

Determining Ownership of the Merchant Credit Card Processing Relationship

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When banks and payment card processors decide to buy or sell portfolios of merchant agreements or enter into agreements with independent sales organizations or other sales agents (all referred to herein as “ISOs”) to process payment card transactions for merchants, a question commonly arises as to which party “owns” or will “own” the merchant relationship. For purposes of this ownership question, “merchant relationship” generally refers to the asset-like components of such relationship, such as the merchant agreements and the processing-related fees attributable to the merchants’ card sales. Determining ownership is important for several reasons which will be discussed below, but primarily to establish which party has or will have the right to sell or transfer such assets to another party.

Unfortunately, there are no rules-based industry definitions or express guidelines to help those who are charged with determining merchant relationship ownership. The notion of “ownership” of the relationship also is complicated by the fact that multiple relationships may be involved. From a bank’s perspective, it may think of itself as the owner of all relationships with a merchant that happens to do business with the bank, for instance, because it is a depositor or borrower. A processor or ISO, however, may think of itself as the owner of the relationship, at least as far as payment card processing is concerned, because it performs the bulk of the sales and customer relationship management functions related to a particular merchant.

While card association rules (e.g., Visa and MasterCard) provide a few rules about the content and treatment of merchant agreements and on the apportionment of liability in the merchant relationship, which can be factored in the overall analysis of merchant ownership as discussed below, they are silent as to who ultimately owns the merchant relationship. For instance, card association rules generally provide, at least for bank card networks, that the acquirer member of the association or network must be a party to the merchant agreement, must consent to the assignment of a merchant agreement to another member and retains ultimate liability for certain merchant credit and fraud losses that are allocated to the acquiring bank under the rules, even if the bank is indemnified for these by a third-party processor or ISO.

Due to this lack of guidance in the card association rules, managers and practitioners are left to fend for themselves and should therefore begin the ownership analysis by examining the existing and past contractual relationships entered into by the parties that involve the merchants in question, such as bank/processor agreements, processor/ISO agreements, merchant agreements and merchant portfolio acquisition agreements. Sometimes these agreements will be express about which party owns the merchant agreements and the related residual income streams. However, if ownership (including the right to convey the merchant agreement and/or the related residual stream) is not clearly defined, the next step would be to determine the intentions of the parties by assessing the bundle of rights and obligations the parties have apportioned to each other under their various agreements.

If the relevant agreements do not expressly specify ownership of the merchant relationship, the first, and perhaps the most important, step in the ownership analysis is to determine which party, if any, has an unrestricted right to transfer the merchants from one processor or bank to another -- also referred to as the “portability” of the merchants. Any restrictions on this portability right lessen, or at least call into question, a party’s claim to ownership. To highlight some of the common restrictions, consider the example of an ISO who would like to sell to a third party certain merchant agreements, which are subject to an agreement between the ISO and a processor. In examining such existing processor agreement, the ISO’s considerations would include (i) consent being required from a third party before the ISO could

transfer the merchants (e.g., Visa rules require that an acquirer consent to the transfer of a merchant agreement to another Visa member), (ii) the ISO not being able to terminate such processor agreement for convenience, (iii) the processor not being obligated to help the ISO convert the merchants from such processor's platform to another processor's platform, (iv) the ISO having the obligation to continue paying residuals to the processor (or another third party) for the merchants in question after their transfer by the ISO, (v) the merchants in the portfolio not having been separated into a unique BIN and/or ICA, (vi) the processor having the right to solicit the merchants after they are transferred, or (vii) the processor having a right of first refusal to purchase the merchant portfolio.

If it is still unclear which party has the right to transfer the merchants because of one or more restrictions in place, the next step is to examine other factors that might indicate that a party has some ownership interest in the merchant relationship. One important factor is risk and liability assumption. Ownership rights often come with a price -- usually taking the form of the assumption of all or a large portion of the liability or risk for losses due to merchant credit and fraud risk. The party that owns the bulk of the risk related to the merchant agreement should also own the bulk of the economics, and is likely going to be deemed to be the owner of that agreement.

Many ISOs, however, even large wholesale ISOs, may choose to assume liability not in exchange for portability-type ownership rights, but for a larger or longer residual stream because of the difficulty and impracticability of porting merchants to a new processor -- it is time-consuming, expensive and may cause the ISO to lose a significant number of its merchants. If that ISO has been given rights to receive the residual stream from merchants it signs up for as long as that merchant is with that certain processor, it can be seen as "owning" that residual stream (even if the merchant relationship may otherwise be owned by the card processor, acquiring bank or other party). However, many times this right is coupled with an obligation on the ISO to continue to service the merchants and/or continue to be liable for the actions of the third party who will begin servicing the merchants.

Even though it may be difficult to determine ownership of each aspect of the merchant relationship given that several parties may lay claim to varying and ambiguous rights and obligations with respect to portability, revenue and risk, it is advisable to document each such determination in contractual form and have that party stand behind its rights and obligations so that there are no questions going forward, each party is protected, expectations are established and future disputes are alleviated.

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