



PRIVATE EQUITY & VC INSIGHTS

The Underwriting Paradox: Fast

Growth, Smart Risk w/ Payments

Payments Insights & Strategies for Investors in
vertical SaaS Platforms

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Merchant Underwriting Strategies within Embedded Payments

Executive Summary

Embedded payments have revolutionized how software platforms monetize and serve their customers, allowing vertical SaaS companies to integrate payment processing directly into their applications. But with this opportunity comes a unique challenge: underwriting thousands of “sub-merchants” at scale with limited direct visibility. Traditional merchant underwriting approaches – built for banks or acquirers dealing directly with merchants – often fall short. This report explores why embedded payments underwriting is uniquely complex, how technology is creating a competitive moat, strategies to balance growth and risk and what investors should evaluate when assessing solutions in this space.



Why Traditional Merchant Underwriting Models Fall Short

In a traditional merchant acquiring scenario, an acquirer or ISO (Independent Sales Organization) directly underwrites each merchant by collecting extensive information (financials, credit history, business model) and often interacting with the merchant. Embedded payments flip this model on its head¹. In an embedded scenario, a software platform (e.g., a SaaS company serving restaurants, salons, or gyms) offers integrated/embedded payments to its customers (the businesses using the software). The platform typically either becomes a registered Payment Facilitator or partners with one. In both cases, the platform, not the payment provider, owns the primary relationship with the end-merchant.

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This setup creates what some analysts call a “double-blind” underwriting scenario. The payment provider (or PayFac) is responsible for underwriting and risk management of the end-merchants, yet they may never interact directly with those merchants – all information comes via the platform. Conversely, the platform might have rich data on the merchant’s operations within the software (appointments scheduled, invoices sent, etc.) but limited insight into the merchant’s broader risk factors (like credit history or activities outside the platform).

Key risk factors inherent in this model include:

1. **Limited Merchant Visibility:** Underwriters rely on minimal data shared by platforms, requiring smart analytics over traditional financial documentation.
2. **Transaction Velocity Spikes:** Immediate merchant activation enables "bust-out" fraud before detection, demanding continuous monitoring over front-loaded underwriting.
3. **Industry Concentration:** Vertical platforms create correlated portfolio risks and novel business models that don't fit legacy underwriting categories.
4. **Platform-Introduced Risks:** Platforms prioritizing conversion over friction can bypass risk controls, while traditional 1:1 underwriting models weren't designed for high-volume, delegated contexts.

Technology-driven Underwriting: A Competitive Moat

Leading embedded payment providers like Worldpay have transformed underwriting into a technology arms race. The ability to instantly approve legitimate businesses while catching bad actors has become the core differentiator for payment facilitators and a key criterion for SaaS platforms choosing payments partners. Advanced underwriting technology is becoming a genuine competitive moat.

Modern merchant underwriting systems use machine learning (ML) models to analyze real-time transaction patterns rather than relying solely on credit scores or manual document reviews. These models learn "normal" behavior patterns for merchants by industry, location, and platform, detecting anomalies that static rules miss. Industry experts report that ML-based risk scoring can identify fraud or credit risks months earlier than traditional methods by spotting subtle usage patterns.

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These systems operationalize data & insights through automated engines that can instantly auto-approve low-risk merchants, route applications for manual review, or reject high-risk cases. Worldpay case studies show SaaS partners onboarding thousands of sub-merchants monthly with 95%+ auto-approval rates while maintaining controlled fraud losses². Technology-driven underwriting improves continuously as every transaction feeds back into the models. Scale becomes a moat—providers like Worldpay leverage billions of transactions to train algorithms recognizing patterns that smaller providers miss. This creates a virtuous cycle: more data enables better models, leading to safer expansion and more data.

Balancing Growth & Loss Prevention

Achieving scale in an embedded payments business means onboarding not just hundreds, but thousands of sub-merchants every month. Managing risk at this pace requires robust systems and a portfolio-level approach to complement individual merchant underwriting decisions. The central challenge is balance: how to meet aggressive growth targets (fast onboarding, high approval rates) while keeping fraud and credit losses within acceptable bounds.

Dynamic Controls & Tiered Limits: New merchants start with restricted transaction limits (e.g., \$20,000 weekly caps) that automatically adjust upward as they demonstrate clean processing history. This "trust but verify" approach enables growth while containing potential damage from bad actors who slip through initial screening.

Portfolio Diversification: Risk teams set concentration limits to prevent over-exposure to single platforms, industries, or regions. For example, capping any one vertical at 25% of total volume ensures that sector-specific fraud surges don't destabilize the entire portfolio.

Automated Early Warning Systems: At scale, manual monitoring is impossible. Providers deploy ML-powered alerts flagging merchants with abnormal chargeback rates, unusual processing hours, or sudden transaction spikes. These systems temporarily hold payouts and trigger analyst reviews before problems escalate.

Risk-Based Pricing: Advanced operators use dynamic pricing and reserves as risk management tools. Higher-risk cohorts face elevated processing fees or rolling reserves, while proven low-risk

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merchants earn volume discounts and faster settlements. This insurance-like approach ensures economic viability across diverse risk profiles³.

Continuous Optimization: Top providers run A/B tests and cohort analyses to optimize the growth-versus-loss trade-off. As one risk executive noted, "We continuously tune our models to find that extra 1% of legitimate merchants we might be declining unnecessarily."

The gold standard: maintaining 90%+ approval rates while keeping fraud losses below 0.5% chargeback ratios. Achieving both requires constant data-driven experimentation, specialized risk teams, and integrated fraud prevention platforms. Leading PayFacs prove that explosive growth and disciplined risk management can coexist—but only with rigorous, continuous attention.

What Should Investors Evaluate w/ Underwriting?

For investors, underwriting sophistication often determines whether embedded payments companies can scale profitably or face issues that derail growth. Strong merchant underwriting capabilities signal sustainable competitive advantage and scalability.

Metrics to Consider:

- **Approval Rate vs. Loss:** Target 90%+ approval rates with <0.5% chargeback ratios. High approvals with low losses indicate effective risk differentiation.
- **Onboarding Speed:** Best-in-class operations onboard merchants in minutes/hours. Multi-day processes suggest manual bottlenecks that hinder scaling.
- **Loss Trend Analysis:** Review historical loss ratios and chargeback rates versus industry benchmarks. Improving metrics indicate maturing risk controls.

Technology Stack Due Diligence:

- **Proprietary vs. Off-the-Shelf:** In-house underwriting engines with customized models show competitive differentiation. Pure third-party reliance suggests limited flexibility.
- **Alternative Data Usage:** Does the provider leverage platform engagement metrics, cash flow data, or digital footprint analysis? Advanced data integration indicates sophistication.
- **Real-Time Monitoring:** Can they demo robust risk dashboards with automated alerts and drill-down analytics?

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Teams and Processes:

- **Risk Team Pedigree:** Look for seasoned professionals from established payments companies, data scientists, and fraud experts.
- **Scalability Proof Points:** Ask: "What percentage of underwriting decisions required manual intervention last quarter?" Declining manual review rates indicate process maturity.
- **Risk Philosophy Alignment:** Understand their risk appetite and how they adjust for market conditions or new verticals⁴.

Ask key questions of your payment service provider, such as: "If you 3x volume next year, can current processes handle it?" and "How do you balance platform partner growth demands with risk controls?" Companies mastering the merchant underwriting paradox—rapid scale without spiraling losses—will capture outsized market opportunities.

Conclusion

The paradox is real: platforms demand frictionless onboarding to maximize conversion, while payment facilitators must maintain rigorous risk controls to avoid catastrophic losses. The winners are those deploying machine learning, alternative data sources, and automated decision engines to thread this needle—approving legitimate merchants instantly while catching bad actors before they can damage portfolios⁵.

Companies with proprietary risk engines, proven loss performance, and scalable processes are positioned to capture disproportionate market share as embedded payments proliferate. Conversely, those relying on outdated manual processes or basic third-party tools face inevitable scaling constraints and regulatory risks. The embedded payments market will continue expanding rapidly, but growth alone won't determine winners. The companies that solve the underwriting paradox—enabling platforms to grow fast while staying safe—will emerge as the dominant players in this trillion-dollar opportunity. Smart investors are betting on the technology and teams that make this paradox possible.

For more insights & support on how Worldpay can help your PE/VC firm or portfolio investments related to payment strategies, contact our Private Equity Partnerships team.

<https://platforms.worldpay.com/partnerships/>

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Sources: ¹ GoCardless Report on Global Payment Preferences – cited in context of regional differences in payment methods, ² Worldpay/Payrix Internal Risk Deep Dive – provided insight into auto-approval rates and risk monitoring best practice, ³ Fintech Compliance Journal – overview of evolving KYC/AML regulations for Payment Facilitators, ⁴ U.S. Payment Forum 2025 – discussion of state and federal regulatory changes for PayFacs, ⁵ Webinar: “Scaling PayFac Risk Management” (2024) – expert panel on balancing growth with risk in payments.