

In Viewpoints, prepaid and stored value card professionals share their thoughts and perspectives on the industry. These are not necessarily the viewpoints of Paybefore.

Who Will Win: The Card Brands' 'Rails' or the Telecoms' 'Pipes'?

As electronic payments continue to transform value exchange, competitors from outside traditional banking disciplines continue to think creatively about how to use their technology and core businesses to get a bite of the payments profit pie.

Today, we have competition between prepaid card companies and wireless telecommunications carriers to handle consumer payments. It's a battle involving federal and state law and regulation, business cases and who "owns" the customer. This short viewpoint can't explore all those elements, but it can look at how government may support or impede these worthy competitors, which in turn may shed light on business case requirements and the importance of close customer relationships.

Rails vs. Pipes

On one side, issuers and program managers using the "rails" of Visa, MasterCard and other card brands continue to innovate and offer enhanced or improved payment systems. In this environment, network branded prepaid cards will continue to grow in acceptance and usage. In the last year, perhaps, our industry passed an important threshold from adolescence to ma-



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turity, in that it is now being regulated as a fully developed financial service.

On the other side, wireless telecommunications carriers are determined not to find themselves and their systems in the position of "dumb pipes,"

as that label was placed on Internet service pipelines developed in the 1980s and 1990s. This time around, they won't be left out of the servicing industry, with no role in the delivery of financial services other than that of a common carrier of data.

And, the telecoms' competitive instrument of choice? Allowing handset owners to pay for goods and services via billings that appear on the phone bill.

As telecoms promote their new payment service capabilities, the questions become: How will they compete with the prepaid card industry? And, who will win, if there is indeed a competitive overlap? Only time will tell, of course, whether the "rails" of the card brands prove to be more efficient at processing payments than the "pipes"

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offered by the telecoms. But there are reasons to say that the current legal and regulatory environment may favor the wireless carriers.

Pay to Mobile in Action

Let's diagram a transaction that might be called "pay to mobile." A consumer holds an account, whether prepaid or post-paid, with a wireless telecommunications carrier and he wishes to purchase a good or service. Typically, these purchases are online micro-payments for such things as ringtones or online games. (Pay-to-mobile systems, however, are not necessarily limited to low-dollar amounts or even online transactions.)

The consumer selects the particular good or service and proceeds to checkout, where he is given, among other options, an opportunity to pay via his wireless phone account. If the pay-to-mobile option is selected, the merchant's Web-site connects to a processor or aggregator, which provides authentication functions and billing services. Much like processors in the prepaid card industry, the pay-to-mobile processor may access databases that support risk-based decisions to authorize or decline the consumer's payment request. If authorized, the good or service is delivered to the consumer, and the consumer is billed via the mobile phone account.

If the consumer has a prepaid account at the wireless carrier, the account is simply decremented. Post-paid accounts result in a line item billed to the consumer,

which shows up as part of his monthly wireless phone statement. As long as the consumer pays, settlement is simple and relatively inexpensive. If the consumer disputes the charge, then a set of contractual arrangements often shifts the loss from the wireless carrier to the processor (and, possibly, from there to the merchant). Many wireless carriers have a standing practice of reversing any disputed charge, without particular analysis regarding the nature or bona fides of the dispute, except in unusual circumstances.

There are variations to the above, as might be expected. On the other hand,



some of the basic elements of the pay-to-mobile transaction process recur as an almost necessary part of this evolving

payment system. The consumer is asked by (or on behalf of) the wireless carrier whether he authorizes the charge, and this authentication function uses a text message inquiry sent to the handset, followed by a "yes" or other confirmation from the handset. The consumer may be charged a separately disclosed fee, but the merchant also may accept a discount to the sales price. Fees and discounts are shared by the processor and the telecommunications carrier.

Evolving Rules May Define How Wireless Carriers Proceed

Much like the earlier days of distributing network branded prepaid cards and processing and settling prepaid transactions, there are many open issues associated with pay-to-mobile transactions. Some issues arise due to the financial services nature of the transactions. Additional issues not shared with prepaid card systems arise from a unique and complex system of state law and governance that applies to landline and mobile telecommunications carriers.

Federal Regulations

Starting with the Federal Reserve's Regulation E (governing electronic funds transfers), it is fairly clear that a wireless account is not an "account" under this consumer protection regulation, and neither the processor nor the wireless carrier is a financial institution. Nor would the handset be an "access device," since it is not linked to an "account." This view is consistent with the Fed's proposed

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CARD Act of 2009 regulations, under which a “mobile phone or sticker containing a contactless chip” may be subject to regulation as a “card, code, or other device” under proposed Section 205.20 when linked to stored funds via a chip or other embedded mechanism 74 Fed. Reg. 60989 (Nov. 20, 2009). By negative implication, the use of the handset as a communications system alone is not covered.

The Fed’s Regulation Z (governing consumer credit products) may create issues in a pay-to-mobile program, but generally the lack of a finance charge coupled with an obligation to pay in full make Regulation Z inapplicable. Technically, the account is not “open end credit” and the carrier is not a “creditor.” See 12 CFR 226.2(a)(17) and (20).

And there’s little reason to think that funds availability (Regulation CC) or truth-in-savings rules (Regulation DD) would

apply to the consumer’s account with a wireless carrier.


Although wireless carriers are subject to some aspects of federal law that deal with anti-terrorism and anti-money laundering, the Bank Secrecy Act/USA PATRIOT Act’s due diligence requirements and “know your customer” rules that apply to the prepaid industry generally would not apply to wireless carriers.

State Laws

State laws may be, in some areas, a bigger burden than federal regulations for wireless carriers involved in payments. For example, various states prohibit “cramming” (placing unauthorized charges on the phone bill) and/or “slamming” (switching phone carriers without the consumer’s consent). This makes the carrier sensitive about authentication and unauthorized billings, since improper merchant charges can create adverse publicity and regulatory inquiry. And, given their activities as financial intermediaries, it’s not always clear that an aggregator or wireless carrier is exempt from state money transmitter or other money services business licensing requirements. Indeed, this may be the great leveler, since compliance with state MSB laws is a barrier to entry that the prepaid industry generally has overcome or met. On the other hand, for a new entrant, such as a carrier or aggregator in pay to mobile, compliance with MSB licensing, examination, investment and other prudential rules may be novel and difficult.

Finally, various—and stringent—industry best practices are a source of internal regulation. The benefit is increased compliance with authorization requirements, better standards for advertising, restrictions on types of merchants allowed to participate and other systemic protections. The downside is that best practices compliance increases operational costs, felt particularly by smaller players in this arena.

Who Wins?

So, which system will end up on top? The wireless industry has a tremendous customer base with billions upon billions of users worldwide. They have top-notch, world-class systems that are at the forefront of innovation. It will be an interesting competition, with the only certain winner being the consumer. 

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