

Understanding How Card Processing is Priced

Casey Leloux, CEO IntelliPay

IntelliPay[®]

www.intellipay.com/government-payments

Understanding How Card Processing Is Priced



Hi, I'm Casey Leloux, CEO of IntelliPay. I've spent 25 years in payments; starting, growing, and running two successful payment-processing companies.

In this overview, I will review the differences between card present and card not present transactions and credit and debit cards. Then I will shed light on how processing is priced, elaborate on how rates are applied, and wrap up by offering some alternate budget-saving options.

So let's dive in.

Section 1: Card Present vs Card Not Present

As the name implies, all transactions where a card is physically used to make payment are considered card-present (CP). Generally, these in-person payments are considered safer from fraud because the cardholder can be identified.

In-Person (Card-Present) Transactions

Card-present transactions are tapped, dipped, or swiped using a terminal, smart reader, mobile, or point of sale (POS) device.

Card Present (CP)

- Terminals
- Smart Readers
- Mobile
- POS
- Anything tapped, dipped or swiped



Google Pay payments are considered card present when used for contactless payments at a store.

Source: Visa.com

Swiping

We don't do a lot of swiping anymore for security purposes because criminals could add skimmer devices that would read or skim the data off the magnetic stripe on the back of the card and use that data to create fraudulent cards. The card brands created a new standard - EMV- to cut down on fraud.

Dipping

EMV or chip cards encrypt cardholder information. The chip and terminal or reader assign a one-time encrypted code to the transaction, making it more secure than swiping. The downside is inserting (dipping) a card takes longer than swiping and if a card needs to be dipped twice, once for the transaction and again for a service fee, customers get frustrated wanting something faster and easier.

Tapping

Enter Tap to Pay. Tapping uses EMV security and close-range wireless communication to securely send payment data from a phone or card to a Tap enabled device or terminal. The security of EMV with the convenience of swiping if the card and device are available.

Section 1: Card Present vs Card Not Present continued

Online (Card-not-Present) Transactions

Card-not-present transactions are anything done online, through customer portals, over the phone, IVR, text-to-pay links sent via SMS, or emails.

Card Not Present (CNP)

- Online Payment Pages
- Customer Portals
- Over the phone
- IVR
- Text to Pay
- Link to Pay



Nearly nine in ten Americans are now using some form of digital (CNP) payments.

Source: McKinsey & Company

The differences between card-present and card-not-present transactions is one key to understanding transaction pricing. Card type is also a determining factor, which we will discuss next.

Section 2: Debit Card Vs. Credit Card

Debit Cards

Debit cards, regulated and non-regulated, are linked to a bank account. Regulated cards, with the lowest fees because of the Durbin Act, are issued by banks with assets of \$10 billion or more.



Debit Card

Connected to Bank Account

Two types:

- Regulated
 - Issued from bank with \$10 billion in assets
 - Durbin Act
- Non-Regulated
 - All others

Low rewards = low cost

Regulated debit cards have the lowest transaction fees.

All other financial institutions issue non-regulated debit cards which have higher fees and will cost the merchant more especially if rewards or perks are added as a lure for these cards.

Understanding How Card Processing Is Priced



Credit Card

Connected to
"Line of Credit"

Two types

- Personal
- Business

Heavy rewards

- Miles/Travel
- Cash back

High rewards = higher cost

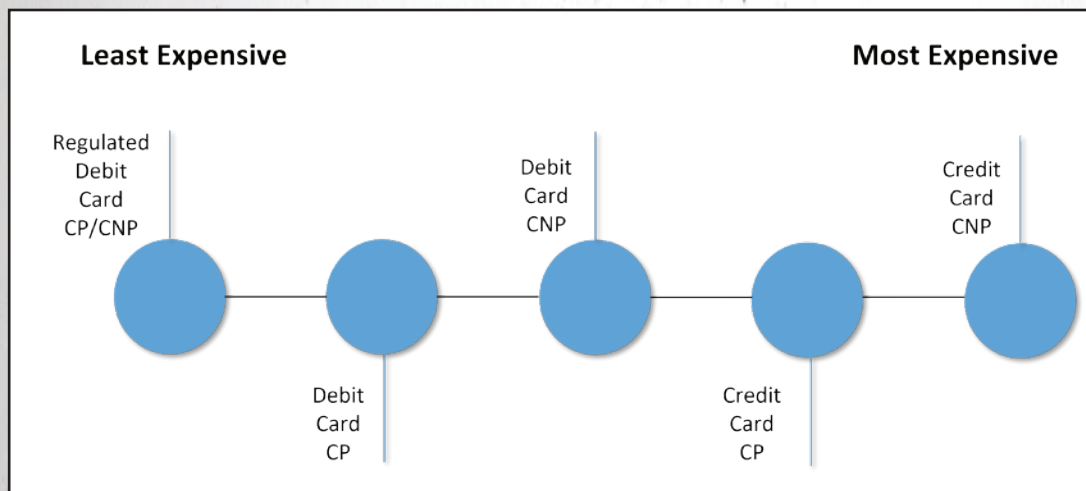
Credit cards with high rewards have the highest transaction fees.

Credit Cards

Credit cards are connected to a line of credit, and again there are two types: personal and business. Since most credit cards have rewards tied to them, remember that high rewards equal higher prices (costs).

Somebody is paying for all those perks and trips to Cancun, and it is not the card issuers. That is something to keep in mind as we go forward.

I have laid out on a scale from least to most expensive and where each card type falls in the chart below.



The least expensive card is the regulated debit card. It doesn't matter on a regulated debit card if it is card-present (CP) or card-not-present (CNP) due to the Durbin Act; they are priced the same.

A credit card used in person has a lower rate than when the same card is used online (card-not-present). So, your most expensive (highest cost) card will be a business rewards card in a card-not-present environment.

One question I get asked is: "If a customer comes up to the credit card machine and hits credit so they don't have to type in their PIN instead of debit, how is that card processed?" It is processed like a debit card; it just goes through the Visa/Mastercard regular rails (network) and doesn't go through what we call a PIN debit network. You do not pay more when a debit card is processed as a credit card.

Section 3: What the heck is Interchange?

Interchange can be very confusing since there are over 120 categories and new ones are being added all the time. However, there are two basic concepts you need to know:

1. *Interchange = wholesale buy rates the card brands put out for processing debit and credit cards.* These rates are generally the same for everyone (The exception is government and utility sectors which are in different categories with a lot lower pricing/interchange fees).
2. *Interchange pricing is based on:*
 - Use of Card (CP vs CNP)
 - Type of Card (Debit vs. Credit)
 - Industry (Rates differ by Industry, same across industry)
 - Amount of Payment

Interchange and Your Merchant Statement

Merchant statements vary in layout and in appearance. While your statement might not look exactly like the sample statement below, there are some common elements. For example, Interchange appears before the card description and Rate % and Amount or Fee amount are typical. Let's dive in to some examples.

	Card Network Fees	Count	Volume(\$)	Rate(%)	Fee(\$)	Amount(\$)
1	Interchange: AM Service/Professional Service Tier 1 American Express, Credit	5	678.96	1.65%	0.1	11.70
	Interchange: AM Service/Professional Service Tier 2, American Express, Credit	6	3,301.48	2.00%	0.1	66.64
	Interchange: DS PSL Key Entry Rewards, Discover, Credit	2	1,784.29	2.03%	0.1	36.42
2	Interchange: MC Business Level 5 Data Rate1, MasterCard Credit	3	3,390.08	3.00%	0.1	102.00
	Interchange: VS Business, Tr5, Prod 1m Visa Credit	4	4,283.83	3.00%	0.1	128.92
3	Interchange: MC Merit 1, MasterCard, Debit	2	1,014.01	1.65%	0.15	17.03
	Interchange: VS US Regulated Debit, Visa, Debit	27	20,170.99	0.05%	0.22	16.03

Interchange fees can also be impacted by volume and transaction size.

- 1 American Express has three levels tiered by payment size. The average ticket on Tier I1 is \$136; the interchange is 1.7% and 10 cents. Tier II the average transaction is \$550; the interchange is 2.0% and 10 cents. So, the fees are higher for the larger transactions.
- 2 The most expensive cards from an interchange perspective were the Visa and MasterCard business rewards cards. The interchange is 3.0% and 10 cents. That is just the wholesale cost; it does not include an agent, broker, or representative for the processor that needs to make their margin.
- 3 Next is a normal debit card; since this is CNP, it came in at 1.65% and 15 cents and a regulated debit card came in with the lowest fees at .05% and 22 cents.

Section 4: Who makes the money?

Let's focus on this snippet from the transaction fee section of the sample statement. The blue box below highlights the agent's (the person who sold you the processing) margin.

Sale: Non-Qualified, MasterCard, Credit	23	12,631.83	0.25%	-	31.59
Sale: Mid-Qualified, American Express, Credit	6	3,301.48	0.25%	0.25	
Sale: Qualified, American Express, Credit	5	678.96	0.25%	-	1.70

Agent margin 25 bps

Taking the wholesale buy rate and adding 25 basis points (0.25%) for the representative margin is called interchange plus pricing. The agent also receives the transaction fee of \$0.10 per item (yellow box - card network fees example above). The agent made \$147 on this statement to cover their expenses and make a small profit. However, many times, that profit is being shared with the processor.

Understanding How Card Processing Is Priced

Section 4: Who makes the money? continued

Type	Amount(\$)
Transaction Fees	168.45
Card Network Fees	1,038.54
Other Processing Fees	18.90
Third Party Fees	1.00
<hr/>	
Subtotal in USD:	\$1,226.89
Tax (0%):	0.00
<hr/>	
Amount Due:	\$1,226.89

The card brands (Visa, Mastercard, American, Express, Discover) set the non-negotiable wholesale buy rates or interchange fees. Then, besides interchange fees, they add assessments and other fees. They make the most money- approximately 85% of your fees (the blue rectangle above).

Agents and processors split what is left over, in this case, \$147, meaning when a request for lower rates is made, the rate concession comes out of the margins of the agent or processor who also provides the customer support. While everyone wants the lowest possible rates to reduce costs, the trade off is a lower service and support level since the business is barely profitable.

I recommend merchants start by ensuring you understand what you are currently paying. Calculating your net effective rate is effective in helping to determine if what you are paying is fair.

Net Effective Rate

Page 1 of the statement shows that the total volume that this account processed was **\$58,835.80**

From that same page, we see the total Fees Paid were **\$1,226.89**

To calculate the Net Effective Rate, divide the total fees paid by the total volume processed.

Net Effective Rate (NER)

$$\$1,226 \div \$58,835$$

2.08%

Statement	
Bill to	Details
Casey Customer 12884 S Frontrunner Blvd Suite 220 Draper, UT 84020 United States	Statement Number: Issue Date: Pending Payment terms: Auto-Draft Billing ID: 123456789123456789123456789909 Billing Account Number: 12345678912345678 Product ID: 2
Summary for: Oct 01, 2027 - Oct 21, 2027	
Total Sales	Transaction Count
\$58,835.80	97
Type	Amount(\$)
Transaction Fees	168.45
Card Network Fees	1,038.54
Other Processing Fees	18.90
Third Party Fees	1.00
<hr/>	
Subtotal in USD:	\$1,226.89
Tax (0%):	0.00
<hr/>	
Amount Due:	\$1,226.89

An excellent net effective rate (NER) is 3% or under. This merchant's NER is very good for this merchant. Their agent (IntelliPay) has eliminated unnecessary fees and optimized this account. I recommend calculating your NER with every statement since additional costs can crop up anytime. Processors love to add fees

Over 3% NER?

If you are over 3%, I recommend you dig into the statement with your agent and see why you are over 3%. Start by looking for new or added fees by comparing your current statement to previous months - processors love to add extra fees. Other areas to look at would be new products or services added, changes in average ticket size, the mix of cards, and changes in CP sales versus CNP sales (selling a higher percentage online).

Section 5: Alternative options

You have worked with your provider to lower their margin to around 8%; any lower, and they wouldn't have an incentive to service your account. Your net effective rate is under 3%, but you must still lower processing costs. To do so, you would need to consider adding a fee to your customers or limiting the types of payments you are willing to accept. I will start with the customer fee options before moving to the limiting payment options.

Cost Reducing /No Cost Options

- Convenience Fee
- Surcharging (Credit cards only)
- Service Fee Program

Payment Type Limiting Options

- Debit only
- More ACH

Cost Reducing/No Cost Options

Convenience Fee

If you have purchased movie tickets online, you are familiar with convenience fees. For a movie theater, online ticketing is an alternative payment method. Their traditional payment method is buying a ticket when you arrive. Convenience fees can only be charged to alternative payment methods.

Key Points

- Example: Customer Owes \$100
- Add a flat fee to the amount of the payment (let's say \$4.00)
- Amount due and fee are processed as one transaction (\$104)
- The fee goes into your bank account
- Have to recognize the fee and assign proper GLA
- May collect more or less (not exact science)

Summary

- Cost "reducer" program
- Only works on Card Not Present Payments

Surcharging (Credit Cards only)

People use credit cards to get the perks. Your margins pay for these perks through higher fees. Surcharging adds a fee equal to the cost of processing to credit cards, not to other forms of payment. Your customer can pay the fee or choose a lower fee option to avoid the fee.

Key Points

- Example: Customer owes \$100
- Program adds a flat or percentage fee to the amount of the payment for credit cards only
- Customers that use a debit card are not charged a fee
- Surcharging is fair for everyone. Your margins shouldn't have to pay for customer trips to Cancun
- Like a Convenience Fee Program, the fee is added and processed as one transaction
- You have to account for the fee in a General Ledger Account (GLA)

Summary

- Cost "reducer" program
- Works with both Card Present and Card Not Present Terminals

Understanding How Card Processing Is Priced

Cost Reducing/No Cost Options cont.

Service Fee - Government & Education

Visa's Government and Higher Education Program (aka service fee) allows fees on debit and credit card CP and CNP purchases with the fee and invoice amount processing as separate transactions. The program is limited to a specific range of merchant category codes, so not all government payments are eligible.

Key Points:

- Example: Customer Owes \$100
- Add a flat fee or percentage to the amount of the payment
- Under \$60 = \$1.50 flat fee
- Over \$60 = 2.50%
- Processes on two separate transactions:
- \$100 on City's Merchant Account – deposits into your bank
- \$2.50 is processed on provider's merchant account – fee is deposited into their bank account
- Provider uses the fee to cover all of the costs!

Summary

- 100% no cost solution
- Works with Card Present and Card Not Present terminals

Payment Type Limiting Options

Accept Debit Card Only

Debit is the preferred payment option across all demographics. With signage and education, debit only has proven successful for some departments in reducing card processing costs.

Key Points:

- Example: Customer Owes \$100
- From our Interchange slide, you see that normal debits cost 1.65% and regulated debit cost .05% + \$0.23 per payment (On average, your net rate will be 1.50%)
- Here's the Idea: Don't accept credit cards with high fees

Summary:

- Cost "reducer" program
- Government is billed for lower cost, debit card processing fees and avoids high costs of credit cards
- Works with both Card Present and Card Not Present Terminals
- Restricts payment methods which may cause push back by customers

More ACH (eCheck)

ACH payments are inexpensive, and where we have seen departments succeed in lowering costs is with the hybrid model outlined below.

Key Points:

- In addition to ACH payments being inexpensive, the processing of ACH payments has improved with better validation and faster disbursement times
- ACH volume grew 3% in 2022 alone

Hybrid Option:

- Many clients will pass a fee on for credit card processing but not for ACH
- Idea: "If you want to use your card, you pay a fee. If you don't want to pay a fee, use ACH"

Summary:

- Cost "reducer" program - the more ACH payments, the lower your fees
- Works with both In-person and Online Terminals

Section 6: Summary

Payment processing is challenging to understand, and reading statements is confusing. I hope you now:

- Can see the different categories and costs for credit and debit cards to protect your budgets
- There is only so low that you can go if you are using the Traditional Model and paying the fees
- Understand if budgets are tight, you may need to consider a "Consumer" Fee or alternative options
- Know that a service fee is the only "no-cost" solution

If you have questions about your situation, we would like to offer you a free 20-minute one-on-one session where you can get all your payments and processing questions answered. To book time, email Phil Buck with times and dates you are available to: phillip.buck@intellipay.com, please include "20-minute consultation" in the subject line.

Wait, There's More

In addition to helping agencies understand how card processing works, there are other ways IntelliPay can help governments reduce the time and money spent on payments including:

Many Ways to Pay

In-Person - credit card machines, readers & terminals

Online payment page, lightboxes & portals

Mobile, on-site & field payments

Text and email payments

Payment Options

Credit and Debit Cards - Visa, MasterCard, Discover and American Express

ACH/eCheck

Google Pay

Venmo/PayPal

Cloud-Based All-in-One Platform

City/County in the Cloud - Google cloud-based management console

One system for all agencies and departments

Integrations with existing systems

Advanced Reporting

Easy-to-use and understand formats

Robust parent/child reports -control by location down to staff level

Custom reports for simplified reconciliations

Integrations

API

Custom

For more information, visit intellipay.com or contact Phillip Buck phillip.buck@intellipay.com or 385-210-1078.