JANUARY 2023

MAXIMIZING DEBT REPAYMENT

SPEED AND EFFICIENCY FOR IMPROVED ROI

PREPARED FOR:

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Speed and Efficiency for Improved ROI

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EXECUTIVE SUMMARY

Lending or advancing funds to consumers comes with a risk of not being repaid. That risk can be greater for lenders and funds advance companies that rely solely on legacy debt payment methods, such as ACH and check. These methods have a greater risk of return because they cannot provide real-time payment authorization. This thought leadership paper highlights the benefits and downfalls of various debt repayment methods. It explains why converting all or a portion of these payments to debit cards can result in increased customer satisfaction and significant potential cost savings.

- **Legacy payment methods, such as ACH and checks, have extended processing times compared to newer forms of payment:** It can take two to three days before lenders are notified that a standard ACH or check is returned for incorrect account information or insufficient funds (NSF).
- **Debit card transactions provide real-time authorization of funds availability:** Debit card transaction authorization, validation, and funds verification occur in real-time and coincide with a funds hold on the consumer account. This eliminates the risk of payments returned because of NSF and reduces the risk of invalid account returns that can occur with ACH.
- **Returned ACH and check transactions increase expenses for lenders and others that offer funds advances:** Besides returned ACH and check fees charged by an issuer or ACH processor, returned payments impact operational staff who must process and represent these payments or attempt to re-contact the customer to receive new payment information.
- **Debit cards for debt repayment are lower cost than some other card payment types:** Visa and other debit network brands offer capped or lower interchange fee rates for consumer debit card debt repayment transactions
- **Converting payments from ACH to debit cards can result in significant savings:** Debit card debt repayment transactions can be more costly per transaction compared to an ACH that processes without issue. However, debit card transactions are much less expensive and are more likely to be successful than a returned ACH transaction, which carries a multitude of potential expenses, risks, and time delays. Lenders solely using ACH are likely leaving money on the table that they could recoup with the addition of debit cards.

INTRODUCTION

Lenders fail when customers cannot pay. Legacy payment methods can be fine for debt repayment in minimal-risk loan portfolios. However, older payment methods come with many issues that increase repayment risk for all lenders and others who advance funds to consumers. The extended delay of returned payment notifications for incorrect account numbers, closed accounts, or NSF associated with legacy payment methods can result in losses for any loan portfolio, especially when consumers have financial issues.

To make matters worse, widespread repayment issues can show up very quickly during economic slowdowns, which occur periodically in the U.S. When payments are returned multiple days after origination, re-presenting the payment or contacting the consumer for payment is difficult or impossible. These issues increase operational expenses and the risk of non-payment for the lender. For these reasons, lenders can benefit by adding a newer method of payment for their loans to close many gaps that exist with older, legacy payment methods while offering a better experience for consumers.

This paper, commissioned by TabaPay, highlights the unique needs of lenders and companies that advance funds to consumers. It highlights the key reasons legacy debt repayment methods are helpful but inadequate on their own and cannot match the benefits and return on investment (ROI) of debit cards.

METHODOLOGY

This thought leadership white paper is based on interviews with executives at four organizations that lend or advance funds and other key players in the debt repayment or payment processing industry, along with desk research, previous Aite-Novarica Group research conducted for Visa, Inc., and the author's experience managing debit card, credit card, and loan products at financial institutions in the U.S.

MACRO LENDING AND REPAYMENT RISKS

Understanding the U.S. lending ecosystem and the factors impacting debt repayment underscores the importance of fast and efficient debt repayment methods. The items in this section highlight the current size of U.S. household debt and key macroeconomic influencers that impact the ability of consumers to repay what they borrow.

CURRENT LENDING ECOSYSTEM

U.S. lending products, such as mortgages, loans, lines of credit, credit cards, and payday loans, along with newer products, such as buy now, pay later (BNPL) and short-term or small-dollar advances, provide needed services to consumers. The popularity of these lending products has helped them to grow to record levels in recent years. The items below include key metrics of the current U.S. consumer lending environment

Consumer Household Debt

Consumer lending has seen record-breaking growth in recent years, with consumer household debt reaching an all-time high of US$16.15 trillion in Q2 2022.[1] This record puts U.S. debt in new territory, with consumers borrowing more per capita than ever.

Recent Increases in Consumer Loan Delinquencies

Record household debt is not a problem as long as consumers can pay that debt. However, there is some evidence that the consumers' ability to repay borrowed funds is weakening. Although still low compared to the pre-COVID-19 pandemic, consumer loan delinquency rates increased by 18% from Q2 2021 (1.45%) to Q2 2022 (1.71%).[2]

Debt in Collections

Lenders have accelerated loan output to keep up with consumer demand for borrowing money. However, the risk still exists that a portion of outstanding mortgage loans, term loans, lines of credit, funds advances, and other debt will either be late or not repaid at all. According to the New York Federal Reserve, approximately 6% of consumers have a

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1 "Quarterly Report on Household Debt and Credit," Federal Reserve Bank of New York, August 2022, accessed November 3, 2022, https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/HHDC_2022Q2.

2 "Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks," Board of Governors of the Federal Reserve System, accessed on November 3, 2022, https://www.federalreserve.gov/releases/chargeoff/delallsa.htm.

debt or bill in collections.[3] However, this 6% rate is low compared to historical averages, which ranged from 9.5% to 14.5% in the decade before the pandemic began.[4]

MACROECONOMIC IMPACT ON REPAYMENT RISK AND LOAN LOSSES

Any loan or advanced amount unpaid represents a loss that impacts profitability and, in periods of high defaults, can pose liquidity risks for companies that lend or advance money. Consumer repayment rates have been positive for the last few years, and the percentage of consumers with debt in collections is at a 20-year low. However, inflation and an economic slowdown could quickly undo this positive lending environment.[5]

These interdependencies between the economy and debt repayment are essential to understand because they underscore the need for a lender to access a payment process that is convenient for the payer, that provides authorizations, and that holds funds in the consumer bank account as quickly as possible.

Economic Downturns and Debt Repayment

In October 2022, Visa Business and Economic Insights further hinted that a recession may be on the horizon, stating that “the probability of a downturn within the next 12 months has increased to 64 percent.”[6]

Historically, recessions come with an increase in delinquencies. Figure 1 displays U.S. recessions since 2000 and the associated lift in delinquency rates. Each period is unique (e.g., increased COVID-19-related government assistance during the most recent recession period likely helped to ease the burden on households), but all recessionary periods include and are followed by a higher delinquency rate. Lenders must pay attention to recessionary indicators to ensure they are ready for a potential increase in delinquencies.

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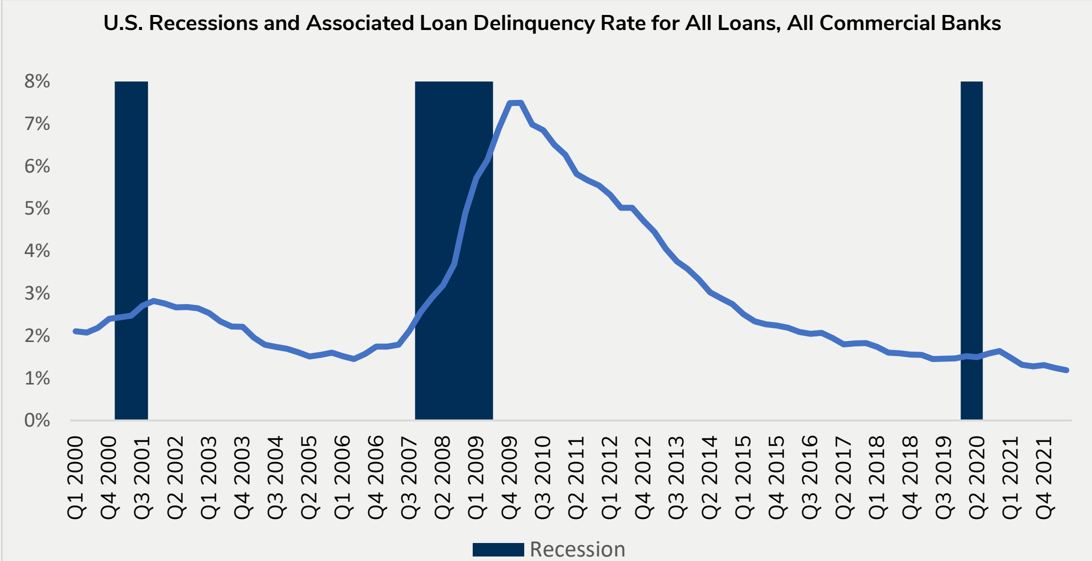
3 "Quarterly Report on Household Debt and Credit: 2022 Q2," Federal Reserve Bank of New York, August 2022, accessed November 3, 2022, https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/HHDC_2022Q2.

4 "Quarterly Report on Household Debt and Credit: 2019 Q2," Federal Reserve Bank of New York, August 2019, accessed November 3, 2022.

5 "Quarterly Report on Household Debt and Credit: 2022 Q2," accessed November 3, 2022.

6 “U.S. Economic Outlook: Special Edition,” Visa Business and Economic Insights, October 6, 2022, accessed November 3, 2022.

FIGURE 1: U.S. LOAN DELINQUENCY RATES AND RECESSION PERIODS



Source: St Louis Fed, Aite-Novarica Group

When consumer delinquencies and defaults begin to increase, which is already occurring in some portfolios, it becomes critical that lenders secure payment confirmation as quickly as possible.

Returned Payments Increase With Degrading Loan Quality

Conversations with executives at lending and funds advance firms indicate that the risk of ACH or check return increases as a borrower's credit quality decreases.[7] The return payment risk may have been low in recent years, likely helped by a strong economy and assistance from government sources. However, ACH and check returns are likely to increase and return to pre-pandemic rates, if not worse, when the economy experiences a recession or high period of unemployment if consumer finances degrade and they struggle to maintain funds in their accounts. For this reason, more modern payment methods, such as debit cards, can help protect lenders and others from the high return rates that can exist with ACH and check payments.

[7] Aite-Novarica Group interviews with executives at four organizations that lend or advance funds and other key players in the debt repayment or payment processing industry.

LEGACY DEBT REPAYMENT OPTIONS

ACH, checks, and in-person (cash) payments are common ways consumers pay a debt or amount owed. This section highlights the major benefits and drawbacks of these legacy payment methods.

BENEFITS OF LEGACY DEBT REPAYMENT METHODS

Financial organizations and consumers are familiar with legacy payment methods, which is one reason for their popularity. Banking services, such as retail lockbox and business banking platforms, help simplify the processing of these payment methods for businesses. Table A highlights the key benefits of dated debt repayment methods.

TABLE A: BENEFITS OF OLDER DEBT REPAYMENT METHODS

PAYMENT TYPE	BENEFITS AS A DEBT REPAYMENT TOOL
ACH	• Work well for recurring debits among low-risk loan portfolios • Cheaper per transaction cost if processed without returns • Debits can be automated and timed to occur with a direct deposit • Same-day and next-day ACH provide account (not funds) validation
Checks	• Well-known payment type and still used by older populations • Can be converted to a digital payment using remote deposit services
Cash	• Guaranteed funds • Real-time transfer of value (limited use until deposited)

Source: Aite-Novarica Group

ISSUES WITH LEGACY DEBT REPAYMENT METHODS

Despite their benefits, legacy debt repayment methods come with problems that make them inefficient in many scenarios, especially when there is an increased risk of the returned payment. Table B highlights key issues surrounding these legacy payment methods.

TABLE B: ISSUES WITH LEGACY DEBT REPAYMENT METHODS

PAYMENT TYPE	ISSUES AS A DEBT REPAYMENT TOOL
ACH	• Processed after debit card transactions by 61.3% of banks, increasing possibilities for NSFs[8] • Returned payments incur a returned payment fee • An acceptable return rate of up to 15% per NACHA guidelines • Routing and account numbers are not always available • No funds validation • It can take days to know if the transaction is successful • Batch cutoff times and long settlement times can delay the payment process for after-hours and weekend payments
Check	• Must be processed by a back office or manually deposited • It can take days to know if funds are sufficient • High estimated operational cost of US$2 to US$4 per check[9] • Checks can take two weeks or more to arrive and process from the time the consumer mails it • Including mail time, checks can take a week or more to process from the date written • Processed after debit card transactions by 61.3% of banks[10] • Checks are harder to reconcile compared to electronic payments
Cash	• Must be manually deposited and processed • Requires a physical location and staffing to accept funds • May increase theft and robbery risk • Operational cost of between 4.7% and 15% of the total volume[11]

Source: Aite-Novarica Group

8 "Data Point: Checking Account Overdraft at Financial Institutions Served by Core Processors," Consumer Financial Protection Bureau, December 2021, accessed November 3, 2022, files.consumerfinance.gov/f/documents/cfpb_overdraft-core-processors_report_2021-12.pdf.

9 Michael W. Kahn, "ACH Costs are a Fraction of Check Costs for Businesses, AFP Survey Shows," NACHA, accessed November 3, 2022, https://www.nacha.org/news/ach-costs-are-fraction-check-costs-businesses-afp-survey-shows.

10 "Data Point: Checking Account Overdraft at Financial Institutions Served by Core Processors," accessed November 3, 2022.

11 "New Research from IHL Group Shows Retailers' Cash-handling Costs Range from 4.7% to 15.3%," IHL Group, January 30, 2018, accessed November 3, 2022, www.businesswire.com/news/home/20180130005244/en/New-Research-IHL-Group-Shows-Retailers%25E2%2580%2599-Cash-handling.

THE MODERN DEBT REPAYMENT METHOD

Debit cards are well known as a means to make purchases, access cash, and pay bills, but they are also extremely effective for debt repayment, alleviating most or all issues associated with legacy payment methods. Accepting payments via debit card can be more expensive per transaction, but it provides many benefits that are unavailable from legacy payment methods and can result in an overall lower cost of payments and improved ROI for lenders.

CUSTOMER AND OPERATIONAL EXPERIENCE BENEFITS

Customer and operational experience benefits include the following:

- **Convenience:** Consumers are typically within arm's length of their debit card and are accustomed to providing card information over the phone or online. For example, 51.1% of consumers reported paying bills with a debit card, highlighting its convenience and growing usage.[12]

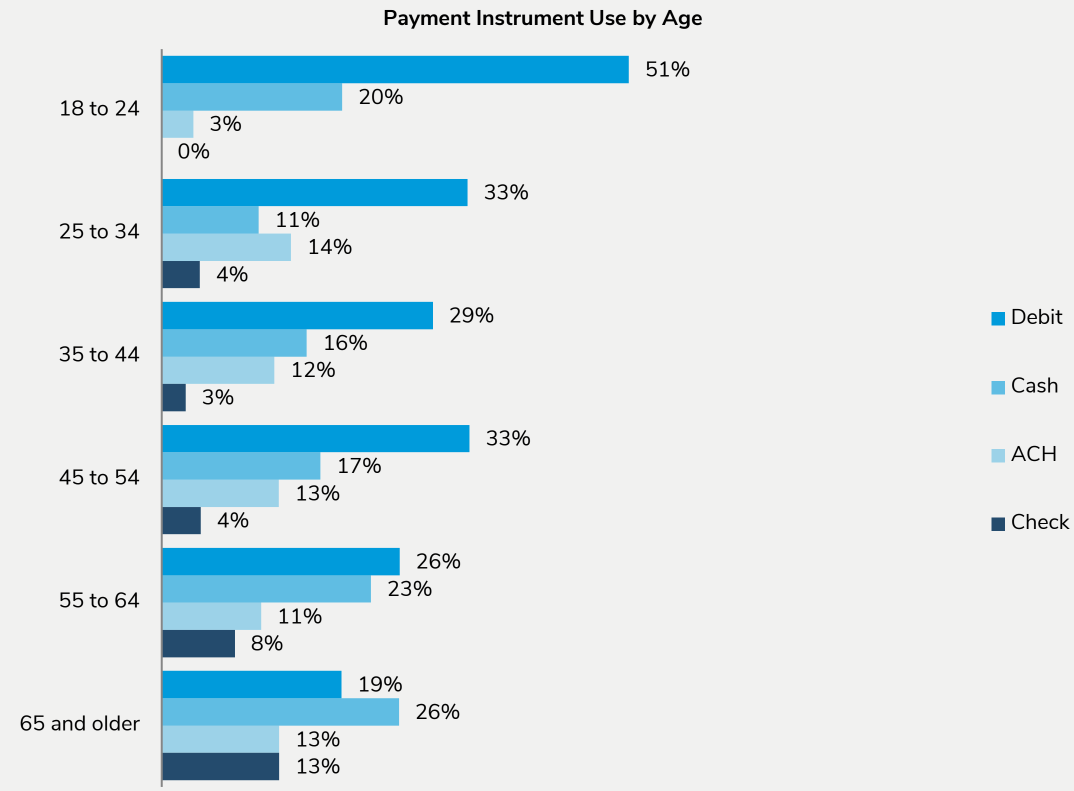
  John Minor, SVP Product & Support, PayNearMe: "Debit card is becoming table stakes for anyone that wants to optimize debt repayment. And allowing consumers to pay with their debit cards directly and via mobile wallets like Apple Pay and Google Pay helps to make the payment process as seamless as possible for consumers."

- **Improved funds credit line access for the borrower:** Because debit card payments are authorized in real-time, lenders can move quickly to make credit line funds available for consumers who may need those funds again in the near term.

- **Preferred by consumers:** Except for those above 65 years old, all age groups prefer to conduct payments using a debit card over any older payment methods (ACH, checks, and cash; Figure 2).

[12] "2022 Annual Pulse Report: Billing and Payment Trends and Behaviors," ACI Worldwide, August 2022, accessed November 3, 2022, https://www.aciworldwide.com/aci-speedpay-pulse-report.

FIGURE 2: CONSUMER PAYMENT CHOICE BY AGE GROUP



Source: Federal Reserve Bank of San Francisco, 2020

- **Priority processing:** According to the Consumer Financial Protection Bureau (CFPB), most banks (61.3%) process debit card transactions before processing check or ACH transactions.[13] This data suggests that at most banks in the U.S., a recurring debit card debt repayment transaction will have priority over a recurring ACH debt repayment transaction processed on the same day. That could mean a recurring debit card transaction is paid, and an ACH transaction is declined as NSF, incurring a US$5 fee for the lender even though the two transactions are processed on the same day.

- **Lower NSF risk for payer:** Consumers must opt into overdraft for debit card payments, which helps to reduce the risk of NSF charges for consumer debit card purchases. Alternatively, there is no similar rule for checks and ACH, which means

[13] "Data Point: Checking Account Overdraft at Financial Institutions Served by Core Processors," accessed November 3, 2022.

that NSF fees, which averaged US$34 each in 2021, can occur with those payment types.[14]

Hamel Kothari, Co-Founder and CTO, Brigit: “When an ACH is declined for non-sufficient funds, the bank can charge the consumer an NSF fee. However, banks cannot charge a fee for insufficient funds on a debit card transaction unless the consumer has opted to allow overdraft.”

- **Real-time payment authorization:** Unlike legacy payment methods, which take days to process, debit card transactions are only approved if the account number is valid, and funds are available. Debit card funds holds are immediately placed on the account to help ensure funds remain available until the transaction is fully processed.

  Faran Taher, Railsr: “Real-time approval of payment, plus the ability to conduct a partial authorization to bring an account current, provides benefits in many ways. They can not only help improve loan repayments but can also help employee morale because agents will not have to wait to know if a payment they collected is good.”

FINANCIAL BENEFITS

Financial benefits include the following:

- **Special interchange category for loan and advance payments:** Visa and other debit card networks offer a capped or special interchange rate for consumer debit card debt repayment transactions.[15]

- **Fast authorization:** Transaction authorization of valid account information and sufficient funds can take seconds, with funds held on the paying account immediately.

  CEO, U.S.-based earned wage access provider: “The difference between accepting ACH and debit card is like the difference between mailing a letter and sending a text message. One takes days, and the other is immediate.”

- **Partial authorization:** Partial authorization allows lenders to process a lower payment amount when the consumer has insufficient funds to pay the due amount.

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[14] "Consumers on course to save $1 billion in NSF fees annually, but some banks continue to charge these fees," Consumer Financial Protection Bureau, April 13, 2022, accessed November 3, 2022, consumerfinance.gov/about-us/blog/consumers-on-course-to-save-one-billion-in-nsf-fees-annually-but-some-banks-continue-to-charge-them/.

[15] "Visa USA Interchange Reimbursement Fees," Visa, April 23, 2022, accessed November 3, 2022, https://usa.visa.com/content/dam/VCOM/download/merchants/visa-usa-interchange-reimbursement-fees.pdf.

When supported by the issuing bank, a partial authorization notification and the available balances are provided in a message back to the lender. At that point, the lender can adjust the payment to a lower amount to ensure that some amount is collected.

Hamel Kothari, Co-Founder and CTO, Brigit: “Debit card payments come with a certainty of success or failure, and chargebacks are extremely rare. This certainty allows us to update an account and make account decisions faster.”

OPERATIONAL BENEFITS

Operational benefits include the following:

- **Account updater:** If supported by the issuing bank, the card account updater ensures that the lending or advance company has the most card account information when the card on file is replaced, such as in a lost or stolen card scenario.
- **Certainty:** Debit card transaction authorization and approval occur in real-time, assuring funds availability.
- **Debit cards allow loan funding via debit card push payments:** Lenders can send funds to the same debit card number using debit card network push payment capabilities, allowing lenders to distribute funds and collect payments with the same debit card credentials, which can result in higher repayment rates.
- **Reduction in payment returns:** Once a debit card transaction is authorized, which happens in near-real time, the transaction cannot be returned NSF.

  Payments industry executive: “The near-instant authorization and approval offered by debit cards mean that NSF returns are basically eliminated. Plus, when supported by the card issuer, the Partial Authorization solution enables lenders to lower the transaction amount and process a partial payment when the entire payment amount is unavailable.”

- **Ubiquity:** Debit cards are the most preferred and used form of payment in the U.S., which means consumers are very likely to have a debit card on hand when it is time to make a payment.[16]

[16] "2022 Findings from the Diary of Consumer Payment Choice," Federal Reserve Bank of San Francisco, May 5, 2022, accessed November 3, 2022, https://www.frbsf.org/cash/publications/fed-notes/2022/may/2022-findings-from-the-diary-of-consumer-payment-choice.

- **More attempts to recoup funds:** In the two to three days it takes to receive an ACH decline, a lender can retry a debit card multiple times. Plus, at around US$0.07 per decline, debit card declines are significantly lower than an estimated US$5 or more for a declined ACH.

OVERALL BENEFITS OF DEBT REPAYMENT METHODS

A debit card as a debt repayment device provides more customer, financial, and operational benefits and has fewer drawbacks than legacy payment forms (Table C).

TABLE C: BENEFITS OF DEBT REPAYMENT METHODS

	DEBIT CARD	ACH
Customer considerations	• Consumer-preferred payment instrument • Eliminates NSF returns • Most common payment method for everyday purchases • Immediate hold of funds • Ubiquitous	• Ubiquitous
Financial considerations	• Processed before ACH and checks at most banks (increased collections) • Immediate hold of funds • Allows for partial authorization • Estimated US$0.07 declined transaction fee • Requires PCI compliance	• Transactions cost US$0.26 to US$0.50 each • Estimated US$5 declined transaction fee

	DEBIT CARD	ACH
Operational considerations	• Immediate account validation • Immediate fund validation • Immediate notification of approval • Includes Account Updater service • Ubiquitous • Requires PCI compliance • High operational impact of chargebacks	• Immediate account validation • Ubiquitous • High operational impact for returned payments • Multiple-day settlement

Source: Aite-Novarica Group

THE IMPACT OF RETURNED ACH TRANSACTIONS

When funds are available, the debit card is more expensive per transaction than ACH. However, ACH returns are costly, often resulting in a US$5 fee per incidence and a conservative 30-minute internal operational impact per transaction.[17] Considering that the average hourly rate of an office and admin support employee is US$20.88, the combined internal cost impact of a returned ACH payment can be significant.[18]

Additionally, ACH returns aren't known for several days, and lenders must keep an overall return rate of 15% of total ACH transactions. Debit card declines occur in real-time, have a low cost, and can be attempted up to 15 times per 30 days without excessive retry fees, providing more opportunity to recoup funds when available without the high return risk once authorization is received. There are many reasons why returned ACH transactions can greatly impact expenses (Table D).

17 "Determining Your True Cost of Payments," AFP and Corpay Video, 58:18, posted by Corpay, March 13, 2022, accessed November 3, 2022, https://payments.corpay.com/resources/webcasts/afp-determining-your-true-cost-of-payments.

18 "May 2021 National Occupational Employment and Wage Estimates United States, occupation code 43-0000," U.S. Bureau of Labor Statistics, accessed November 3, 2022, https://www.bls.gov/oes/current/oes_nat.htm#43-0000.

TABLE D: EXPENSE OR IMPACT OF ACH TRANSACTIONS

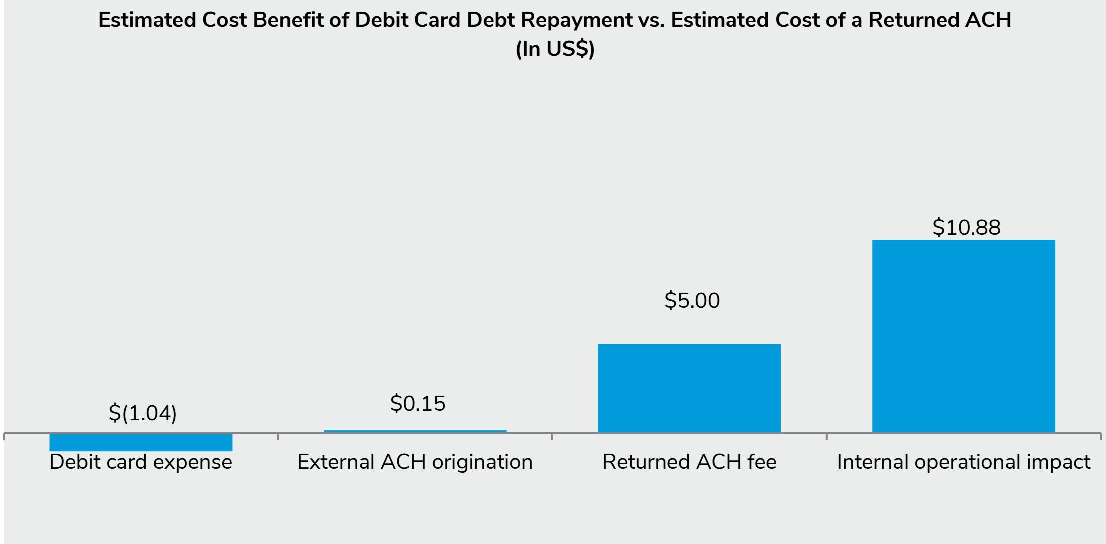
EXPENSE OR IMPACT ITEM	ESTIMATED COSTS OR POTENTIAL IMPACT
External cost for originated ACH transactions	The estimated external cost for each originated ACH debit transaction is approximately US$.15.[19] Retried ACH transactions are estimated to have the same external cost.
ACH Returned payment fees	The estimated per-item cost of a returned ACH is US$5 but will vary by the provider (versus an estimated US$0.07 per declined debit card transaction).
Customer experience expense	A positive customer experience helps ensure that the customer will continue the relationship after the loan is paid. Issues such as NSF returns, searching for the account and routing number, and the delayed nature of an ACH return can all negatively impact the customer experience.
Increased non-payment risk	Difficult to estimate as multiple factors influence non-payment. However, losses are likely because notification of returned ACH transactions can occur days after initiation, and customer contact may be problematic.
Estimated operational expense of a returned ACH	Returned payments can significantly impact staff and operational expenses, especially when returns must be reviewed and handled manually. The impact of a returned ACH on staffing and operational costs is estimated to be US$10.44, although this amount will vary by company.

Source: Aite-Novarica Group, TabaPay

When considering the many direct and indirect expenses of a returned ACH, the value of accepting debit cards likely to result in a returned ACH becomes clear (Figure 3).

[19] "Determining Your True Cost of Payments," Corpay, March 10, 2022, accessed November 3, 2022, https://payments.corpay.com/resources/webcasts/afp-determining-your-true-cost-of-payments.

FIGURE 3: POTENTIAL NET FINANCIAL BENEFIT FROM DEBIT CARD



Source: Aite-Novarica Group

BEST PRACTICES TO MAXIMIZE DEBT COLLECTION ROI

Only using legacy methods of payment limits lender and consumer options and results in lower collection rates. Lenders using only ACH can see improvements in payments ROI by adding debit as a repayment option. It is also essential for lenders to find the right mix of ACH and debit card transactions to optimize their unique expense and repayment rates. This section discusses multiple factors lenders should consider when designing their unique payment mix.

IDENTIFY A "COST PLUS" CARD PROCESSOR

A "cost plus" card processor pricing model means that card transactions are charged interchange, network fees, and processing fees. A flat fee pricing model charges a flat rate for all card processing, regardless of whether the published interchange rates are very low or capped. For example, a US$240 consumer Visa debit card transaction under a flat rate pricing agreement might cost US$0.25 plus 3% of the transaction amount (US$7.45). Alternatively, a "cost plus" merchant processor would charge lenders an estimated US$1.04 (US$0.46 interchange fee plus a US$0.33 network fee and a US$0.25 processor fee) for the same transaction.

Unfortunately, flat fee merchant processing models are the most expensive to process debit card payments since they are designed for credit, business, and other cards in addition to debit. Lenders and merchants should be careful not to default to a flat fee model, which may appear simpler at first, but will almost always be more expensive per transaction. A "cost plus" merchant processor is the most economical option for card processing, especially in debt repayment, where transactions are limited to debit cards, and the lender pays the cost of the interchange and network fees plus a processing fee.

Exempt and Regulated Consumer Debit Card Interchange Rates

The Durbin amendment to the Dodd-Frank financial reform legislation signed into law in 2010 limits debit card interchange fees for consumer debit card issuers with over US$10 billion in assets to US$0.21 plus 0.05% of a standard purchase transaction. Since the legislation, debit card issuers with over US$10 billion in assets have been referred to as "regulated" issuers and are responsible for approximately 60.7% of debit card transactions.[20] Alternatively, issuers with less than US$10 billion in assets are referred to as exempt issuers and are responsible for the remaining 39.3% of debit card transactions in the U.S.

Debt repayment transactions have a lower interchange rate compared to purchase transactions. However, there is still a difference between debt repayment rates for regulated and exempt consumer debit card transactions. Some acquirer processors can differentiate between regulated and exempt debit cards, and lenders can use this information to optimize payments and achieve lower costs. Table E provides an estimated Visa consumer debit card transaction expense at a "cost-plus" merchant processor for a US$240 transaction.

TABLE E: ESTIMATED VISA CONSUMER DEBIT CARD US$240 DEBT REPAYMENT COST

FEE TYPE	REGULATED DEBIT CARD	EXEMPT DEBIT CARD	ESTIMATED AVERAGE
Interchange	US$0.34	US$0.65	US$0.46
Network fees	US$0.33	US$0.33	US$0.33
Merchant processor fee	US$0.25	US$0.25	US$0.25
Total	US$0.92	US$1.23	US$1.04

Source: TabaPay, Aite-Novarica Group

DESIGN AN EFFICIENT DEBT REPAYMENT TYPE RATIO

Each lender should design program rules to guide which payment mix maximizes repayment, reduces losses, controls costs, and stays within ACH requirements of under 15% return rates. Lenders Aite-Novarica Group interviewed for this report indicated that shifting volume from ACH to debit can increase individual payment costs but helps to

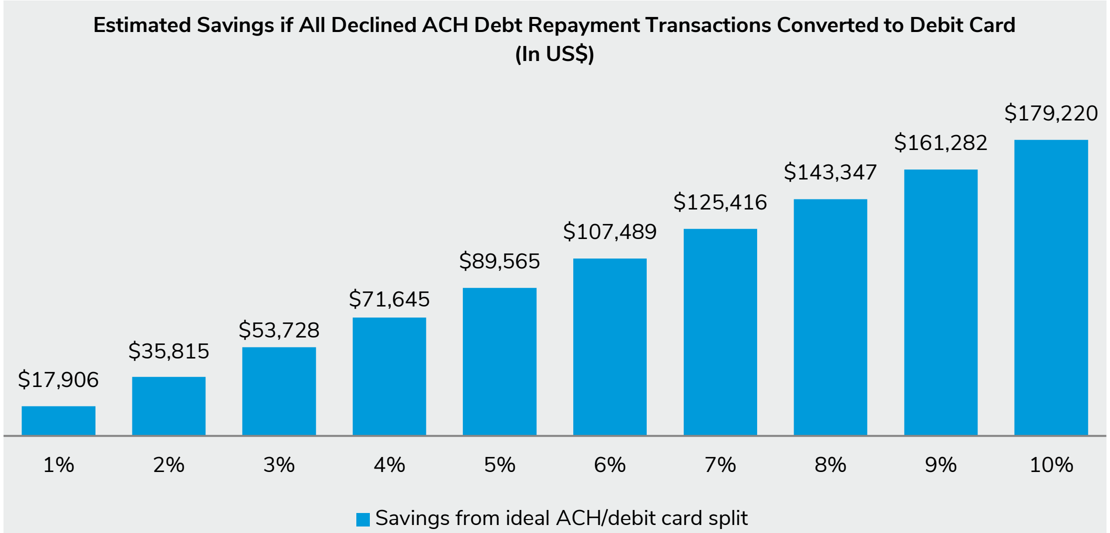
20 "Regulation II (Debit Card Interchange Fees and Routing): Average Debit Card Interchange Fee by Payment Card Network," Board of Governors of the Federal Reserve System, September 23, 2022, accessed November 3, 2022, www.federalreserve.gov/paymentsystems/regii-average-interchange-fee.htm.

maintain NACHA compliance, reduce ACH payment return fees, and improve repayment rates.[21]

> CEO, U.S.-based earned wage access provider: "ACH declines were at the heart of adding debit cards as an option. Debit also provides better experiences for our customers by being faster and preventing them from incurring overdraft fees."

By using the cost estimates presented in Table D and the estimated cost of a processed consumer Visa debit card debt repayment transaction of US$1.04, it is possible to calculate the potential cost-benefit of an ideal ACH to debit card debt repayment mix that matches the ACH return rates (Figure 4).

FIGURE 4: ESTIMATED SAVINGS OF REPLACING ACH DECLINES WITH DEBIT CARD



Note: Estimates for lenders that process 120,000 debt repayment transactions per month. US$240 per transaction.
Source: Aite-Novarica Group, Tabapay

It may not be possible to transition only those ACH transactions that are certain to be returned, but this model shows the value in developing rules for clients or situations that generally result in a returned ACH for conversion to a debit card payment.

[21] Aite-Novarica Group interviews with executives at four organizations that lend or advance funds and other key players in the debt repayment or payment processing industry.

PROACTIVELY MITIGATE COLLECTION RISK

Every lender's customer mix is different. Still, based on client interviews and portfolio modeling, there are basic guidelines to help mitigate collections risk amplified by returned ACH and check payments. Every lender and its client base is unique, but the following strategies may help limit returned payments and their associated collection risk:

- Encourage clients to provide debit card and ACH payment information to maximize payment options if a recurring payment is returned
- Require clients to pay via debit card if an ACH transaction is returned NSF. Doing so can help to improve portfolio repayment rates and limit returns among high-risk payers
- If the ACH overall return rate is 3% to 9% of monthly payments, consider moving a greater volume of transactions away from ACH and to debit card
- If the ACH overall return rate is over 9% or risks reaching 15% of total transactions, consider moving a more significant number of transactions to debit cards to maintain NACHA compliance

Faran Taher, Railsr: "A major downside of ACH is that if a payment fails, we do not know for two or three days."

Ultimately, the client base for every lender or company that advances funds is unique, and so is the current lending environment. In addition to adding debit cards as a repayment option and shifting some transactions from older payment methods to debit cards, companies should actively monitor their portfolio for changes. Companies should also pay attention to micro and macro factors and look to use debit more proactively because loan quality will likely regress from its current state.

ELIMINATE CHECKS AND CASH PAYMENTS

Checks and cash payments have higher overall costs than ACH and debit card payments. While it may not be possible or realistic to turn down a payment type, lenders and others receiving these types of payments should create a conversion plan or incentivize payers to move to digital payment types. Doing so can help reduce operational expenses associated with those payment types, reduce theft of cash, and potentially increase the availability of funds.

UTILIZE ALL DEBIT CARD FEATURES

Lenders should remember that debit cards provide benefits beyond a single payment. Once debit card information is received, lenders can securely store the card credentials or a secure token on file for recurring payments. Combined with the benefits of an account updater service, lenders can accept card information once and potentially use the same information to process payments for the life of the relationship.

Lenders can also benefit from debit cards by using the same card number to disburse loans or advance funds to clients using real-time payment services available on debit cards (e.g., Visa Direct). Using the same card number to send and accept funds makes accepting debit cards efficient and valuable for lenders and funds advance companies of any size.

CONCLUSION

Legacy repayment methods only work well when all the puzzle pieces fit together: consumers provide the correct account information, they have sufficient funds when the payment reaches their bank, and there are no clerical or keying errors. Legacy repayment methods also come with many downsides, such as longer processing times and delayed notification of declined payments, making them unideal when payment certainty is key for lending success.

On the other hand, debit cards alleviate the most important issues seen with legacy payment methods and can provide lenders with significant savings over returned legacy payment methods, such as ACH and check. They allow lenders and others that advance funds to maximize the customer experience, simplify operations, reduce risks, and maximize the certainty of repayment. And the value of debit cards becomes more robust as the risk of delinquencies and non-payment rises, such as in an economic downturn. Without offering a debit card debt repayment method to consumers, lenders risk loss from higher operational costs and may see higher debt write-offs compared to their peers that support debit cards for debt repayment as payment delinquencies rise.

Ideally, lenders and companies that advance funds for repayment will combine ACH and debit card payments to fit their portfolios. This payment mix will be unique between organizations and depend on various factors with the ultimate goal of maximizing on-time payment and collections while minimizing total losses (e.g., transaction expense, write-offs, lost revenue, and employee time).

ABOUT TABAPAY

Founded in 2017, TabaPay is a Mountain View, California, headquartered technology company that provides instant payments and payouts for fintech innovators. Meeting the shift towards instant, online transactions, TabaPay built a new platform to own the money movement process end-to-end, resulting in more reliable and lower-cost transactions for clients and their users.

Today, TabaPay is the modern and reliable money movement platform built for Fintech that lets users pay and get paid how, when, and where they want. With TabaPay, fintechs and lenders can:

- Support any use case and payment medium in one platform via a unified API
- Build better user experiences with best-in-class authorization rates across all payment methods
- Save 35-70% in processing fees with least-cost routing, custom rates, and full cost transparency
- Improve reliability with direct network connections for more options with fewer points of failure
- Advance funds to consumers, pay off lines of credit, and collect debt payments for maximum ROI

The TabaPay difference is direct access to 15 banking partners, 14 networks (card, RTP, and ACH), multiple geographies, innovative products, and features in one unified API. TabaPay is trusted by >2,000 Fintechs and Financial Institutions and is ranked a top merchant acquirer in the U.S., processing over a million transactions a day.

For more information, visit www.TabaPay.com

ABOUT AITE-NOVARICA GROUP

Aite-Novarica Group is an advisory firm providing mission-critical insights on technology, regulations, strategy, and operations to hundreds of banks, insurers, payments providers, and investment firms—as well as the technology and service providers supporting them. Comprising former senior technology, strategy, and operations executives as well as experienced researchers and consultants, our experts provide actionable advice to our client base, leveraging deep insights developed via our extensive network of clients and other industry contacts.

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