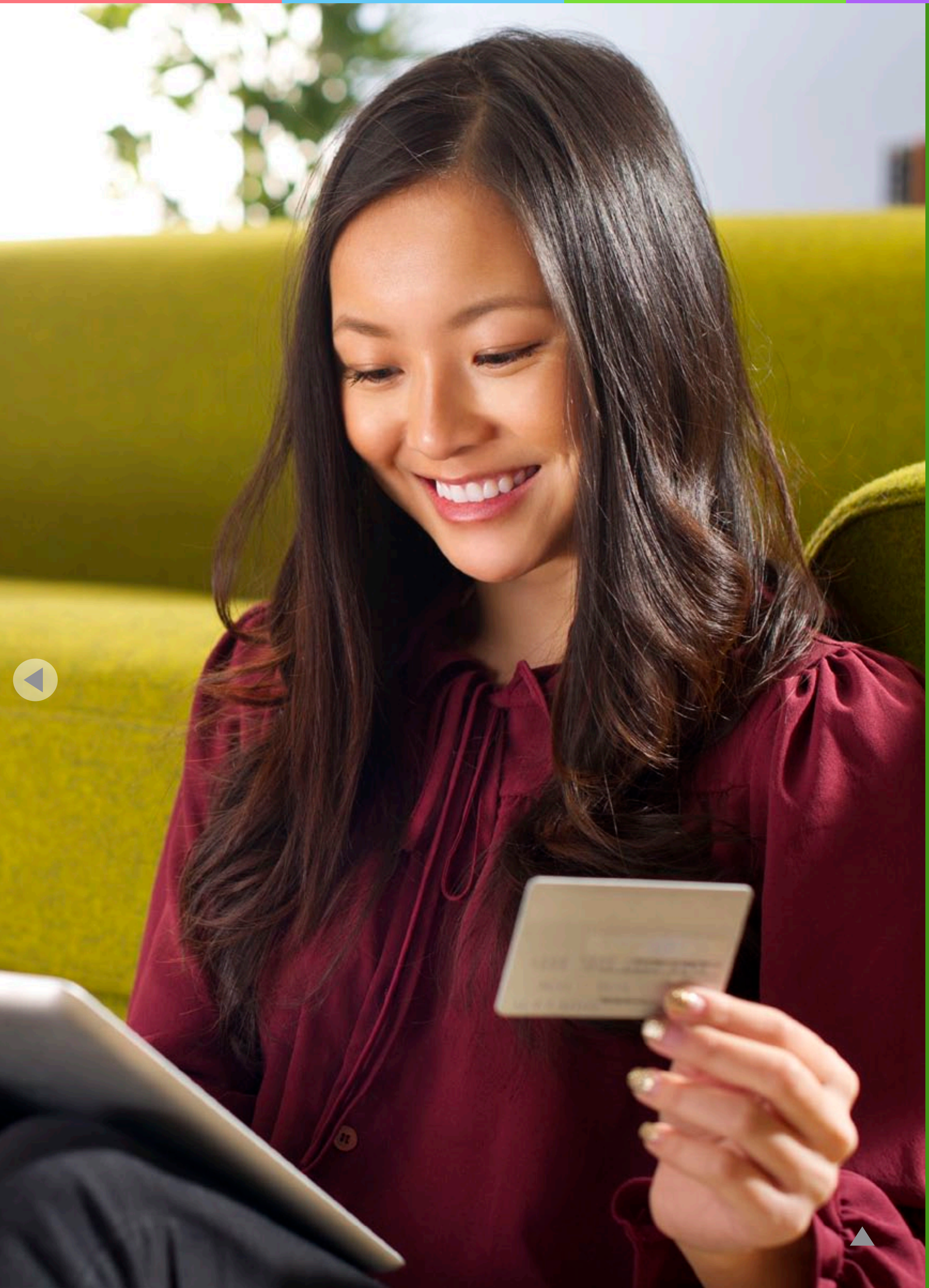
Understanding credit card fees

What is your subscription business paying for and to whom are you paying?

Monster Revenue



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The complexity of the credit card ecosystem

Credit cards are popular with subscription customers due to their simplicity and convenience, but the fee structure can be complex.

With credit cards, consumers can simply assign a card to their account and automatically charge their subscription fee each time it comes up for renewal. And subscription businesses can rely on credit cards as a reliable, safe long-term method of payment. However, behind the scenes, the credit card ecosystem is surprisingly complex, involving a large number of players and an enormous number of fees and charges.

Every business currently using – or considering switching to – a subscription business model needs to be aware of the cost of supporting recurring credit card payments so that they can avoid unnecessary fees and maximize their revenue.

This eBook provides a high-level overview of the ecosystem to enable subscription businesses to decide how they can minimize and optimize their handling of credit card fees and charges.

Identifying the players

A single credit card transaction will be touched by several parties as data is passed from one entity to another.

At various stages, subscription businesses could incur fees and charges from some of these players in exchange for the services they provide. A closer look at the payment ecosystem highlights each party and the role they play from the initial payment submission to card approval (or decline).

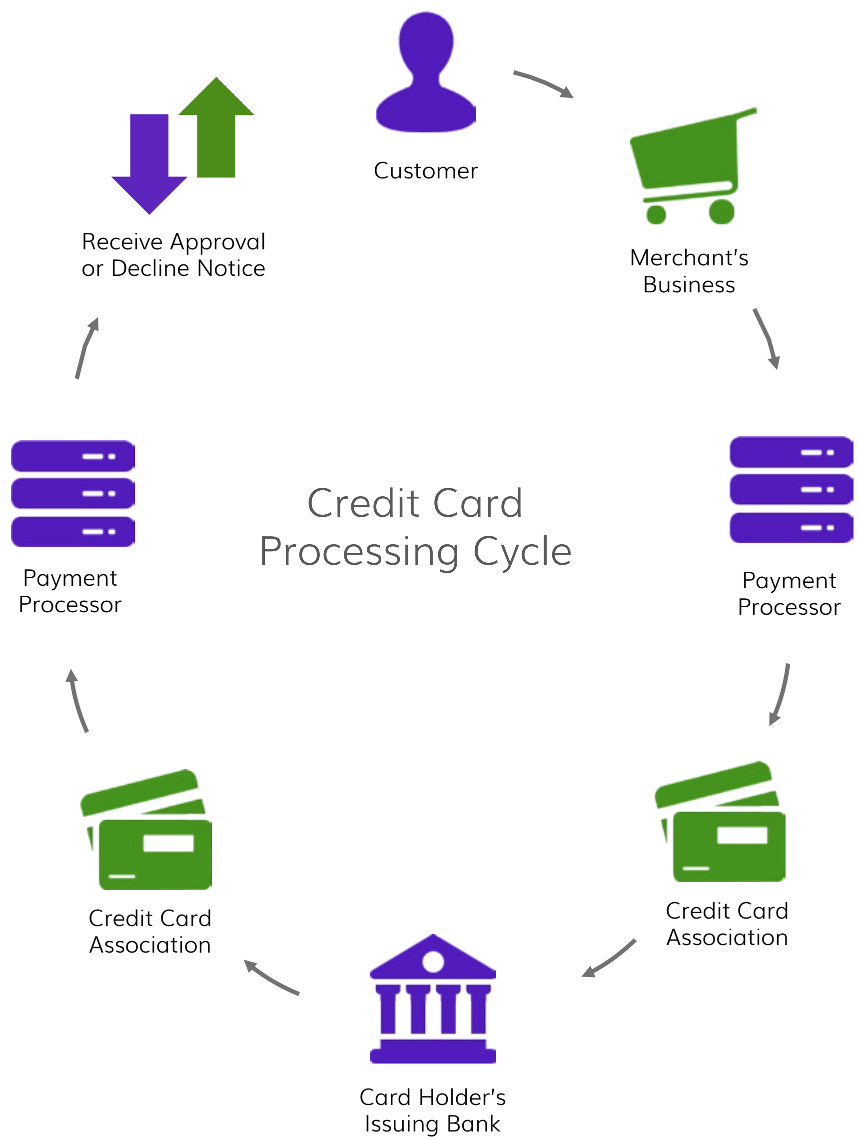
Let's start by identifying the key players:

- **Customer/Cardholder:** The user who has subscribed to a recurring scheduled payment.
- **Merchant:** The subscription business providing a service and receiving payment from the customer on a recurring basis. Merchants must coordinate with various financial agencies to process customer payments and transfer funds to their accounts.
- **Merchant of Record:** Not all merchants are set up to deal with the complexities of processing card payments. In those cases, the merchant can make an agreement with a *merchant of record* to be responsible for accepting payments on their behalf and managing payment processing logistics.

- **Payment Gateway:** In the case of digital commerce, the *payment gateway* is the software or service that directs customer payments from the merchant page or site to the *payment processor* or *acquiring bank*. *Payment gateways* are expected to provide a secure connection between the different parties and protect payment data as it is transferred.
- **Payment Processor:** A *payment processor* acts as a mediator between the merchant and financial institution (i.e., *acquiring banks*). The *payment processor* processes the customer payments, executing those transactions and submitting them to *credit card associations* for additional processing. *Payment processors* may also fulfill the *payment gateway* function.
- **Credit Card Associations:** These entities create the credit card and set the rules that govern the transaction terms for card payments between issuers and acquirers. The most widely used *credit card associations* include Visa and Mastercard.
- **Issuing Bank:** These are the financial institutions that issue credit cards to consumers. *Issuing banks* set the contractual terms of repayment on charged purchases and approve each transaction. Examples of *issuing banks* in the US are Citi and Wells Fargo.
- **Acquiring Bank:** A merchant wanting to accept credit card payments will open a merchant account at an *acquiring bank*. The *acquiring bank* deposits funds received from credit card payments on behalf of the merchant. The *acquiring bank* is responsible for all financial and compliance risks associated with a card transaction.

Some players can fill more than one role, such as American Express, which is both a credit card association and also an issuing bank.

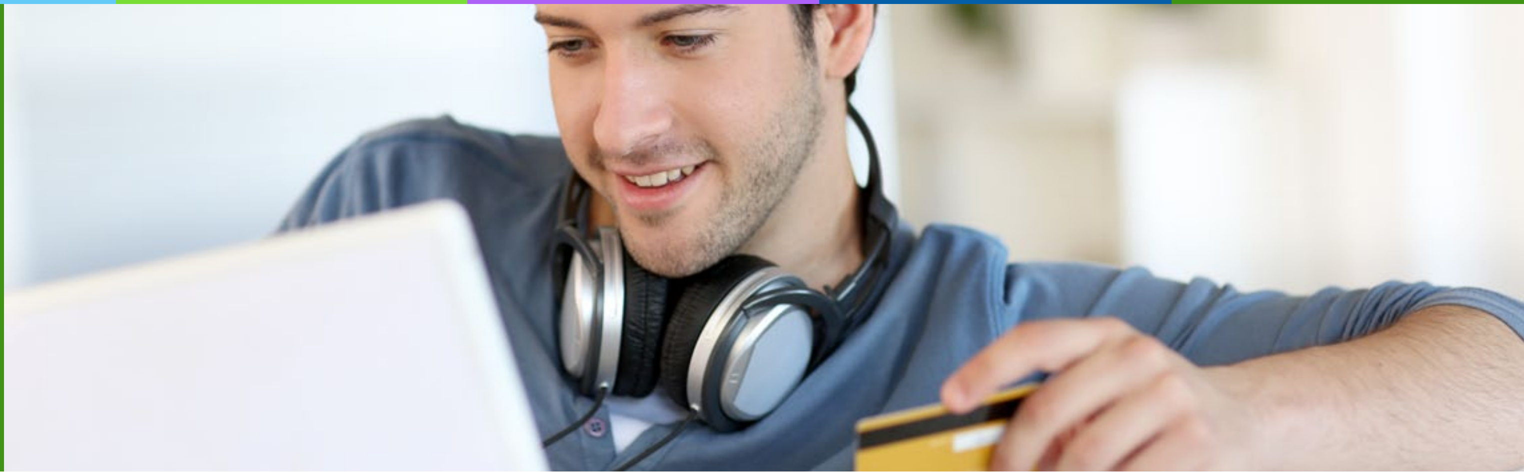
Mapping out the ecosystem



With all major players accounted for, let's take a look at how the payment process works:

1. The subscription customer places an order on the merchant page or application. Depending on the exact setup, payment information (credit card number, card expiration date, etc.) may be entered directly on the merchant services site.
2. The *payment gateway* captures the payment data and sends it to the *payment processor* via a secure, encrypted transfer.
3. The *payment processor* finishes processing the transaction and transfers the collected card and payment information to the *credit card association* network.
4. The *credit card association* (Mastercard, Visa, etc.) submits the transaction to the customer's *issuing bank* to either approve or decline the transaction.
5. Once the transaction is confirmed or denied, the issuing bank relays that information through the *credit card association* back to the *payment processor*.
6. The *payment processor* delivers an approval or denial code to the merchant.
7. If the transaction is approved, funds from the *issuing bank* are transferred to the *payment processor*, which then transfers those funds to the *acquiring bank*.
8. The *acquiring bank* deposits those funds into the merchant account.

Fees merchants pay for credit card processing



There are three main types of fees that subscription businesses are charged:

Wholesales fees, set by credit card associations and banks, are basically non-negotiable and consist of:

- **Interchange fees**
- **Dues and assessments**

Payment gateway fees are charged by the payment gateway

Markup fees are charged by the payment processor

Subscription businesses may be charged a wide variety of fees for each card transaction. Let's explore these fees.

Interchange fees

Interchange fees are set by the credit card schemes (Visa, Mastercard, etc.) and are passed through to the card issuer.

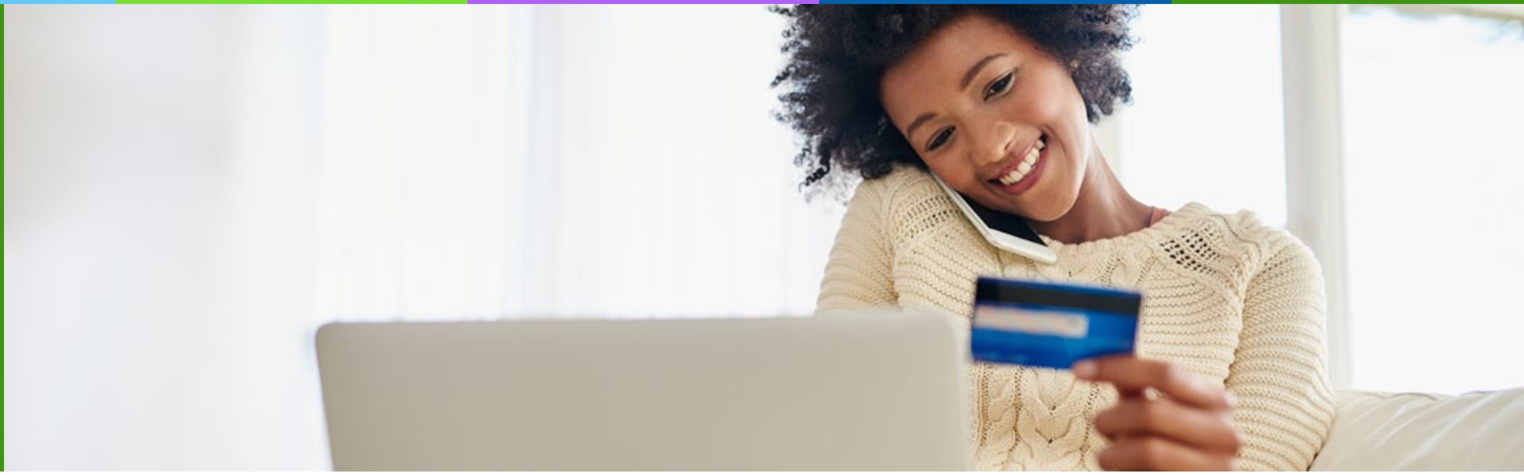
Interchange fees are paid by a merchant's bank to a cardholder's bank and compensate the issuing bank for the benefits of accepting electronic payments and other transaction related costs. For example, if a cardholder makes a $100 credit card purchase and the interchange rate for that purchase is $0.10 plus 2.1% of the total transaction amount, then the cardholder's credit card company will receive $2.20 as a result of that credit card purchase.

Interchange fees are basically non-negotiable. All payment processors pay the same interchange rates to the credit card schemes. There are a variety of factors that can influence how those percentages and flat fees are determined including:

- **Merchant category:** The type of business a merchant operates.
- **Card type:** Credit card associations may charge lower interchange fees on low-risk cards, for example corporate cards or luxury consumer cards.
- **Card present vs. card not present:** Card-not-present transactions typically incur higher interchange fees. Because the vast majority of subscription card payments will involve card-not-present transactions, merchants should keep a close eye on published interchange rates.

For examples of interchange fee types and charges see Visa's interchange table and Mastercard's interchange table.

Fees charged by credit card associations: dues and assessments



There are many different types of dues and assessments.

These fees are mostly small, charged by the card schemes and passed along to merchants. They are typically fixed and non-negotiable. While at their core, interchange fees help credit card associations account for the costs of processing payments, dues and assessments are essentially fees paid by merchants to credit card associations for the right to process transactions using each credit card brand.

The credit card schemes all charge different dues and assessments and each uses different fees and terminology, which makes it challenging to understand exactly what you are being charge for and compare.

Some of the most common dues and assessments are volume-based fees, taking a set percentage from the gross transaction value for a given period of time. International service assessments are charged whenever a customer uses a card issued in a different country. Examples of assessment fees charged by Visa are acquire processor fees, credit voucher fees and fixed acquirer network fees.

The current* assessment rate for Visa is 0.13% for credit cards and 0.11% for debit cards. If a cardholder makes a $100 purchase using a Visa credit or debit card, then the Visa card association will receive $0.13 or $0.11 in assessment fees depending on the card type. The current* assessment rate for Mastercard is 0.125%.

*Subject to change

Fees charged by payment gateway service provider

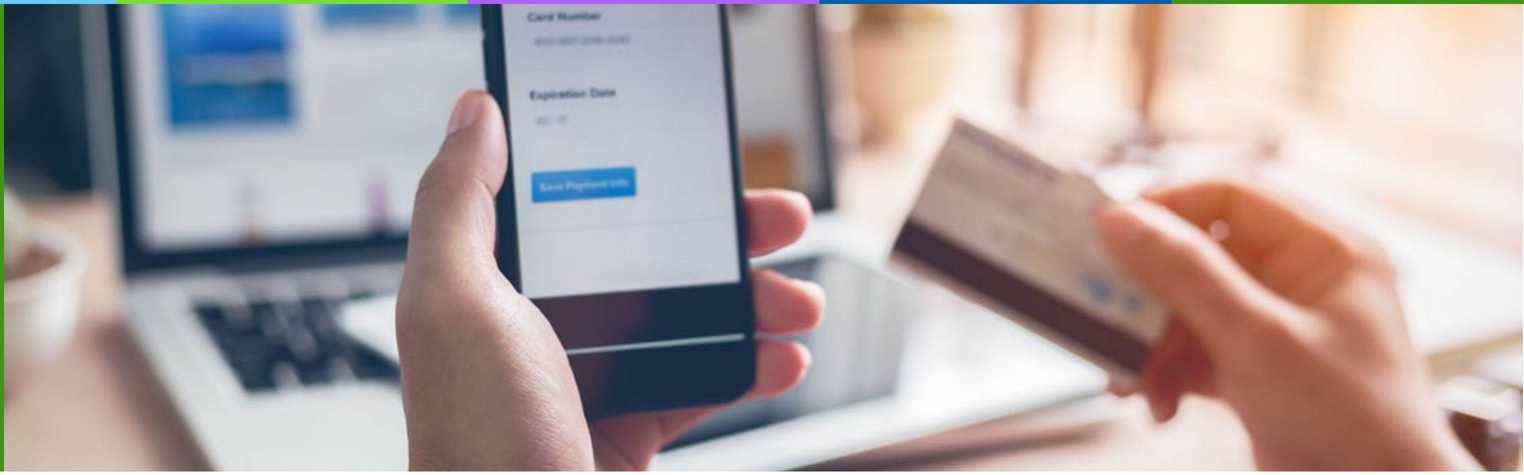
Payment gateways apply to eCommerce businesses, roughly parallel to point-of-sale physical transactions.

Gateways can make transaction processing much easier for subscription businesses by integrating to multiple payment service providers and offering multiple payment methods. But that convenience comes at a cost.

Gateway fees are usually fixed rates that are attached to each processed transaction. Payment gateway providers may offer discounts on gateway fees if the merchant bundles those services together with add-on features such as reconciliation tools and online statements.

Smaller subscription businesses that require such services could get more value by purchasing a payment gateway bundle. Gateway fees may often be bundled in with processor fees.

Fees charged by payment processor (markup fees)



The third type of card transaction fees subscription businesses need to account for are those set and charged by the payment processor.

Unlike some of the other fees discussed, these can often be negotiated, making it even more important for subscription businesses to fully understand what they are being charged for on each transaction.

Payment processors may offer two different pricing modes – ***interchange plus*** (or ***pass through***) pricing and ***bundled*** pricing (also referred to as ***tiered*** or ***bucket pricing*** or ***bundled discount rate***). These are essentially two different methods for the payment processor to charge the merchant for the interchange fees due to the credit schemes.

With ***interchange plus***, the credit card association interchange fees are passed directly on to the merchant in a relatively transparent manner, with the addition of a processor markup.

With ***bundled*** pricing, the payment processor wraps all charges into a single rate. This is much simpler for a subscription business to track and offers cost predictability. However, by "losing" the details of the interchange fees, it become much harder to decipher exactly what you are being charged for.

Payment processor fees can vary significantly depending on the specific services used.

Payment processor fees are either digital, physical or content-based services. Shrewd navigation of these fees could help merchants reduce unnecessary costs and improve their profitability. The most common payment processor fee types include:

- **Cross-border:** Payment processors typically charge a fee whenever customers use a card issued in a different country. Merchants will have to take these fees into account when determining whether to support international payment methods.
- **3D Secure:** Many payment processors offer *3D Secure* as an additional security layer to safeguard transactions and payment data. Merchants must pay an extra fee to implement that security.
- **Chargeback:** Whenever a customer disputes a charge on their credit card statement, the merchant is charged an additional fee to have the payment processor manage that claim.
- **Gateway Fees:** If the payment processor also provides gateway services, the merchant will be subject to other payment *gateway fees* (as discussed earlier).
- **Chargeback Service:** Payment processors may offer additional services to protect merchants against fraudulent chargeback claims.
- **Batch Processing:** Depending on the exact payment processing framework, the merchant may submit a batch file containing all payments from a set amount of time (every business day, for instance) to the payment processor, which delivers that information to the acquiring bank.
- **Monthly Minimum:** Payment processors may set a certain number of transactions that must be completed each month. If that threshold is not met, the merchant will still be charged the minimum fee.
- **Monthly Fees:** A fixed monthly fee that payment processors may charge for use of payment processors, in addition to all other fees charged each month.
- **Account Setup:** a one-time setup fee for new accounts.
- **Terminal Fees:** Less of a concern for subscription-based or digital businesses, payment processors may charge merchants to use point-of-sale terminals.

Getting the best payment processing terms

And maximizing subscription revenue.

The payment processing cycle is extremely complex. It involves several different players – many of whom can fill more than one role. Numerous fees could be potentially levied against a subscription-based business, some of which are fixed while others can be negotiated. Understanding precisely what is being charged – and why – is a daunting task, but also essential for getting the best payment processing terms and maximizing your subscription revenue.

The unfortunate reality is that subscription businesses are unlikely to have the experience, expertise or time to dig into the credit card ecosystem, acquire the expertise needed to truly understand what they're being charged, let alone determine if those charges are completely necessary and if there are other better deals available elsewhere. Accordingly, many businesses opt for the easy options, and in the long run end up paying more than they should.

Vindicia's extensive experience can help subscription businesses effectively navigate the credit card payment landscape. Our team of industry veterans can provide the expert consultation needed to select the payment options that best suit your business operations. Contact our team to learn more.

About Vindicia

Vindicia, and Amdocs company, offers comprehensive subscription management solutions that help businesses acquire and retain more customers. Providing much more than just a billing and payments system, the company's SaaS-based subscription management platform combines big data analysis, strategic consulting and proprietary retention technology. Vindicia provides its clients with more recurring revenue, more customer data, better insights, and greater value throughout the entire subscriber lifecycle. To learn more visit www.vindicia.com.

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