

Embedded payments are a powerful way for B2B software platforms to improve customer experiences and accelerate revenue growth. Leading software companies have transformed their business models by combining subscription revenue with payments monetization.

We identified this opportunity 10 years ago, when we launched Stripe Connect, our multiparty payments solution for platforms and marketplaces. Then, software platforms had to invest considerable resources into building payments infrastructure if they wanted to allow their customers to accept payments natively through their products. Early Connect adopters, such as Shopify, Lyft, and Instacart, were able to offload the complexity of payments facilitation to Stripe, so that they could launch embedded payments faster without diverting resources from their core offering.

Now, more than 10,000 platforms use Connect for embedded payments, with many, including Lightspeed Commerce and Jobber, extending their payments businesses with [embedded financial services](#). We continue to invest in Connect to help platforms evolve their offerings beyond payments into [lending](#), [cards](#), [financial accounts](#), and even [crypto](#).

As long-standing advocates of the embedded payments opportunity for software platforms, we highly recommend this report from 451 Research. In fact, we consider it essential reading for any product leader in SaaS who is evaluating opportunities to improve customers' experiences, boost retention, and unlock new revenue streams. We are honored to be recognized by software platforms as "the gold standard" for hybrid payment facilitation deployments.

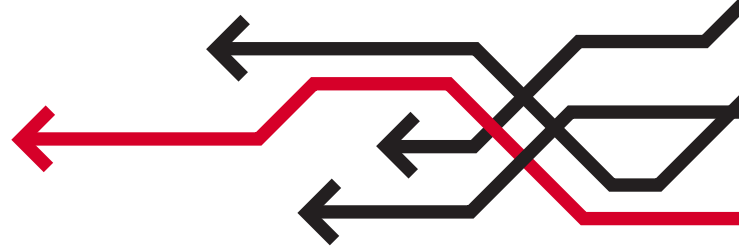
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Exploring the Payments Opportunity for B2B Software Platforms

Jordan McKee Principal Research Analyst

This report aims to provide clarity on the payments opportunity for software platforms. It provides an overview of the business rationale for offering payment services, a discussion of the various models to consider and a view into the longer-term opportunity in financial services. In doing so, it highlights various vendors that offer capabilities for software platforms to play a more direct role in enabling their customers to accept payments.

The following is an excerpt from an independently published 451 Research report, "Exploring the Payments Opportunity for B2B Software Platforms" released in March 2022.

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Executive Summary

Introduction

The business case for B2B software platforms to play a more direct role in payments is simple: enhance the user experience, drive revenue growth and increase product stickiness. The avenues for execution are less succinct. There are many possibilities for software platforms to consider, ranging from relatively straightforward referral models to becoming full-fledged payment facilitators that directly participate in the flow of funds. Each model has its own advantages and tradeoffs, and there is no single right answer.

For many software platforms, the road to payments can be a confusing one, clouded by similar vendor marketing narratives and opaque descriptions of the time, resources and investment involved. There is no shortage of partners to consider. Most payment processors have begun to lean into the distribution opportunity that software platforms present, although capabilities and approaches vary widely. Simultaneously, an ecosystem of payments-enablement startups has emerged to equip software platforms that wish to run payments in-house with various infrastructure to do so.

While the considerations are many, one thing is straightforward: All software companies are payments companies. Those quick to recognize this – such as Shopify and Toast – have transformed their value propositions and the growth trajectory of their businesses. Those that haven't risk falling short of their customers' expectations and their market potential.

This report aims to provide clarity on the payments opportunity for software platforms. It provides an overview of the business rationale for offering payment services, a discussion of the various models to consider and a view into the longer-term opportunity in financial services. In doing so, it highlights various vendors that offer capabilities for software platforms to play a more direct role in enabling their customers to accept payments.

About This Report

This report examines the growing trend of B2B software platforms offering payment services to their end customers. It covers the business drivers, discusses the various deployment models, provides overviews of key vendors and explores the implications of the trend for payment service providers. Further, it offers a perspective on the longer-term opportunity for software platforms in embedded finance. The report includes data from 451 Research's Voice of the Customer: Macroeconomic Outlook, Business Trends, 2022 Outlook survey and Voice of the Enterprise: Digital Pulse, Business Reinvention and Transformation 2021 survey. Additionally, it includes select findings from a custom merchant survey of more than 250 payments decision-makers across North America, Latin America, Europe and Asia conducted in Q4 2021.

Key Findings

- More than 1 in 10 (13%) merchants indicate their businesses use an integrated payment processing service from one of their primary software vendors. Among those that don't, 75% are very interested in doing so.
- Driving revenue growth, enhancing the user experience and increasing product stickiness are the three key drivers fueling software platforms' move into payments.
- While becoming a registered payment facilitator is a possible option for most software platforms, the opportunity and financial costs associated with execution and ongoing operation make it a viable option for very few.
- A new approach commonly referred to as the hybrid model is gaining significant traction in the marketplace. It offers software platforms a combination of lower development and operational burden (as compared to the payment facilitator model) and improved control and margins (as compared to the integrated model).
- While payments are an ideal entry point for software platforms into financial services, the long-term opportunity is much broader and larger. Software platforms should enter into payments with a vision around how they can expand into embedded finance.

Becoming a Payments Provider: Weighing the Options

The concept of software platforms enabling merchants with payment acceptance capabilities is not new. Activity began to ramp up in the early 2000s as independent software vendors (ISVs) started to establish reseller, or independent sales organization (ISO), relationships with payment processors. This partnership structure opened the door to payments monetization for software platforms, enabling them to share in the transaction revenue for the merchants they referred to their payment processing partners. It also created an avenue to deliver a slightly more integrated payment experience to software end users, though it fell short of providing ownership over critical areas such as instant merchant onboarding, customer support, branding and payouts. Mercury Payment Systems, acquired by Vantiv (now FIS) in 2014 for \$1.65bn, and Cayan, acquired by TSYS (now Global Payments) for \$1.05bn in 2017 were early pioneers of this trend. Today, most payment service providers offer these types of integrated payment opportunities for software platforms. While they offer the least amount of control over the user experience, setup is generally low-impact, and depending on the commission structure negotiated, they can present a reasonably lucrative monetization opportunity.

In 2010/2011, rule changes enacted by Visa and Mastercard created what is known as the payment facilitator model. The payment facilitator model removed the barriers for software platforms (and various types of service providers) to establish direct contracts with their merchant customers (known as sub-merchants) and move funds on their behalf. It also expanded the margins software platforms can earn in payments, in exchange for taking on significantly more risk and responsibility. Square and PayPal are among the earliest examples of payment facilitators. Today, there are more than 250 payment facilitators registered with Mastercard in the US.

The Payment Facilitator Model: More Than Meets the Eye

Many software platforms we speak with that are early in their payments journey initially want to become payment facilitators, prior to developing a complete understanding of what's involved. At face value it's an attractive model, offering the most robust transaction margins (as high as ~100 basis points, though generally closer to 50-75 basis points), the highest level of control (e.g., instant onboarding, control over payouts, control over underwriting criteria) and complete ownership over the end-to-end payment experience. It's also an incredibly demanding model characterized by substantial risk, responsibility and investment. As a payment facilitator, the software platform truly becomes a payments business.

A cornerstone of the payment facilitator model is the ability to sign merchant acceptance agreements on behalf of an acquiring bank (e.g., the merchant does not need to enter a direct relationship with the acquiring bank). This means the payment facilitator is responsible for sub-merchant underwriting and due diligence, and ultimately has liability for their actions. For instance, if a sub-merchant commits fraud and disappears (e.g., merchant bust-out scheme), the payment facilitator is left holding the bag financially. Under this model, the payment facilitator can also – but doesn't necessarily have to – receive settlements from the acquiring bank on behalf of its sub-merchants (e.g., they are in the flow of funds), and then settle those funds directly to its sub-merchants.

As a payment facilitator, the software platform must take ownership over a wide range of tasks, including sub-merchant underwriting, transaction monitoring (e.g., to ensure compliance with card networks, manage fraud), payment card industry (PCI) compliance, banking compliance (e.g., anti-money laundering [AML], Office of Foreign Assets Control [OFAC], know your customer [KYC]), dispute management and customer support. The many functions performed by payment facilitators require resources and capital. Upfront costs often range from \$1m-\$3m and a team of 4-10 full-time employees is generally required for ongoing operation. While we have heard of well-prepared software platforms becoming payment facilitators in under a year, it's not uncommon for a launch to take two to three years.

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The payment facilitator journey entails multiple steps before a launch is possible, including:

- Producing a complete business plan to attain sign-off from a bank ‘sponsor’
- Identifying and integrating technology partners (e.g., payment gateway, ID verification vendor, alternative payment methods)
- Attaining PCI certification
- Developing multiple business- and customer-facing tools and systems (e.g., dispute management system, onboarding flow, merchant dashboard, risk management system, reporting tools)
- Building out business processes (e.g., customer support, reporting)
- Creating underwriting policies
- Registering with the card networks (e.g., Visa, Mastercard)
- Securing various licenses (e.g., potentially attaining money transmitter licenses and regional licenses)
- Hiring specialized consultants (e.g., RPY Innovations) to assist in navigating the above processes

A payment facilitator must appropriately staff up – such as hiring risk, engineering, payments, legal and finance talent – to manage the various functions and systems associated with payment acceptance and merchant onboarding. They must also handle ongoing tasks such as license renewals, annual PCI validation, managing 1099-K forms (and local equivalents) and customer support. Many of these requirements can necessitate significant rebuilding when entering a new geography, and substantial engineering and development is often necessary to accommodate new regulations (e.g., Payment Services Directive Two [PSD2]) and card network mandates (e.g., EMV 3-D Secure [3DS]).

Figure 4: Unpacking the Payment Facilitator Model



Source: 451 Research, 2022

These descriptions aren’t intended to dissuade software platforms from becoming payment facilitators, but rather to provide visibility into the significant responsibility it entails. There’s good reason why the number of registered payment facilitators in the US measures in the low hundreds rather than thousands. Under this model, the software platform must truly act and operate as a payments company. Typically, this means making trade-offs on the core business.

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That isn't to say that becoming a registered payment facilitator is not a viable option. Vertical software platforms that operate in low-risk verticals and those that have extensive in-house payments expertise can be candidates for this approach. Generally, they will need to facilitate at minimum \$50m-\$100m in annual transaction volume per country – though ideally significantly more – to break even on the ongoing operational expense. A common figure we heard cited throughout the research process was \$1bn in annual transaction volume per country as the threshold where the investment in becoming a payment facilitator starts to become more easily justifiable.

FIS (Worldpay) and Fiserv (First Data) are among the most prominent and experienced providers that directly enable payment facilitators. They have dedicated functions (e.g., product, legal, solutions, sales, operations) built out to service payment facilitators and collectively are responsible for enabling, by our estimates, more than two-thirds of the registered payment facilitators in the US. In our conversations with these providers, we understand they are up-front with prospective clients about the demands involved with becoming a payment facilitator. One estimated that roughly half of the software platforms that approach them about becoming payment facilitators are underprepared. Another noted to us that their risk appetite has reduced significantly in recent years, and that they are not shy about turning underprepared software platforms away. After all, if one of their payment facilitators goes under due to mismanagement (e.g., poor underwriting), these providers are left with full financial responsibility.

The Role of Payment Facilitator Enablers

Recent years have seen a new cohort of startups emerge to address certain complexities associated with developing the necessary infrastructure to operate as a payment facilitator. These providers are often referred to as payment facilitator enablers, or payment facilitator-as-a-service providers, and provide platforms with modules intended to shoulder some of the technical and operational burden of becoming a payment facilitator. For example, several of these platforms offer the technical infrastructure to support tasks such as merchant onboarding (including AML, KYC and risk management), dispute management, settlements and payment token vaulting, while still enabling the software platform to maintain control over their approach to payments (e.g., configuring fees, payout schedules, transaction limits). Examples of notable vendors in this category include Finix, Payrix and Infincept.

Payment facilitator enablers offer the benefit of purpose-built tools for software platforms that wish to become registered payment facilitators but don't want to build the necessary infrastructure from the ground up. This can help to improve the speed-to-market and unit economics associated with the payment facilitator model. Some, such as Finix, also provide professional services to help software platforms with execution. Still, under this framework, the full risk, liability and regulatory burden is owned by the software platform, as are the operational tasks. Further, most payment facilitator enablers are US or North America-centric, meaning their ability to support global rollouts is limited.

The Rise of the Hybrid Model

While becoming a registered payment facilitator is a possible option for most software platforms, the opportunity and financial costs associated with execution and ongoing operation make it a viable option for very few. Traditionally, software platforms had to weigh becoming a payment facilitator against the alternative, which was to utilize an integrated payments revenue share model. As previously discussed, this model entails tradeoffs of its own, and may fall short of the customer experience and margin goals software platforms have in payments. This dynamic has given rise to a new model commonly referred to as the hybrid model, also known as the white label model or managed payment facilitator model. This model is pitched as offering the best of both worlds – a combination of lower development and operational burden (as compared to the payment facilitator model) and improved control and margins (as compared to the integrated model). The hybrid model is what we currently see the overwhelming majority of software platforms pursuing.

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The hybrid model involves leveraging some or all of another payment service provider's infrastructure and services. This helps to reduce the software platform's development work, operational expense and regulatory exposure, ultimately accelerating time to revenue. Resource-intensive tasks such as KYC/AML checks, PCI compliance and validation, licenses and underwriting are generally handled by the software platform's payment partner. Similarly, since the payment service provider's infrastructure (e.g., gateway, token vault, payout mechanisms, reporting tools) is utilized, the need for ground-up technology buildouts is negated. Because of this, time to market with the hybrid approach is commonly in the four- to eight-month range, and often faster if the software platform chooses an integration with limited customization. While implementation and integration will typically require the support of at least several developers, the headcount requirement is minimal compared to becoming a registered payment facilitator.

Under the hybrid model, software platforms can still provide a payment offering that looks and feels like their own, complete with their own branding and integration with their user experience. Even customer onboarding can be fully integrated and offered instantaneously. To the merchant, it typically feels as though the software platform is the one directly providing the payments capability.

The primary tradeoff of the hybrid model is that the software platform must cede a certain degree of flexibility/autonomy and margin to the vendor that is delivering their underlying payments capabilities. The level of flexibility and autonomy varies from vendor to vendor. Typically, the underlying underwriting criteria and merchant terms and conditions are non-negotiable and are fully controlled by the payment service provider offering the hybrid capability. From a margin standpoint, the most significant variable here is which party owns the liability associated with transactions. Generally, this is negotiable, and the more risk the software platform is willing to take on (e.g., chargebacks), the more control and margin they will be granted by their payment partner. Additional factors, such as customer support and custom funds flows, are often negotiable depending on the partner.

Most payment providers that enable the hybrid model give software platforms access to 'buy rate' pricing, which the software platform can then mark up with their own margin. Factors such as volume and liability will influence the rates that software platforms have access to. Software platforms may also be able to generate additional revenue by marking up pricing on their payment partner's other products (e.g., instant payouts, fraud prevention, analytics) if they offer them. Examples of notable providers in this category include Stripe, Adyen, Chase (WePay), Payrix, Paysafe, BlueSnap and Finix.

Several providers – including Stripe and BlueSnap – also offer a hybrid option that is more turnkey and fully hosted. It shares similarities with the traditional integrated payments model, but we see it as more deeply embedded. This type of deployment is co-branded, and the underlying payment service provider assumes complete ownership of all tasks (e.g., onboarding, fraud liability, customer support). Here, the software platform typically monetizes through a revenue share, and the software platform's merchants have a direct relationship with the underlying payment service provider. We see this deployment as generally a better fit for smaller software platforms, those with limited transaction volume in a specific country or those looking to get to market as fast as possible.

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Capabilities and strengths across vendors in the hybrid category vary widely. Examples of areas to assess include:

PLATFORM

- Geographic support
- Onboarding flows (e.g., optionality for hosted onboarding, optimizations)
- Risk ownership (e.g., option for software platform to own)
- Customer support (e.g., option for software platform to own)
- Pricing (e.g., buy rate, revenue share)
- Licenses
- Uptime
- Risk and fraud monitoring (e.g., tools, option for software platform to own)
- Omnichannel support
- Branding (e.g., white label)

PAYMENTS

- Local acquiring capabilities
- Alternative payment method support
- Payouts (e.g., real-time support, customizability of schedules)
- Funds flows (e.g., customizable)
- Authorization rates
- Card network tools (e.g., account updater, network tokenization)
- Recurring/subscription payment support
- Invoicing compatibility

TOOLS

- Reporting and analytics tools (for both the software platform and end-users)
- Value-added services (e.g., working capital)
- 1099-K form management
- Integrations (e.g., with business software packages)

We encourage software platforms to conduct thorough vendor assessments and schedule inquiry time with 451 Research to identify payments partners best suited for their own individual business needs and requirements.

Provider Overviews

A wide variety of vendors provide payment-enablement capabilities to software platforms. Not all of them are captured in this section. Here, we highlight more than a dozen providers (in alphabetical order), selected based on their market traction and/or the frequency of their citations throughout our research process.

Stripe

Stripe enables software platforms with payment capabilities via its Connect offering. We heard from software platforms throughout our research process that Connect is the gold standard when it comes to hybrid deployments and that Stripe's APIs, onboarding optimizations and ability to streamline global expansion were second to none. As one software platform told us, "Stripe is as fancy as it gets." Software platforms can fully white label their Connect deployment, establish custom funds flows, take ownership over liability and support, and access buy rate pricing. Stripe also enables co-branded deployments with direct charges. With this approach, liability and support are offloaded to Stripe, and software platforms monetize via a revenue share. Through Connect, software platforms can reach more than 40 countries via a single integration and can support omnichannel payments. Stripe also stands out for its ability to equip software platforms with a variety of financial services capabilities to offer their end customers (and monetize), including working capital (Capital), card issuance (Issuing), and banking as a service (Treasury).

From Embedded Payments to Embedded Finance

Payments are an ideal entry point for software platforms into financial services. A payments relationship generates data, trust, and inevitably, additional banking needs. This creates the bedrock for software platforms to offer a full suite of embedded finance capabilities to further enhance their revenue, user experience and customer retention objectives. Every software platform that is offering payments – or even considering it – should have a broader vision around the long-term opportunity in financial services. Embedded finance, not embedded payments, is the endgame.

Working capital is among the most logical first steps from payments into embedded finance. As a provider of both software and payments, software platforms have deep visibility into the performance and sales dynamics of their customers' businesses. This puts software platforms in a position to make more informed lending decisions and take automatic repayments as a percentage of daily sales. Moreover, it enables software platforms to catalyze the growth of their customers' businesses, creating multiple opportunities (e.g., increased transaction volume as the business grows) down the line. Toast, for instance, has offered its working capital product, Toast Capital, for approximately two years and in 2021 originated over \$100m in total loans. Shopify, which has offered Shopify Capital since 2016, advanced more than \$324m in Q4 2021 alone (up 43% year over year). According to 451 Research's Voice of the Customer: Macroeconomic Outlook, Business Trends, 2022 Outlook survey, nearly one in five (19%) businesses with fewer than 1,000 employees intend to take out a loan or line of credit in 2022.

Expense cards represent another area of opportunity. Software platforms can enable their customers to issue expense cards to their employees, complete with customizable spending controls. In doing so, they can generate interchange revenue based on the transaction volume generated via their cards. We also see an opportunity for software platforms to deliver integrated expense reporting capabilities as part of their software package, which could create an additional monetization opportunity.

As software platforms get further along in their embedded finance journey, offering a money management product can transform the platform into a financial operating system for their customers. This is an account through which customers can receive expedited sales deposits, deposit funds and make payments. Coupled with a card product, the account can function much like a traditional bank account, allowing customers to make purchases and withdraw cash from their balance. Software platforms can generate both interest revenue (on total funds stored) and interchange revenue (on card transactions), along with providing detailed, granular reporting on their customers' finances. Shopify Balance, offered in partnership with Stripe via the Stripe Treasury product, is among the best examples of what this looks like in the wild. Launched in January 2022, Shopify says "thousands of merchants" are already active users.

As software platforms get deeper into embedded finance, it's easy to see additional areas for expansion. Payroll, insurance, purchase financing and even investments such as 401(k) all represent relevant areas in which capabilities can be delivered. Software platforms should be guided by one key question in embedded finance: "How can we make our customers' financial lives easier?"

While there are a variety of stand-alone providers that can support embedded finance use cases, such as Marqeta for card issuance and Parafin for working capital, software platforms should press their payment partners on their product roadmap for embedded finance in an effort to deliver the most integrated experience. Apart from a select few, most payment providers to software platforms have yet to deliver on embedded finance.

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Figure 5: Three Near-Term Embedded Finance Opportunities for Software Platforms

Product	Use Case	Revenue Model
Working capital	Use transaction data and operational insights to make lending decisions and fund customers' growth. Repayments can be captured as a percentage of daily sales.	Revenue share percentage on loan volume
Expense cards	Enable customers to issue expense cards to their employees with dynamic spending controls. Provide integrated expense reporting within software.	Interchange revenue share percentage on transaction volume
Money accounts with spending cards	Enable customers to receive expedited sales deposits in an account that they can also deposit funds into and pay bills from. Issue a spending card where customers draw on their account to make purchases and withdraw cash. Provide deeper reporting on business finances within software.	Interest revenue on total volume of funds stored; interchange revenue share percentage on transaction volume

Source: 451 Research, 2022

About the Author



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Jordan McKee is a Principal Research Analyst for Customer Experience & Commerce, leading the coverage of the payments ecosystem at 451 Research, a part of S&P Global Market Intelligence. He focuses on the digital transformation of the commerce value chain, with an emphasis on the major trends and technologies impacting payment networks, issuing and acquiring banks, payment processors and other payments industry stakeholders. His research helps vendors and enterprises assess and address the implications of the ongoing digitization of the shopping journey.

Jordan joined 451 Research with the company's acquisition of Yankee Group in 2013. Before joining 451 Research, he worked at OnProcess Technology, helping telecom and financial services businesses improve their customer experience and service supply chain strategies. Prior to this, he was a member of FM Global's internal market research unit, analyzing trends in the insurance sector.

Jordan is listed on the Electronic Transactions Association's Forty Under 40 list for 2018. He is frequently engaged by the media to share his insights on digital payments and has been quoted in the Wall Street Journal, New York Times, Forbes, TIME, Businessweek and The Financial Times. McKee is a regular speaker at client and industry events, delivering keynotes and moderating panels at SXSW, Money20/20 and ETA TRANSACT. Additionally, Jordan is a Forbes fintech contributor and sits on the board of advisors for the Mobile Payments Conference.

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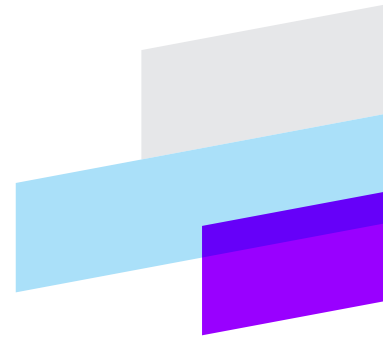
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Stripe Connect is an end-to-end money movement solution that allows software platforms to build and scale global payments and financial services businesses with less overhead and more opportunities for growth. With Stripe, software platforms can create better payments experiences, from onboarding to payouts, and streamline operations with tools to manage complex funds flows, consolidate reporting, and integrate with key business systems. Stripe's powerful APIs simplify the complexity of payment facilitation so companies can get to market faster and expand to new markets with lower upfront and ongoing costs. More than 10,000 platforms, including Shopify, Mindbody, and Lightspeed Commerce, have transformed their businesses with embedded payments and financial services from Stripe.

Contact us at sales@stripe.com or visit www.stripe.com/connect to learn more.

