

## **HOW TO CHOOSE AN ISO**

By Paul A. Rianda, Esq.

Even though I am an attorney, I find myself giving a lot of “business” advice to my clients. One of the topics I most commonly discuss with clients is how to choose an ISO. In this article, I will discuss the state of the typical agent/ISO relationship, the different value propositions ISOs utilize to acquire and retain agents and the criteria you can utilize in order to determine which ISO is the right one for you.

### **The State of the ISO/Agent Relationship:**

To a large extent, the sale of merchant accounts on a wholesale basis from ISOs to agents has become a commodity market. What I mean by that, is the pricing from the ISO to the agent has been driven so low that there is not any significant difference in the pricing offered by different ISOs.

Most all ISOs are offering the same financial terms and conditions to agents. Gone are the days where an ISO would expect you to enter into an exclusive relationship with it and charge you a fee for submitting applications. Now, the typical Agent Agreement is a non-exclusive agreement where the agent is not charged any application fee. The agent and the ISO generally split the profits derived from a merchant on a 70-30 basis over a slightly inflated cost of goods sold. The cost of goods sold is generally interchange plus a few basis points on the discount rate. In addition, the ISO will also charge an approximately five dollar fee to the agent per merchant per month to pay for the ISOs overhead and customer services expenses. In addition, the typical Agent Agreement does not provide for the agent to assume any risk for merchant losses, unless the agent is responsible for the fraud that causes the loss.

What this means for the agent is that it is faced with a bewildering array of different ISOs competing for its business without being able to differentiate between them by way of price. In addition, all the ISOs are offering the same legal terms and similar customer service levels. This leaves the agent in a situation where it must try to determine what makes a particular ISO the one it chooses to do business with above all others. It also leads to a situation where the ISOs have to find a unique value proposition, other than price, to differentiate themselves from other ISOs in order to obtain additional sales agents

### **Value Added Propositions:**

In order to recruit new agents, ISOs need to come up with new ways of making themselves stand out in the crowd of similar ISOs. One way of doing so is a simple proposition of paying for merchants by paying an agent a “bounty” per merchant. This practice was first used by ISOs as a way to attract high volume processing merchants to roll over existing merchants to a new ISO. The price paid by the ISO to the agent was often tied to the prior processing volume of the merchant. However, recently, ISOs have been willing to pay a bounty for even new merchants, typically \$100 or so. Cash is one way ISOs are using to attract agents.

Another recent innovation utilized by ISOs is paying agents in advance for the future residual stream of a merchant. ISOs have been paying merchants anywhere from twelve times and up of the

merchant's projected monthly residual stream when the merchant application is submitted and approved by the ISO. The ISO in turn usually gets full ownership of the merchant once the payment is made and the agent does not have the right to any further residual payments derived from the merchant. This allows agents that do not have the financial means to initially support their operations to fund their operations through these up front residual payments.

These up-front payments can be used to replace the revenue stream that used to be derived from leasing of equipment. Over the past few years, competitive pressures have lead to a situation where agents make far less revenue from equipment leasing. The detriment to the agent of these up-front residual payments is that they are basically mortgaging their future to be paid merchant residuals now. It is a good way to transition and start a business if the agent can later move to a typical agent/ISO relationship where they are paid their residuals on a monthly basis instead of up front.

Another way that ISOs differentiate themselves from the others is by allowing their agents to become equity owners in the ISO. However, this tactic has been used by relatively few ISOs to obtain additional agents. There are numerous state and federal securities laws that make this type of arrangement fairly problematic. Given that each state has its own separate securities laws, it is quite easy to run afoul of securities laws in these types of situations without even knowing it. In order to do this in an appropriate fashion, the legal start-up expense is quite expensive which is a barrier to many ISOs that may want to pursue this strategy.

One of the oldest ways of differentiating an ISO is the personal relationships that the principals of the ISOs are able to develop with their agents. Be it on the golf course, in Las Vegas or at the local bar, ISOs have always tried to create a personal relationship with their agents. The ISOs that are able to do so, build a strong and loyal agent base that is less likely to be lured away just because a new ISO can offer a few more dollars to the agent.

These are just some of the more common of many ways that ISOs try to make themselves stand out from their competition. But how does an agent determine which ISO it should choose? The question comes down to a financial decision, as well as deciding if any of these value-added propositions appeal to the agent. There are also other important items to consider as discussed below.

### **Criteria for Choosing an ISO:**

Choosing an ISO is probably the most important decision an agent can make. Each agent has its own reasons for choosing a particular ISO. However, there are a few important aspects of the agent/ISO relationship that should always be considered:

**Value Added Propositions:** The agent may have certain financial or other requirements that it would like from an ISO. I have listed a number above, such as paying a bounty for merchants and paying merchant residuals up-front. Other agents may want a good leasing program or bonuses for reaching certain processing volumes. Whatever your requirements, it is best to write them down at the outset, when you are trying to find an ISO. This allows an agent to come up with a clear set of goals and present them to the ISO in a meaningful and logical fashion.

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**Reputation:** The most important thing an ISO has is its reputation in the bankcard community. It is important to learn about the ISO's past history in regard to paying residuals and accepting merchant applications. A well-regarded ISO that has a long history of paying out its residuals obviously is a much better alternative for most agents, than a start up ISO that may or may not have a proven track record. However, given the massive consolidation in our industry, past payment of residuals is not a fool proof indicator of the future chances of the ISO paying residuals.

**Customer Service:** For the most part, agents rely on the ISO to retain the agent's customers. Most of the agents do not perform their own customer service but allow the ISO to do it for them, for a fee of course. This leaves the agent in a situation where it must be able to rely upon the ISO to properly service the agent's customers. Finding out from other agents the customer service reputation of an ISO is an important step before moving to contract with that ISO.

Choosing an ISO is not an easy or fast process. However, it is probably the most important decision any agent will make as a business owner. As such, it is worth the time and effort to make sure the ISOs you choose are going to pay you what you expect and give you the value-added items that you require.

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\* Paul A. Rianda, Esq. is a partner in the Southern California law firm of Kring and Chung, LLP, and has worked in and with the bankcard industry for the past 9 years. For more information about this article or any other matters, please contact Mr. Rianda at (949) 261-7700 or via email at [prianda@kringandchung.com](mailto:prianda@kringandchung.com).

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