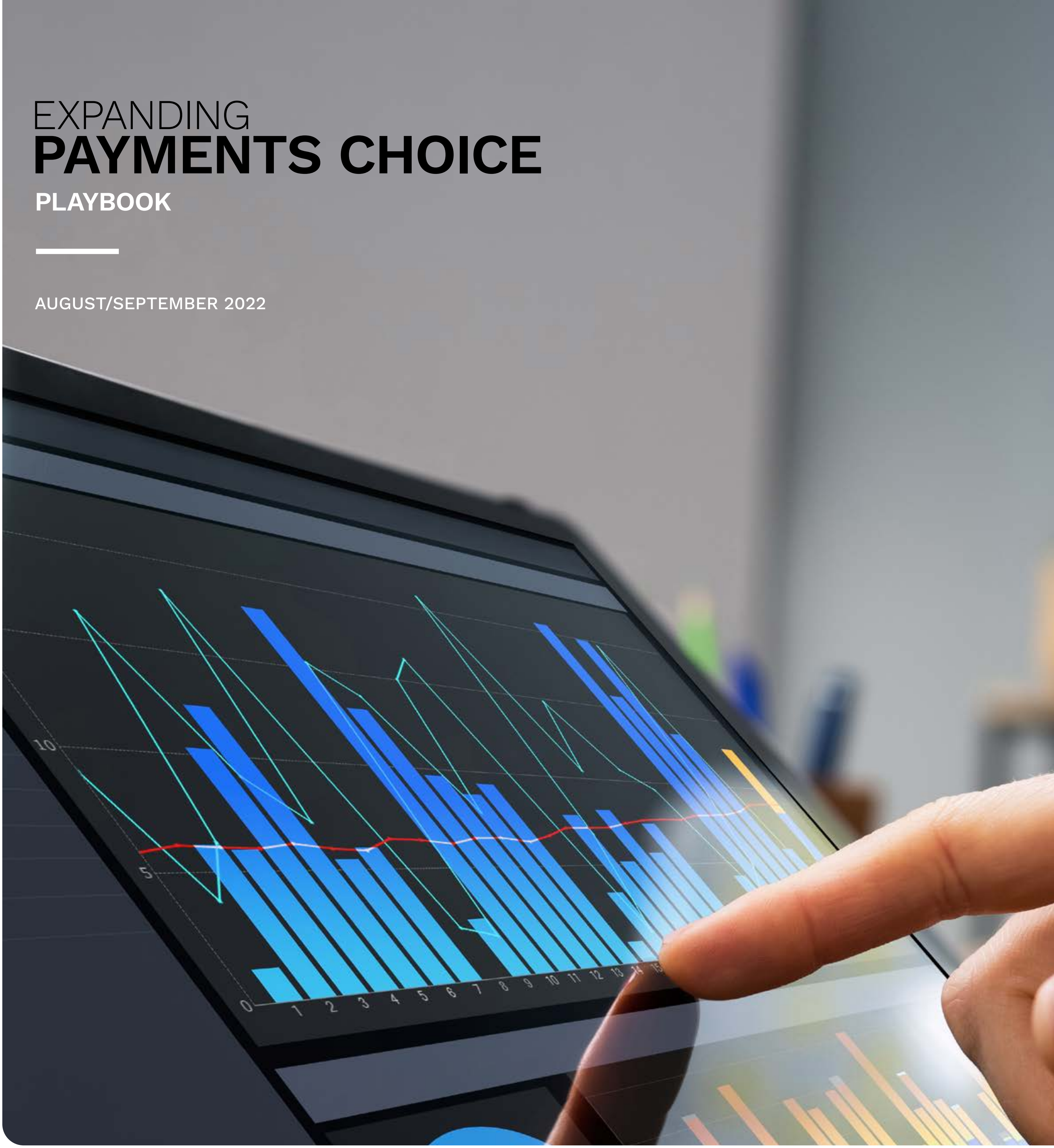
EXPANDING PAYMENTS CHOICE PLAYBOOK

AUGUST/SEPTEMBER 2022



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EXPANDING **PAYMENTS CHOICE**

PLAYBOOK

Read the previous edition

■ JULY 2022

Expanding Payments Choice Playbook

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ACKNOWLEDGMENT

The Expanding Payments Choice Playbook was produced in collaboration with Onbe, and PYMNTS is grateful for the company's support and insight. PYMNTS retains full editorial control over the following findings, methodology and data analysis.

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Cutting Through The Global Economy's Regulatory Jungle

Regulatory compliance is a significant task for any business disbursing money to individuals, and many Latin and North American companies expect the complexity of compliance to grow in the coming years. The IRS is already stepping up how it enforces regulations related to payroll tax withholding, finding additional ways to punish offenders within the existing regulatory structure. At the same time, however, many companies do not think they meet international standards regarding anti-money laundering (AML) and anti-corruption laws and regulations.

Noncompliance can lead to millions of dollars in fines for some of the biggest offenders, but fines in the tens of thousands of dollars can hit small businesses hard. Beyond the risk of fines and penalties, compliance failures can hurt companies' reputations and cause lost business. This is particularly prevalent among younger consumers, who are more likely than others to view scandals as a reason to take their business elsewhere.

Globalization has created ample opportunities for companies, but it has also added compliance complexities. Whether staying on top of sanctions to prevent getting caught up in an international scandal or calculating taxes for international employees, companies conducting cross-border business have a greater compliance burden today than ever before.

Some companies doing business internationally or with international workers may have the staff and resources necessary to track all regulations, while others turn to private firms for help — especially if the business has struggled with compliance in the past. This edition of the Expanding Payments Choice Playbook, a PYMNTS and Onbe collaboration, examines the complexities and consequences of ensuring regulatory compliance in an increasingly globalized world and the many reasons some companies choose partners that can help them navigate the emerging legal and regulatory landscape.

Feature Story

Nearside On The Complex **Task of Compliance**

ONE OF THE FIRST STEPS IN COMPLIANCE IS SIMPLY VERIFYING THE CUSTOMER'S IDENTITY,

according to Bert Friedman, vice president of compliance at Nearside. As a provider of small business banking products, Nearside supplies the data control and security that enables its customers to be verified when conducting transactions.

"The biggest challenge is ID verification: knowing who our customer is," Friedman said.

The digital age has added to the complexity involved. In the past, opening an account with a financial institution (FI) involved face-to-face interaction. Now many account holders may not even know the physical location of their FI, and there may never be a physical interaction with the bank. In addition, with customers potentially operating in various regions, Nearside has to be aware not only of the requirements under federal law but also of what state laws apply to its customers.

FINDING A BALANCE

Ensuring that Nearside can verify customers accurately requires managing multiple, overlapping databases, Friedman said. While that can lead to duplication, it helps to ensure against missing information. Even the most comprehensive single database may accurately identify applicants just 80% of the time, particularly when dealing with small businesses that may have only existed for a short time before seeking banking services.

Even then, Friedman said there is still a balance to be struck in terms of cost. Any system can be made tighter or more exact, but at some point, the degree of improvement is unacceptably small compared to the added cost.

"It's always a trade-off, and I think the conversation isn't static. It has to be an ongoing conversation," Friedman said.

What is cost-prohibitive today may not be tomorrow as technology continues to evolve. In addition, a measure that may not have seemed necessary in the past can become necessary in the future as changes in the marketplace or in criminal behaviors shift the focus on securing services against bad actors. Nearside is constantly evaluating cost and efficacy to ensure that efforts are properly balanced, Friedman said.

THE USER EXPERIENCE

Tim Wu, head of growth at Nearside, said that organizations must balance security and compliance needs with the user experience. When working with small businesses, that goes even deeper than having a user-friendly interface. It also means ensuring that Nearside can meet customers where they are in terms of the platforms and software they are already using to run their businesses.

“Just giving them different options for getting us the documentation that we need to verify them in different ways is very helpful,” Wu said.

He explained that he has worked at companies in the recent past that still required some documentation to be submitted by fax.

“How often are you even anywhere near a fax machine these days?” Wu said.

BETTER RISK MITIGATION THROUGH TECHNOLOGY

Technology continues to help Nearside mitigate risk in a customer-friendly way even once the customer has completed the application process, Wu explained. Automated systems help look for red flags in customers’ transactions and behaviors, adding a layer of security in case anyone slips past the verification process. Such systems can be designed to examine data with a higher degree of finesse than humans can, yet manual intervention ensures that humans are always in control of the most important decisions.

Friedman said automation is significant in making large amounts of data manageable.

“It helps in just winnowing that firehose-worth of transactions down to at least a controllable flood,” he said.

ADDRESSING REGULATORY LAG

While technology is making compliance easier, it is also complicating regulation. As a former federal regulator, Friedman said he is very familiar with how slow regulation can be to catch up with technology — with regulation often being a decade behind, he said. That leaves a significant gap for companies trying to stay on the cutting edge. On the one hand, they have to mitigate against immediate risk, but they also have to anticipate future regulatory developments. Retooling systems can be costly if a company takes a mitigation path that falls out of compliance with future regulations.

Compliance is not just a matter of knowing what is but also one of anticipating what may be, Friedman said. Every company involved in financial services must be risk-based, and the risk profiles of two companies, even ones operating in the same space, may not be the same. As a result, compliance is a constant cycle of identifying, assessing, mitigating and monitoring risk.

Q&A

ED WOODSON
Chief legal officer

onbe

Where are smaller companies most likely to struggle with regulatory compliance when making disbursements, and how does this impact those businesses?

The regulatory environment for the payments industry is notoriously complex. Requirements vary based on the payment modality (e.g., prepaid cards, push to debit, check, ACH), the jurisdiction (by state and country) and the purpose of the payment (e.g., consumer incentives, refunds, payroll, etc.). Understanding these requirements can require a team of internal specialists that smaller companies rarely possess or a team of outside experts who are often very expensive to retain. Smaller companies that fail to obtain such expertise can easily suffer liability under relevant consumer protection or unclaimed property laws.

How can a third party make compliance simpler for smaller companies making disbursements, and what is the value of that?

Simply put, when you engage Onbe or someone like Onbe, you can leverage the investments we have already made in understanding regulatory requirements. Our investments provide smaller companies additional value in avoiding regulatory fines and penalties. When we know who you are paying, where they are located and why you are paying them, we can design a customized, compliant solution.

For larger companies with the staff and resources to manage compliance, what is the value added in working with a third party for disbursements?

Just because a company has sufficient financial resources to source and retain relevant expertise doesn't mean it's the best way for it to allocate capital. If payments are not the bread-and-butter business of a particular company, they may not have enough work to fully occupy retained talent. Why pay for a team of regulatory experts when you run only a handful of payments programs each year? Without the volume and the specialized expertise in payments, the internal staff's approach to compliance in disbursements would, at best, be reactive, completely missing the ongoing proactive process of monitoring and assessing the payments regulatory landscape. It's a classic example of gaining efficiency and proficiency through outsourcing.

What compliance concerns are there for companies paying contractors or freelancers, and what are the risks involved when they are not compliant with regulations?

First, even outside the realm of payments, I would consult an HR expert to ensure that 'contractors or freelancers' are not actually 'employees' in the relevant jurisdiction. But a few questions from a payments perspective are as follows:

Were the contractors in question adequately notified regarding 'how' they would be paid (i.e., the payment modality) and the costs, terms and conditions associated with that method? If not, then you may need to structure your program to allow a default modality with zero costs and easy access for the contractor (e.g., check or ACH).

When the contractors in question were informed of the payment modality, were they allowed choice of other payment methods that may be required in the relevant jurisdiction or does the jurisdiction allow a payment method to be mandated?

Even in the case that the 'contractors or freelancers' are not actual employees in the relevant jurisdiction, is there a point in the jurisdiction in which the number or amount of disbursements require cash-free access using the modality (e.g., a certain number of free in-network ATMs per payment or free access checks per month)?

What happens to payments that are not redeemed by the contractors, including checks not cashed, ACHs that are rejected, or funds on prepaid cards that have not been spent?

Are there any caps in the jurisdiction on the number and type of fees that may be charged for the disbursement?

Answers to all these questions can vary significantly depending on where you, and your contractor, are located.

PYMNTS Intelligence

Managing The Costs And Challenges Of Regulatory Compliance

A SURVEY OF COMPANIES ACROSS LATIN AND NORTH AMERICA FOUND THAT MORE THAN HALF PAID REGULATORY FINES OR OTHERWISE SUFFERED FINANCIALLY IN THE PAST YEAR DUE TO UNMITIGATED COMPLIANCE RISKS.

Between fines and fraud, which 71% reported experiencing issues with, respondents saw average profit losses of 1% in the last year. Sixty percent of companies surveyed expect greater compliance risk in the coming year, with anticipated regulatory increases attributing to much of this heightened risk. Forty-six percent of respondents expect greater compliance requirements related to labor, and 41% expect more aggressive regulatory enforcement across the board.

Even as companies expect compliance to become more challenging, just 22% said they follow international best practices for AML, and just 18% said the same about anti-corruption compliance. Fifty-five percent acknowledged fines or financial losses related to compliance violations in the past year, and 32% reported having gone through compliance-related investigations.

Forty-four percent of respondents believe their companies will increase compliance-related spending in the future, and their expectations surrounding increased requirements and more aggressive enforcement could influence that. More than 70% of companies surveyed said their corporate leaders respond to increased regulatory burdens and enforcement by paying greater attention to compliance, but upholding their reputations plays an even bigger role.

This month, PYMNTS examines the difficulties and costs of ensuring regulatory compliance when making disbursements and how working with third parties could help companies better mitigate risk.

KEEPING MONEY CLEAN

In addition to combating fraud and other online retail security challenges, a recent report found that 80 institutions across the industry dealt with €2.5 billion ($2.5 billion) in AML fines in 2021. International sanctions can further complicate guarding against money laundering. As the list of sanctioned countries changes — or even as the level of sanctions changes — companies must remain aware of how this could alter when and where they do business to prevent exploitation by those wanting to avoid sanctions.

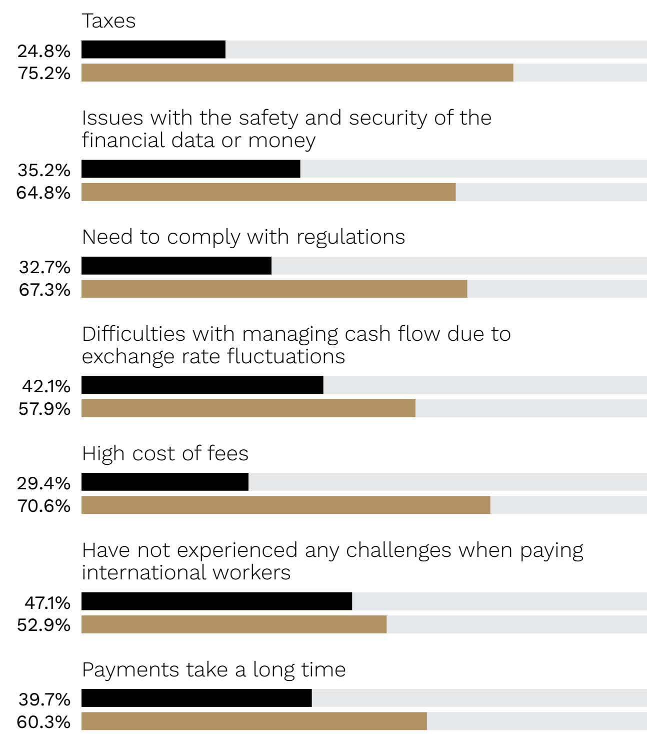
There are risks involved in failing to comply with regulations and legislation, but heavy-handed approaches meant to ensure compliance have their own financial risks. The monetary value of lost transactions due to false positives in 2021 was nearly four times the value of losses to direct fraud for those same companies.

Even companies that are well-versed in finance often struggle to stay compliant. Money laundering is one of the primary areas in which financial institutions face backlash from regulatory bodies. Issues such as failing to provide proper governance or ensuring that the financial institution has collected all necessary information from individual or business clients can result in harsh penalties that may even include prison time.

FIGURE 1:

Firms' use of private agencies to address payment challenges when paying international workers

Share of firms using private agencies, by specific payment challenges



Source: PYMNTS
Cross-Border Payroll And Contractor Payments Report, May 2022
N = 250: Complete responses, fielded March 10, 2022 – March 29, 2022

■ Did not use a privacy agency
■ Used a privacy agency

CROSSING BORDERS WITHOUT CROSSING REGULATORS

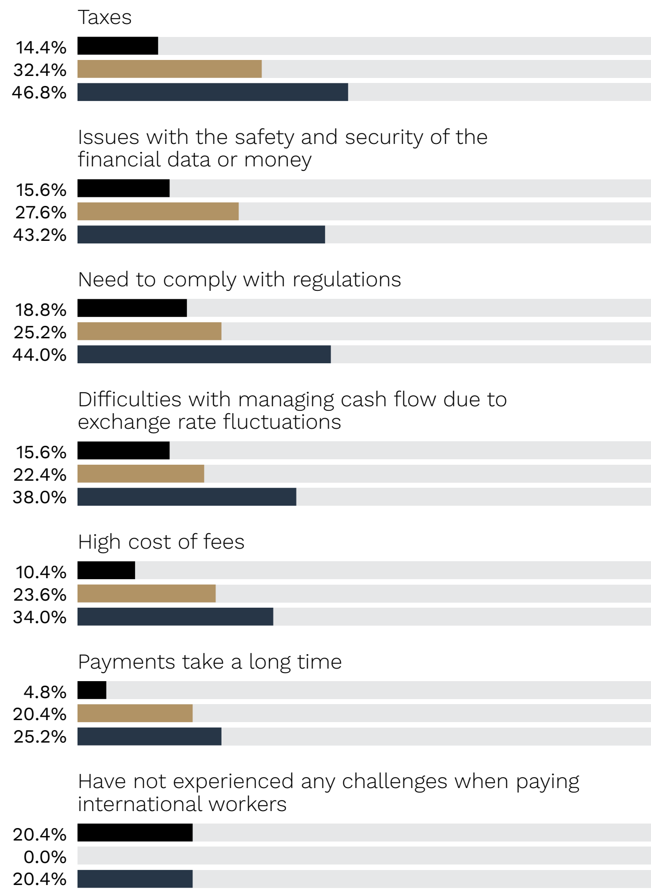
International trade complicates regulatory compliance for payroll as well. Nineteen percent of surveyed firms cited regulatory compliance as their most critical challenge when paying international workers. The less companies spend on international workers, the greater the challenge: 32% of companies that spend less than one-quarter of their budgets on international workers say compliance is a critical issue, compared to just 12% of firms that spend 50% or more of their budgets on these employees. Managing payroll taxes and regulatory compliance when paying international workers figures just as large as fluctuating exchange rates and financial data security for these companies.

Among U.S. firms, 18% cited taxes as their biggest challenge for international payments — double the share of U.K. firms that said the same. This potentially indicates that firms that employ international workers are less likely to struggle with compliance. At the same time, 20% of firms generating revenues of more than $500 million said taxes were a challenge, compared to 10% of those generating less than $500 million.

For many of these companies, the answer lies in working with third parties. Sixty-seven percent of companies using private agencies to ensure compliance said they had experienced challenges when paying international workers. Across the board, from taxes to regulatory compliance, companies that had experienced difficulties paying international workers were significantly more likely to turn to a private agency for help than those who had not.

FIGURE 2A:

Challenges firms faced when paying cross-border workers
Share of firms that faced select challenges when paying cross-border workers

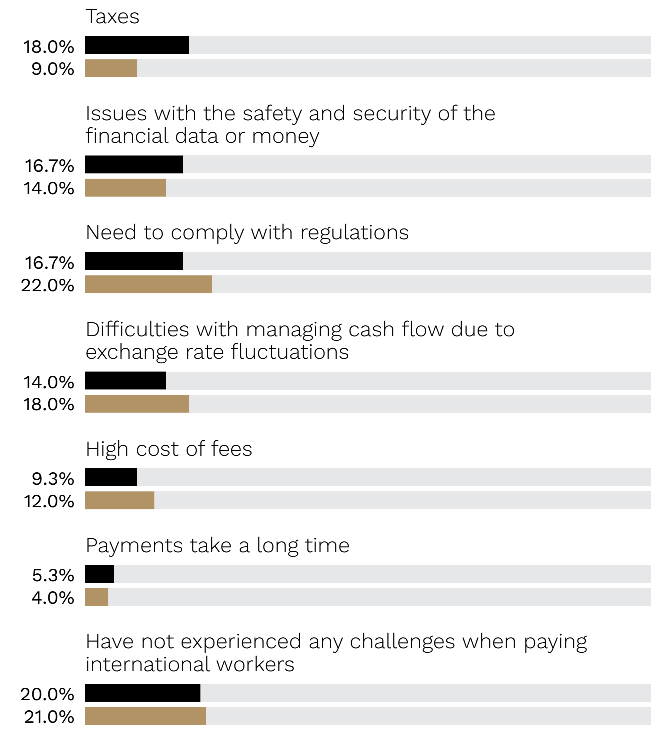


Source: PYMNTS
Cross-Border Payroll And Contractor Payments Report, May 2022
N = 250: Complete responses, fielded March 10, 2022 – March 29, 2022

- Most important
- Selected, but not most important
- Total

FIGURE 2B:

Challenges firms faced when paying cross-border workers
Share of firms that faced select challenges when paying cross-border workers, by country

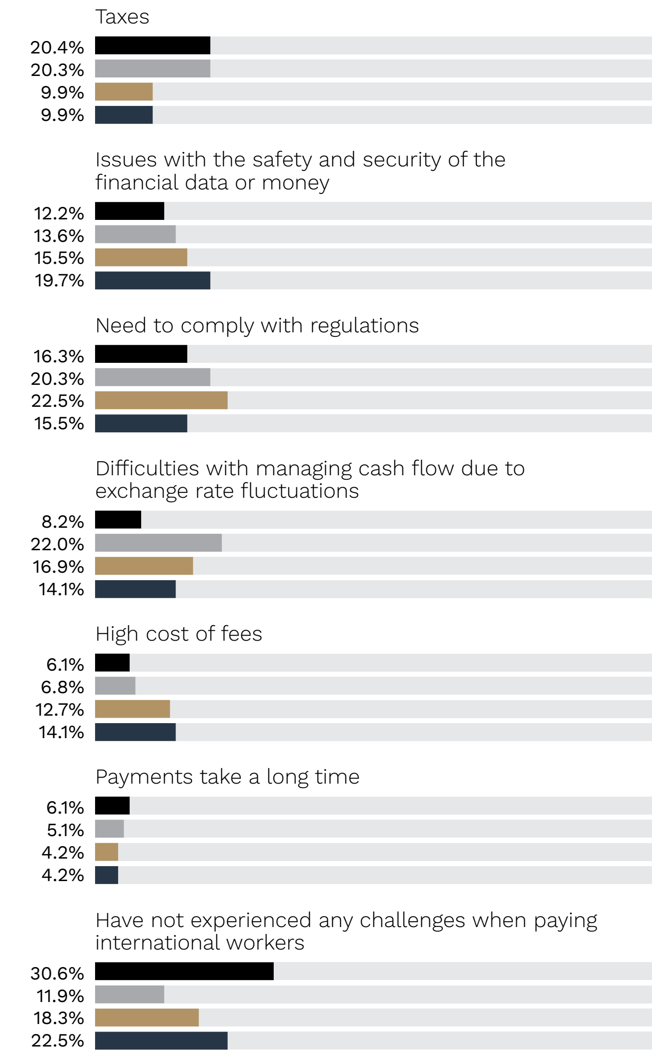


Source: PYMNTS
Cross-Border Payroll And Contractor Payments Report, May 2022
N = 250: Complete responses, fielded March 10, 2022 – March 29, 2022

- United States
- United Kingdom

FIGURE 2C:

Challenges firms faced when paying cross-border workers
Share of firms that faced select challenges when paying cross-border workers, by revenue

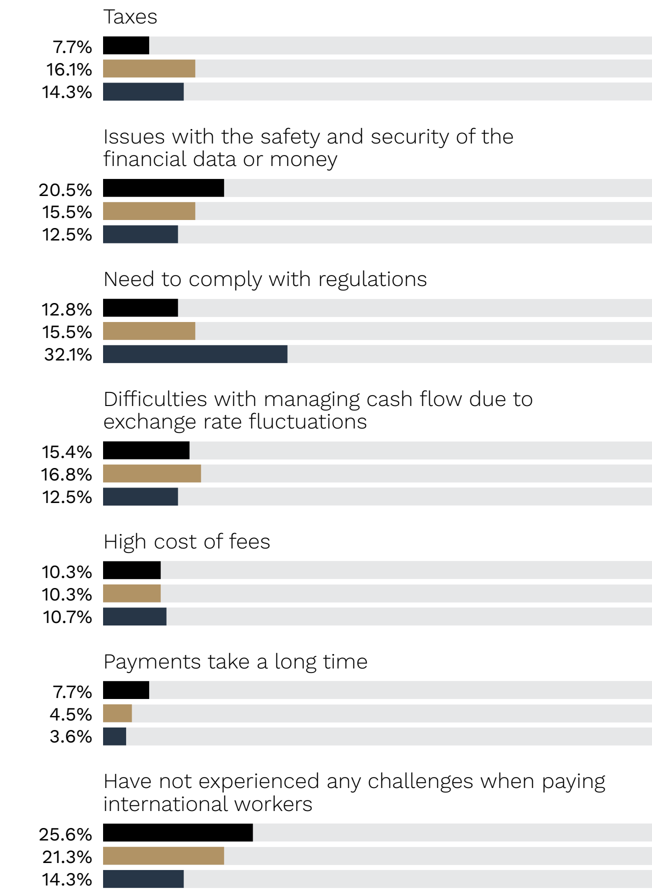


Source: PYMNTS
Cross-Border Payroll And Contractor Payments Report, May 2022
N = 250: Complete responses, fielded March 10, 2022 – March 29, 2022

- $1 billion or more
- $500M to $999.99M
- $250M to $499.99M
- $100M to $249.99M

FIGURE 2D:

Challenges firms faced when paying cross-border workers
Share of firms that faced select challenges when paying cross-border workers, by international employee payroll share



Source: PYMNTS
Cross-Border Payroll And Contractor Payments Report, May 2022
N = 250: Complete responses, fielded March 10, 2022 – March 29, 2022

- 50% or more
- At least 25%, but less than 50%
- Less than 25%

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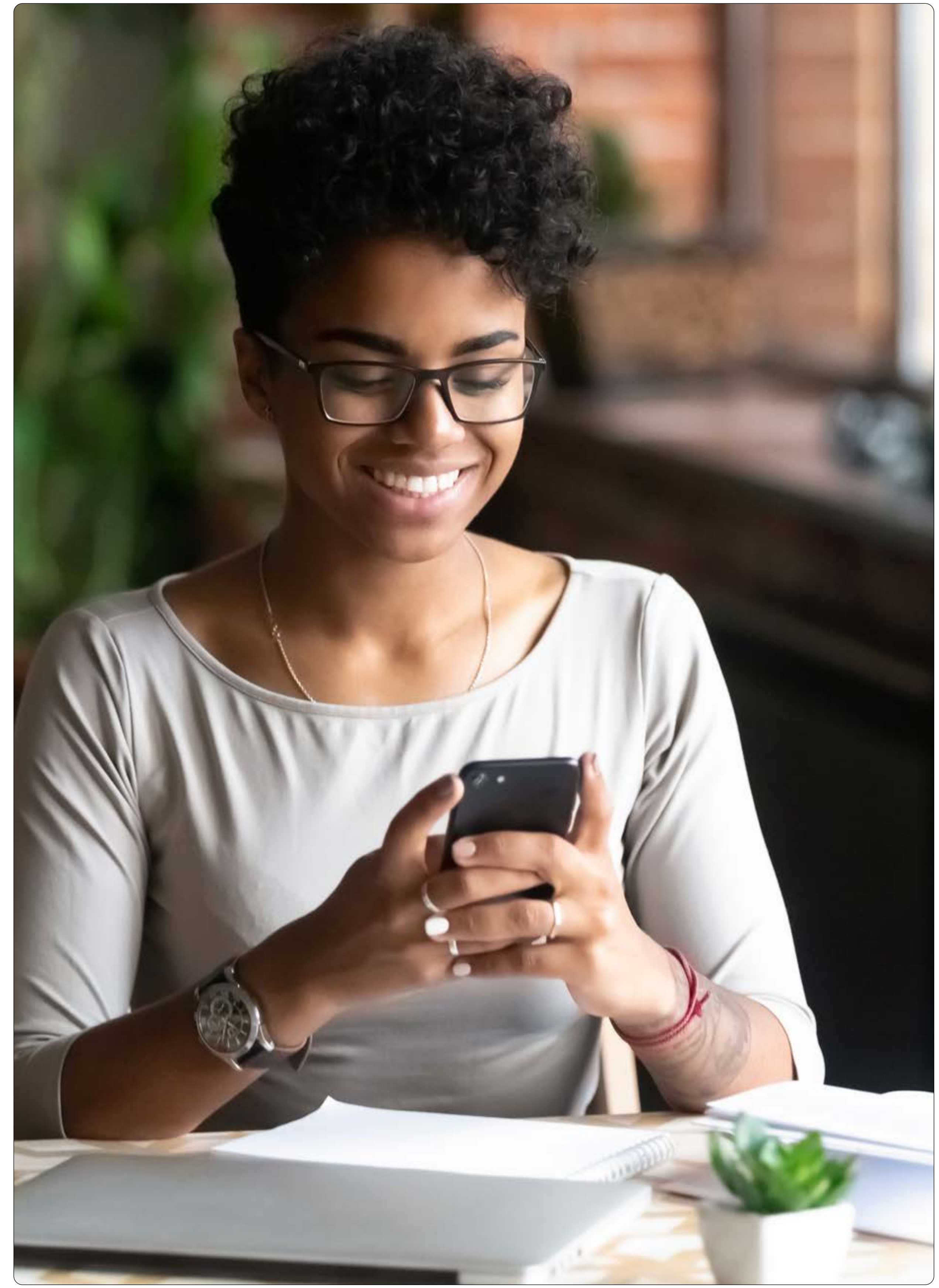
PREPACKAGED PAYMENT SOLUTIONS

Whether internationally or domestically disbursing funds, many firms are now turning to prepackaged solutions that address both the complexity of modern payment rails and the challenges of regulatory compliance. The right third-party application programming interfaces (APIs) enable true any-to-any transactions such as transferring funds between customers' accounts or paying third parties. They should also have fraud management and regulatory compliance features baked in. This not only saves firms time and money on development but also makes it easier to keep up with a payments landscape that changes almost daily.



NEWS & TRENDS

PAYROLL LAWS AND REGULATIONS PRESENT PITFALLS FOR EMPLOYERS

IRS PURSUING STIFFER ENFORCEMENT OF PAYROLL TAXES

More than 70% of taxes collected in the United States come from payroll taxes, making payroll tax enforcement a priority for the IRS and the Department of Justice. The IRS will now look at how employers are spending unpaid payroll taxes and could potentially charge income taxes on those missing funds, in addition to any other penalties, if the IRS finds the business owners used the funds for themselves. This is of particular concern for small businesses, for which payroll taxes are the most likely reason they will find themselves on the wrong side of the IRS.

Some employers might be tempted to use payroll tax money to cover expenses when times are tight. The lack of barriers between employers and their employees' withheld taxes can make this particularly tempting, but once a business has started to accumulate payroll tax debt, the situation can quickly spiral due to penalties and interest. With the IRS now looking into how businesses are spending missing payroll tax withholdings, employers using that money to cover business expenses without reporting it as business income could find themselves even deeper in debt to the government.

NEW YORK CONTRACTORS ACCOUNTABLE FOR SUBCONTRACTORS' PAYROLL

Small business owners are not the only ones who need to be aware of changing enforcement measures and payroll laws. Earlier this year, the state of New York enacted legislation making contractors liable for mishandling subcontractors' payroll. The new law shifts the ultimate liability for unpaid wages and benefits of construction workers from the direct employer to prime contractors. As a result, workers who would have had to seek compensation from their direct employer in relation to wage theft will now be able to seek that compensation from the prime contractor that hired their employer.

Advocates of the new law allege that bad actors within the construction industry had exploited the existing law, which only permitted workers to seek unpaid wages from their direct employer. Subcontractors have been accused of hiding assets, changing corporate identities and employing other means to evade accountability and liability. In addition to these changes to accountability, the new legislation also permits contractors to withhold payment if subcontractors fail to provide certain payroll records.

NORTH CAROLINA FRANCHISEE FOUND IN VIOLATION OF OVERTIME LAWS

Payroll involves much more than just regular wages, and failure to understand how bonuses, commission and other incentives are regulated can land employers in hot water. One Taco Bell franchise owner recently discovered this the hard way after being found in violation of labor laws by the U.S. Department of Labor. Operating six Taco Bell franchise locations in North Carolina, the franchisee was determined to have violated labor laws in how it calculated the overtime pay requirements of 31 assistant general managers. Ultimately, the Department of Labor determined the managers were owed $56,900 in overtime wages by their employer.

Federal law permits employers to claim 10% of bonuses, commissions and incentives toward the $684 per week salaried employees must be paid to be exempt from overtime pay requirements. Investigators determined that more than 10% of the managers' wages were from bonuses, commissions and incentives. Because of this, the managers did not qualify as overtime exempt, and the franchisee owed the employees overtime wages.

DISBURSEMENT TROUBLES DOG FIs

BOA FINED FOR MISHANDLING STATE UNEMPLOYMENT BENEFITS

Running afoul of regulations related to disbursements to individuals is not just a problem for smaller organizations, and even one of the nation's largest banking institutions recently found itself on the wrong side of the law. Bank of America (BoA) is facing more than $200 million in fines from two federal agencies related to its disbursement of unemployment benefits in the early days of the pandemic. A Consumer Financial Protection Bureau (CFPB) investigation found that BoA implemented a faulty fraud detection program that automatically froze the accounts of customers who had received pandemic unemployment benefits. In addition, the CFPB determined that the unemployment recipients were unable to receive support from BoA when they sought to have their accounts unfrozen.

The Office of the Comptroller of the Currency is fining BoA $125 million for mishandling of a prepaid card program used to distribute unemployment insurance and other public benefit payments, and the CFPB has imposed a $100 million fine for the faulty fraud program that froze recipients' accounts. In addition to the fines, the CFPB is also requiring BoA to provide redress to affected customers as well as a lump sum harm payment.

FIs COULD LOSE CUSTOMER OVER REGULATORY NONCOMPLIANCE

The fall of the regulatory hammer is not the only risk for FIs that fail to keep up with their compliance obligations, and those that see fines as simply a cost of doing business may find the costs are higher than they think. A recent survey of U.K. consumers found that more than half would leave an FI if they found out it was involved in a money laundering scandal. Younger generations are more likely to do so, with 68% of 25- to 34-year-olds and 64% of 18- to 24-year-olds saying they would switch under these circumstances.

The survey results stand in contrast to research indicating that many firms choose to incur fines related to money laundering. Thirty-five percent of firms said they incur AML fines and make violations all the time, and 52% consider the risk of incurring such fines or violations. With consumer trust dipping, banks must become more vigilant in avoiding fees and fines related to money laundering.

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ABOUT

PYMNTS

PYMNTS is where the best minds and the best content meet on the web to learn about “What’s Next” in payments and commerce. Our interactive platform is reinventing the way in which companies in payments share relevant information about the initiatives that shape the future of this dynamic sector and make news. Our data and analytics team includes economists, data scientists and industry analysts who work with companies to measure and quantify the innovation that is at the cutting edge of this new world.

onbe

With more than 25 years of industry experience and offices in Chicago, Philadelphia and London, Onbe is a FinTech that manages and modernizes customer and workforce payouts for corporate clients ranging from mid-market to the Fortune 500. Onbe’s team of experts and technology platform offers clients a turnkey solution to offload their entire B2C disbursement operations, relieving them of the cost, complexity and risk that come with orchestrating these payments in-house — all while delivering on today’s consumer expectations to instantly receive digital payments with ease. To learn more, visit www.onbe.com.

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