

## **THE PORTFOLIO PURCHASE PROCESS**

Many sales agents want to sell their portfolio residuals in order to raise cash. However, they do not have an understanding about the process that is involved in selling residuals. Below I will discuss the process and the various steps involved in order for a sales agent to sell its portfolio residuals.

### **Portfolio Residual**

This article contemplates a situation in which a sales agent sells a portfolio residual of a few thousand dollars a month up to approximately twenty thousand dollars a month in income. This is the type of transaction wherein a buyer will pay the sales agent a multiple of the average monthly residuals in order to purchase the right to continue to receive those residual payments in the future. This article is not intended to cover circumstances under which an entire company is sold or a portfolio residual stream of over twenty thousand dollars a month is sold.

There are a number of companies in the industry that specialize in purchasing portfolio residual streams. These companies can be easily found in most industry trade publications. If you want to sell your residual streams, it is usually prudent to contact a few of these companies to gauge their interest. Once they have shown interest, the question becomes what are the next steps in order to actually sell the residual payments?

### **Due Diligence**

Once of the things that a potential purchaser will want to review and analyze is documentation to verify the portfolio residual you are going to sell. This usually takes the form of providing the buyer at least three, if not, six months of residual reports for the portfolio residual stream. In addition, the purchaser will want to review the sales agent's contract with the credit card processor that is paying the residuals to the sale agent.

The residual reports for the portfolio residual stream that is being sold are important to the buyer to the extent that they can tell the buyer about potential pit-falls in a particular portfolio residual. Buyers are usually looking for concentrations of risk in the portfolio residual that is being sold in order to determine if they want to purchase the portfolio or not. Things such as large merchants that make up a substantial percentage of the portfolio residual being sold, inconsistent residual payments and other risk factors are analyzed by the buyer to determine the portfolio purchase price.

For instance, if there is one large merchant that makes up half of the portfolio residual, obviously if that merchant leaves, the buyer can lose a substantial amount of its expected profit. As a result, most buyers would be not willing to pay as high a price for a portfolio that has large merchants in it as they would for a portfolio that has many small

merchants. That is because with many small merchants there is little risk that the departure of any one merchant would substantially impact the future residual payments.

The buyer will also review the relevant Agent Agreement to determine if there is anything in the Agent Agreement that can endanger the portfolio residual. For instance, things such as exclusivity provisions, monthly production requirements (i.e. the agent must submit three merchants per month to the ISO or it loses its residual), and other similar items could lead the purchaser to not want to purchase the portfolio residual stream or reduce the price it is willing to pay.

One of the other common practices in the due diligence process entails the buyer interviewing the sales agent and its credit card processor to determine the sales agent's reputation and the reason for the sale. The sales agent's credit card processor can often shed light on whether or not the sales agent has been a good sales agent in the past. A good referral is important to the buyer to make sure that the sales agent will not do anything to negatively impact the long term viability of the portfolio residual payments. In addition, the sales agent must have a plausible reason for selling the portfolio residuals. Given the fact that the purchases of the residual will be made at a discounted price, the sales agent must have a good reason for selling the portfolio or the buyer will become suspicious of the seller's motives.

### **Documentation**

Once the buyer has satisfied itself that it wants to make an offer on the portfolio, it will often send over an offer sheet detailing the terms and conditions of the sale. The main term and condition is, of course, the purchase price, which is usually based upon a multiple of the average monthly residual payments that have been paid to the seller. If the seller accepts the offer, then it is time to document the transaction.

There are two main components to the documents that are used to memorialize the purchase and sale of the portfolio residual. The first is a Portfolio Purchase Agreement. This agreement sets forth the price and other terms and conditions under which the portfolio will be sold from the seller to the buyer. Some of the standard provisions in the portfolio purchase agreement are that the seller has good title to the asset that is being sold, namely the portfolio residual, and that the seller will do all it can, including servicing the merchants, in order to allow the buyer to get the benefit of the residuals. Of course, the most important provision is that the seller may not solicit the merchants that it is selling away from the credit card processor where they have been placed. Otherwise, the seller can sell the portfolio of merchants and then rewrite them, thus destroying the value of the portfolio to the purchaser.

The other main document that needs to be signed during the process is the Assignment letter. Any prudent purchaser will want the credit card processor where the

sales agent has placed the merchants to agree to the sale. This agreement takes the form of an assignment wherein the credit card processor agrees to quit paying the seller the monthly residual payments, and instead pay them to the purchaser.

Residuals sales are a valuable way for sales agents to raise cash when it is needed. Such a portfolio purchase sale can be beneficial to both the buyer and the seller, and is becoming more and more a standard practice in the bankcard industry.

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\* Paul A. Rianda, Esq. is an attorney who has specialized in providing legal advice to the bankcard industry for the past 10 years. For more information about this article or any other matters, please contact Mr. Rianda at [www.riandalaw.com](http://www.riandalaw.com), (949) 261-7700 or via email at [paul@riandalaw.com](mailto:paul@riandalaw.com)

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