

WHAT TO EXPECT WHEN YOU SELL YOUR PORTFOLIO RESIDUAL

Sales agents decide to sell their portfolio residuals for a variety of reasons such as expanding their marketing efforts, paying for unexpected expenses, getting out of the bankcard business, making a major purchase such as a house and a variety of other reasons. In this article, I will discuss the process involved in selling a portfolio residual and the issues that the sales agent can expect to encounter during that process. The subject matter of this article does not encompass the actual sale of merchants, merchant agreements or the movement of merchants to different ISOs.

What is a Portfolio Residual?

In the context of this article what the sale of a portfolio residual means is that the sales agent is selling its right to receive continuing residual payments under an Agent Agreement with a particular ISO that the agent has submitted merchants to over the years. In essence, what this entails is the ISO is merely making out the residual check in the name of the purchaser of the residual stream, not the sales agent that originated the merchants.

Picking the Purchaser:

Once the sales agent has decided to sell its portfolio residual, the first step in the process is determining what companies are in the market to purchase residuals. The most logical potential buyer to approach is the ISO that is paying the sales agent the residuals that sales agent is selling. Many ISOs are actively purchasing portfolio residuals of their sales agents. However, some ISOs do not have the capital on hand to purchase their sales agent's residuals.

The benefit to the sales agent of selling to the ISO that is paying the sales agent is that the ISO may value the asset more highly than a third party purchaser. That is because the ISO that is making the payment to the agent does not have to worry about issues such as the agent moving merchants or engaging in other activities that could cause payment of the residual stream to be terminated. Therefore, the ISO has a much lower risk of losing the residual stream and hence could be willing to pay the ISO a higher price than a third-party purchaser.

The other group of potential buyers is third parties that purchase portfolio residuals in a purely financial transaction. There are a number of companies that purchase portfolio residuals at a discount, because over the long run they can make a profit purchasing the revenue stream associated with the portfolio residual. The easiest way to find these potential purchasers is through the various trade publications in the industry that allow these portfolio purchasers to advertise in their publications. There are

only about three to five companies that specialize in purchasing portfolio residuals so once you find that many potential purchasers your search is complete.

Due Diligence:

Once an agent has contacted potential purchasers, the next stage of the process is that the potential purchaser will perform a review and analysis of the portfolio and related financial information, commonly known as the “due diligence” process. Any knowledgeable purchaser of residual streams will want to see the residual reports associated with the merchants for at least the prior three months or even for up to an entire year. The potential purchaser generally is looking to see if there is any seasonality to the residual derived from the merchants to determine if the amount of the residuals fluctuates over time. The purchaser will take this issue into account when calculating the price it is willing to offer as that price is usually derived from taking an average of the monthly residual payments.

Other issues the potential purchaser will be analyzing in the residual reports are any particularly large merchants in the portfolio and the attrition rate for the merchants. A purchaser is concerned when one merchant makes up an inordinately large percentage of the portfolio residuals it is purchasing. If there are some large merchants in the portfolio, the purchaser will want to contact those merchants to ensure that they will stay with their current credit card processor. The residual reports also provide the purchaser with the ability to determine the attrition rate the portfolio is experiencing. The larger the attrition rate, the less a purchaser is going to be willing to pay.

A sales agent is well advised to have all its residual reports available in electronic format to provide to any potential purchaser for a minimum of the prior six months. This allows the sales agent to provide the potential purchaser with the information it needs to make a realistic evaluation of the value of the portfolio residual stream. Purchasers appreciate this type of organization on part of a seller and it will make the process move much more smoothly.

Once the potential purchaser has done its due diligence and satisfied itself that the portfolio is one that it wants to make an offer to purchase, the next step is determining the purchase price. The purchase price is a multiple of the average monthly residual as derived from the prior month’s residual reports for the portfolio. Those in the industry that are purchasing residuals are doing so in order to make money on the transaction. Many sales agents I have spoken to in the past have high expectations as to the multiple that they will be paid by any potential purchaser. However, my experience has been that market does not support the high multiples that most sales agents expect.

Documenting the Transaction:

Once the parties agree on a price, the next step is to document the transaction by entering into a Portfolio Purchase Agreement and an Assignment. The Portfolio Purchase Agreement sets forth the terms and conditions under which the sales agent is willing to sell the portfolio residual to the purchaser. Typical provisions in such an agreement include purchase price, the terms of payment and non-solicitation clauses that bar the sales agent from soliciting any of the merchants that are sold to change their credit card processing in the future.

As to the payment of the purchase price, a purchaser will not often pay the entire purchase price upon the closing of the transaction. Many purchasers will make an up-front payment and then make payments for the rest of the purchase price for up to one year after the initial closing of the transaction. This is often done to make sure that the residual stream continues to perform at the expected rate and to ensure that the sales agent does not move merchants to another credit card processor.

The other document that is usually part of such a transaction is the Assignment Agreement assigning the portfolio residual from the sales agent to the purchaser. The ISO that is paying the residual must agree to allow the assignment of the portfolio residual from the sales agent to the purchaser. If this consent to an assignment is not obtained, conceivably the ISO can terminate the payment of the residuals to the sales agent under most Agent Agreements. In addition, the assignment allows the purchaser to have the ISO paying the residual make future checks out to the purchaser and not the sales agent. Therefore, it is critical to obtain the consent to an assignment from the ISO that pays the portfolio residual to the sales agent.

Once the Portfolio Purchase Agreement and Assignment are signed by all parties, the transaction is concluded. The purchaser is entitled to the payment of all future portfolio residuals and the sales agent can do what it likes with the portfolio buy-out proceeds.

A sales agent can obtain a healthy capital infusion to allow it to pay off obligations or fund future business endeavors through a portfolio sale. Portfolio purchases are becoming more and more common in the industry and will continue to be a good source of funds for sales agents to meet their capital requirements.

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