchants generally have a moderate percentage of sales credits and chargeback rates. Those merchants are less risky than the previous category, and the underwriting team at the online payment provider may request alternatives to mitigate the risk, such as a security deposit, rolling reserve or additional guarantors.

Low-risk merchants complete the sale by providing the goods and services requested before or at the same time as the card transaction is authorized and processed or when the sale is completed by providing the goods and services for future deliveries or when providing soft goods or services.

Low-risk merchants generally have a low percentage of sales credits and low chargeback rates. Factors associated with low-risk merchants are usually positive and receive favorable consideration in the acceptance process.

ISOs also should calculate the risk and level of exposure, which are based on the merchant’s activity and history. Risk is calculated according to how long the merchant has been operating, the number of chargebacks. ISO&AGENT FEBRUARY 28, 2013

Evaluate Risk Before Taking On Merchant Transaction Accounts

By Garima Shah

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That’s why the risk evaluation includes calculating the potential exposure to the online payment provider and the mutual benefits to the two companies. The expected potential exposure is assessed based on the maximum exposure and the evaluated risk.

Based on the results of this sample risk evaluation process, a decision is reached regarding whether to offer merchant processing services to the applicant business.

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People & Promotions

Greg Cohen has joined Merchant Warehouse, a Boston-based ISO, as chief revenue and strategy officer.

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