High-Risk Merchant Processing Just Got Riskier

by Rachel Hirsch

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In September, the payment processing industry took a massive, unexpected hit when the U.S. government designated PacNet, a large Canadian payment processor, on the U.S. Treasury's Office of Foreign Asset Control's (OFAC) list of transactional criminal organizations (TCO) for its role in processing for direct mailer merchants alleged to have defrauded their customers.

The OFAC action was accompanied by Department of Justice (DOJ) indictments, as well as civil settlements against direct mailers. The OFAC action is unprecedented, as it is the first time that the agency has included a payment processor on the TCO list – a designation typically reserved for criminal organizations like Japan's Yakuza.

The aftershocks of the OFAC action are being felt outside payment processing circles – namely, by merchants who already face hurdles in securing processing solutions that work for their business models. Given the heightened scrutiny that payment processors are now under, merchants can expect that banks will engage in a fresh round of "de-risking" of third-party payment processors and their merchant clients.

So what makes a merchant's business high-risk? In the past, when merchants and payments-industry professions were confronted with that term, certain industries immediately came to mind: adult content, Internet gambling, and like.

These days, however, the term "high-risk" is not confined to those industries, but can be attributed to merchants that meet a certain risk profile. Generally, the perceived risk threat comes in the form of elevated chargebacks. Several factors increase this risk profile, including:

- offering recurring billing;
- debiting consumer accounts;
- engaging in high-pressure sales tactics; and
- conducting high-dollar average monthly sales and transactions.

For these merchants, processing solutions have always been a problem, leaving many to create elaborate corporate structure schemes for load balancing purposes. To the extent these high-risk merchants come under scrutiny by a regulator like the FTC, these types of corporate structures often serve as yet another indicia of fraud to support the regulator's depiction of the merchant as a "scammer" or a "fraudster" – the FTC's adjectives of choice.

So what does the OFAC action mean for high-risk merchants? Well, it means that payment processors are going to be on higher alert about the merchants they process for because now, more than ever, their actions in assisting these merchants can lead to scrutiny not only from civil regulators, but potentially from criminal agencies as well. For high-risk merchants, especially in the trial and continuity space, this means instituting and following a culture of compliance that focuses primarily on customer satisfaction, which, in turn, means lower chargeback rates. This means:

- displaying important billing terms and conditions clearly and conspicuously;
- obtaining affirmative consent to any negative option offer;
- offering truly "free" samples during an adequate trial period;
- offering refunds to dissatisfied customers without any high-pressure sales tactics; and
- making claims about a product that can be substantiated.

While these may seem like lofty goals, they may be the reality merchants now face in the post-OFAC action world. Of course, retaining qualified counsel is always key to actualizing these goals. [FF]

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