The Rules have Changed:

White Paper on How Surcharging can Dramatically Lower the Cost of Accepting Credit Cards for U.S. Businesses.

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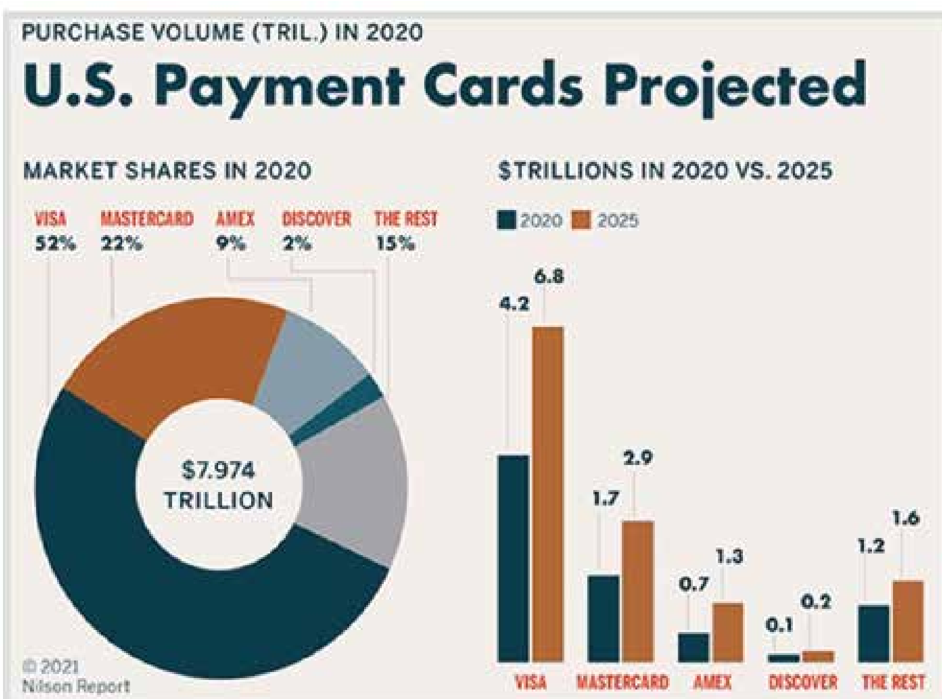
Overview

Accepting credit cards for payment of goods and services is a double edged sword for businesses in the U.S. On the plus side, it makes it easier for consumers to pay and typically increases the amount of the sale. The problem is the cost to accept plastic is one of the largest avoidable line-item expenses businesses incur and increases on a regular basis.

The purpose of this white paper is to provide insight for businesses on how to effectively mitigate the costs of credit card acceptance resulting in a direct increase in profitability and EBITDA.

Credit Card Usage in the US

According to a 2021 Nilson Report (1), U.S payment card purchase volume will grow from $7.9 Trillion in 2020 to an estimated $12.8 trillion dollars in 2025, a whopping $4.9 trillion dollar increase.



What Makes Card Acceptance so Costly

There are several factors that determine the cost to businesses when accepting credit cards including interchange fees (issuing banks), card brand fees (Visa, MC, Discover, AMEX, etc....), and fees added by the processor.

The main culprit for the high cost of acceptance is due to the rewards programs offered by the issuing banks (points, miles, cash back, etc....). According to Scott Schuh, senior economist, policy advisor and director of The Consumer Payments Research Center at the Federal Reserve Bank of Boston, "[Rewards are] a cost to the bank and like any economic unit, they typically try to recover their costs with the price of the product," Schuh explains. "... A card that does not pay rewards is a low-cost card to the bank and a card that pays high rewards is a high-cost card to the bank."

Schuh adds, “The major reason that interchange fees for rewards credit cards are higher than those for traditional cards is because banks use the interchange fee to help subsidize the cost of the rewards program” (2).

Origin of Surcharging - An Alternative to Traditional Payment Acceptance

In 2013 a U.S. federal judge approved a multibillion-dollar class action settlement in favor of a group of businesses vs. Visa and Mastercard. The lawsuit was based on antitrust practices Visa and Mastercard used to fix fees charged to merchants when accepting credit and debit cards as well as preventing merchants from steering customers to less expensive forms of payments.

The settlement opened the door for businesses to add a fee, or surcharge, on each credit card payment to offset the cost of accepting credit cards (3). This was a big win for businesses as the card brands had prohibited surcharging in the past and opened the door for a paradigm shift in the way businesses accept credit cards.

Rules of Surcharging (4)

There are specific rules regarding how a surcharge is applied when accepting card payments. The following rules must be followed to maintain compliance with the card brands and individual state laws:

- The amount of the surcharge cannot exceed 3% of the total sale and the surcharge amount cannot be greater than the cost of acceptance (the cap was reduced by Visa from 4% to 3% effective 3/15/2023).
- Only credit cards can be surcharged, you cannot add a fee to debit or prepaid cards.
- The cost of the product or service must be processed together as one transaction.
- The receipt must show the surcharge amount as a separate line item.
- The merchant must be registered with the card brands.
- Disclosure of the fee must be given to the consumer (e.g., signage if face-to-face, verbiage on checkout page if eCommerce, and verbal if payment received via phone).
- There are currently two states that still prohibit surcharging; CT, and MA (4).

Non-compliance with the card brand rules and individual state laws can result in fines, termination, and ultimately being added to the MATCH list by the card brands list in extreme circumstances (5).

Advantages of Adopting a Surcharge Strategy

Using a surcharge strategy, merchants are now decreasing their net processing fees and making substantial improvements to their profitability. Some examples of verticals utilizing surcharging include; SAAS (software companies), membership (i.e., golf, gyms, clubs), wholesale distribution, automotive, medical practices, legal firms, manufacturing, B2B, and Private Equity firms. The following case studies showcase how surcharging impacts results.

Example - SAAS Provider

Merchant Profile:

Industry leader and service provider of managed cloud computing.

Overview:

- Annual Total Revenue over $2B
- Annual Card Processing Volume $300M
- Average Monthly Processing Volume $25M
- During the rollout, 6.3% of subscribers switched from credit cards to ACH payments to avoid paying the surcharge eliminating another $43K in processing fees.

Net Impact from Surcharging

	Processing Volume	Processing Costs	Effective Cost
Prior to Surcharging	$25,000,000	$685,000	2.74%
Post Surcharging	$23,425,000	$65,700	0.28%
Net Monthly Savings		**$619,300**	
Additional Savings (6.3% Shift to ACH)	$1,575,000	$43,155	
TOTAL MONTHLY SAVINGS		**$662,455**	

Cumulative Savings

Summary:

The main concern from the client was whether customers would be willing to pay a credit card fee and would it have a negative impact on the their business. While rolling out the program the merchant’s Treasury Team relayed that customers who did not want to pay the credit card fee simply switched to ACH payments (6.3% of the credit card volume changed to ACH).

Example - Membership

Merchant Profile:
Large operator of private golf clubs, business clubs, sports clubs, and alumni clubs with over 70K active members.

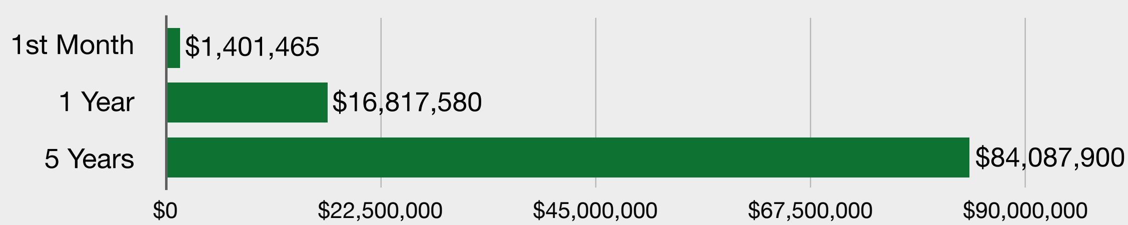
Overview:

- Annual Revenue over $1B
- Annual Card Processing Volume $600M
- Average Monthly Processing Volume $50M
- During rollout there was a shift from card receivables to ACH payments of 10.1%

Net Impact from Surcharging - Membership

	Processing Volume	Processing Costs	Effective Cost
Prior to Surcharging	$50,192,138	$1,375,265	2.74%
Post Surcharging	$44,671,003	$125,079	0.28%
Net Monthly Savings		**$1,250,186**	
Additional Savings (10.1% Shift to ACH)	$5,521,135	$151,279	
TOTAL MONTHLY SAVINGS		**$1,401,465**	

Cumulative Savings



Summary:
When the surcharging rollout was completed fewer than ten customers had cancelled their memberships due to the new billing model, which is less than 0.014% of their 70,000+ active customers. To reiterate, 10.1% of card receivables switched to ACH payments.

Conclusion

As evidenced in the case studies and supporting information cited in this white paper there is tremendous upside for businesses when adopting a fully-compliant surcharge strategy. The benefits of shifting to this type of payment acceptance include:

- Dramtically reduce the cost of accepting credit cards.
- No-fee option for consumers if they pay with a debit card, check, or cash.
- Substantial bottom line savings and immediate increase in EBITDA.

Notes:

1. "Payment Cards in the U.S. Projected." Nilson Report, posted October 31, 2021. https:// nilsonreport.com/mention/1494/1link/

2. "Bonus or Bogus: Who Pays for Rewards Credit Cards?" Cardratings, Christina Couch, Contributor, updated February 17, 2021. https://www.cardratings.com/bonus-or-bogus-who- pays-for-rewards-credit-cards.html

3. "U.S. Judge Approves Retail Credit Card Fee Settlement." Reuters, Andrew Longstreth, updated December 13, 2013. https://www.reuters.com/article/us-usa-creditcard-settlement/u-s-judge-approves-retail-credit-card-fee-settlement-idUSBRE9BC0W120131214

4. "Visa Core Rules and Visa Product and Service Rules." Visa, last modified October 16, 2021. https://usa.visa.com/content/dam/VCOM/download/about-visa/visa-rules-public.pdf (Section 5.5.1.5 US Credit Card Surcharge Requirements)

5. "MATCH Documentation," MasterCard, accessed January 5, 2021, https:// developer.mastercard.com/match/documentation/