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- I. **Costs of Merchant Processing.** This paper provides an overview of the cost drivers for merchant processing; describes how merchant processors categorize merchants and defines the most common types of fees assessed by merchant processors.
  - **Overview**
  - **Interchange**
  - **Types of Fees**
  - **Common Rates and Fees**

### **Merchant Processing: The Basics**

Debit and credit card processing is a vital service for any business serving consumers. You should think of your merchant services account as you would any bank relationship by shopping for the right account for your business and protecting and fostering that relationship once established. Payment processing accounts can be separated into two broad categories; card present accounts for retail stores, restaurants and other businesses where the card holder and merchant are present at the same time and card-not-present merchants for Internet, mail order and other businesses where the card holder and merchant are not at the same location.

All merchant accounts today are for the processing of credit and check cards (debit). These cards can be Visa, MasterCard or Discover. Additional options include the processing of American Express, gift card, check verification, ACH and PIN debit. All merchant accounts must be provided by a bank even though it may be sold by a third party. Card present merchant accounts are typically less expensive to process because there is less risk as the card and cardholder are physically present at the time of the sale; unlike a card-not-present transaction where the merchant can not validate the cardholder has their card in their possession.

Card-not-present merchants may choose to only accept payments through an aggregator such as Paypal rather than obtaining their own merchant account. The reason a business owner would choose to do this is although Paypal is more expensive for each transaction, the fixed monthly fees are less. Further, with Paypal, your funds are typically deposited into your deposit account more slowly than if you had your own merchant account. Finally, by only accepting Paypal you limit your pool of potential customers as not all individuals have a Paypal account. Regardless, if you are a cash restricted business owner and ubiquitous payment processing is not as critical a Paypal account may be right for you.

One more note for the novice – the terms ‘acquirer’, ‘payment processor’, and ‘merchant bank’ all mean the same thing. That is the entity that is processing your card transactions and processing your funds until they are released to you.



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### **Costs for Merchant Processing**

As stated, because card present accounts represent less risk, the discount charged on the amount processed will be less than the discount for a card-not-present merchant account. Discount is the percentage assessed by the payment processor on each sale. The largest single component of the merchant processor's expense is Interchange which is the transfer pricing that the acquiring (or merchant) bank pays the issuing (or cardholder) bank. Interchange is the primary reason for the discount rate and is the same for all acquirers and is posted for both Visa and MasterCard on their respective websites. Though it is not critical you know the categories, you can get an understanding of the relative amounts by viewing them at:

[http://usa.visa.com/merchants/operations/interchange\\_rates.html](http://usa.visa.com/merchants/operations/interchange_rates.html)

[http://www.mastercard.com/us/merchant/pdf/MasterCard\\_Interchange\\_Rates\\_and\\_Criteria.pdf](http://www.mastercard.com/us/merchant/pdf/MasterCard_Interchange_Rates_and_Criteria.pdf)

There are hundreds of different categories with the disparity between the least and most category to be approximately 2 percent.

All acquirers will have a discount rate, which we will discuss in more detail below, however; there are several other fee categories to consider when establishing a merchant account, including; set up fees, monthly fees, minimum fees, third party or VAR fees, PCI and early termination fees. It is important to note that not all acquirers have all these fees, but you need to ask about them as unlike when you establish a credit card account with a bank, a merchant account is a commercial product and the same laws that protect consumers and specify certain disclosures do not exist with commercial products. To be clear, MAKE SURE YOU UNDERSTAND ALL FEES associated with your merchant account.

**Set up Fees:** This fee may be charged by your sales professional for the set up of your account or for the Terminal or gateway (see Merchant Equipment/Hardware and Processing Solutions below). Though some acquirers provide the equipment or gateway for no charge, they typically charge more for service or have a high termination fee to make up for the out of pocket expense. The key here is to know if you are paying for the third party or gateway or if the fee is merely to set up your account.

**Discount Rate:** This is the fee charged on your Visa, MasterCard and Discover Sales. It is expressed in a percentage. It is typically the most significant fee associated with your merchant account. Debit or check card sales are often priced below credit card sales but as you can see from Exhibit 1, some acquirers blend the rate. The discount fee is usually tiered with a Qualified Discount Rate, Mid Qualified Discount Rate and Non Qualified Discount Rate. The tiers are needed to separate the least and most expensive Interchange rates. Be sure to understand if in addition to the Mid and Non Qualified surcharge if your acquirer also has an added Mid and Non Qualified transaction fee. This is becoming more common. Finally some acquirers also have a Rewards tier that is inserted between the Qualified and Mid Qualified Rate to account for the differential from some rewards cards. This is not



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necessarily a bad thing, as it may allow for a lower Qualified Discount Rate, but you should be aware of it.

**Transaction or Authorization Fees:** This fee is charged either on a sale or return transaction or on the authorization inquiry. Be wary of an acquirer that has both a transaction fee and an authorization fee. If they do, the fees should be much less (half) than a similarly situated acquirer that only has one of these fees.

**Monthly Fees:** Many acquirers name their monthly fees differently. Be sure to ask what all your monthly fees amount to and what you get for those fees. Most accounts have some form of a monthly fee often referred to as a customer service fee, statement fee, maintenance fee or account fee. Do not sign up for any warranty or maintenance program. You will be better served paying for any equipment if it malfunctions and/or buying your own supplies when needed.

**Annual Fees:** Some acquirers charge an annual fee. Make sure you get value if you are paying an annual fee and you clearly understand what that fee entails.

**Minimum Fees:** Most acquirers charge a minimum fee that will be assessed if your combined discount and transaction/authorization fee do not exceed a certain amount. The minimum fee is assessed by subtracting the amount you were billed for your discount and transaction/authorization fee from the minimum fee amount.

**Card Network Surcharges:** Though not a significant overall expenditure in your merchant processing, most acquirers pass-through the Card Network Surcharges. The most prominent of them is the network surcharge which is just under 2 cents for each card brand charged on either the authorization or sale transaction. Less common network surcharges include a premium on foreign cards and small per usage penalty fees if you do not follow best practices. For example, if you process an authorization but do not follow through with a sale or process a sale without first obtaining an authorization, you will get a small penalty fee under 11 cents per action.

**PCI Fees:** Payment Card Industry (PCI) Data Security Standards (DSS) fees are becoming ever more common. While some acquirers charge this fee to assist you in obtaining PCI compliance, this fee should not exceed \$10.00/month and should provide you genuine education and ongoing services if you are assessed this fee. Such services include scanning services (for Internet processing accounts) and assistance with your Self Assessment Questionnaire (see PCI compliance).

**Third Party or VAR Fees:** Third parties can be a needed and necessary component of your merchant account. While it would be too long to list all third party fees here, it is important with any third party to compare their fees with at least one other similar third party to ensure the fees are in line with their competitor. Common third parties include Internet Payment Gateways and wireless transaction providers.

**Early Termination Fees:** One of the widest disparities in acquiring pricing is in the Early Termination Fee. This fee is often overlooked because it is not assessed until you close your account and is not associated with your account set up. Be sure to clearly understand your Early Termination Fee. Never agree to an Early Termination Fee that is charged regardless of when you close your



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account. Also, require that any Early Termination Fee be a fixed fee and not a formula based on your processing costs.

**Other Fees:** Most acquirers typically charge for chargebacks, batches, Address Verification (inquiries) and for certain service requests but these fees should not appreciably change your overall cost of processing.

#### Exhibit 1-Common Rates and Fees

Fee Category	Range	Comments
Set up Fee	0 - \$100	Separate fee for a gateway or terminal from set up cost.
Disc. Fee(Card Present)	1.60%-1.85%	If debit priced separately, may have debit as low as 1.30% but credit would be higher
Disc. Fee(Card Not Present)	1.99%-2.50%	If debit priced separately, may have debit as low as 1.85% but credit would be higher
Mid-Qual. Discount	0.50%-1.00%	Rate is ADDED to Qualified Discount Rate
Non-Qual Discount	1.30%-2.30%	Rate is ADDED to Qualified Discount Rate
Tran or Auth. Fee	\$0.15-\$0.25	If your average sale is small, this fee is more significant in your overall costs
Monthly Fee	\$8 - \$12	This fee may be called 'statement fee' or 'account fee'
Annual Fee	0-\$100	Make sure you know what you are receiving in return for this fee
Minimum Fee	\$10-\$25	This fee is more critical if you have months where you do not expect to process
PCI Fees	0-\$20	Make sure you know what you are receiving in return for this fee
Third Party –Gateway(monthly)	\$10-\$20	Typically, there is also a set up fee
Third Party –Gateway(Trans.)	\$0.01-\$0.10	Be sure to compare this to similar third parties
Third Party-Wireless	\$15-\$20	Typically, there is also a set up fee
Early Termination Fee	\$200-\$500	Term is typically 2 to 3 years—be wary of longer term or no end date
Address Verification Fee(AVS)	\$0.00-\$0.15	Only needed for keyed, Internet or mail/phone order transactions





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- II. **Merchant Processor Selection.** This Paper describes how to select a merchant processing sales representative, the differences between merchant processing banks and how to select the right processor for you.
- **Merchant Processing Sales Representative Selection**
  - **Merchant Processor (Acquirer) Selection**
  - **Factors Determining Merchant Risk Profile**
  - **Merchant Processing Banks**

### **Merchant Processing Sales Representatives**

Selecting the right sales representative will be critical to your merchant processing success. They will represent you to the acquiring bank and provide the options for you to select from. Although there are many acquiring banks to choose from, there are literally thousands of merchant sales representatives selling for those banks. Similarly to dealing with independent representatives in other industries such as insurance or mortgage banking, you can often get a better deal from the independent representatives than directly from a bank, however, independent representatives can also price far in excess of what a bank representative charges. The key to getting a good representative is to do your research. Ask the representative for 3 references and do a Google search on both the individual representative and the company they are representing. Be wary of doing business with anyone without a physical location on their business cards or are operating without their own website. Make sure they are registered to represent an acquiring bank as indicated on their business card so you can contact that financial institution should the need arise. Finally, as stated previously, clearly understand what the early termination fee term and amount is before signing the contract.

Finally, ask your sales representative if they represent more than one acquirer so you know they are putting you in the right acquirer for your business type.

### **Acquirer Selection**

There are many payment processors to choose from. The key is selecting the right payment processor to afford you the best price and proper match. To do this, you want to first understand your risk to the payment processor. Because most payment processors require a personal guarantee from the owner of a small company, your personal credit is one of the factors that will determine the relative risk of your merchant account. Additionally, as we discussed, a card present account will typically be seen as less risk than a card not present account. Exhibit 2 compares the common items that determine the overall risk of a merchant processing account.



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### Exhibit 2-Factors Utilized in Determining Risk Profile of a Merchant Account

Attribute	Lower Risk	Higher Risk	Comments
Processing Method	Card Present	Card Not Present	Card present transactions represent less risk to the merchant processor
Average Ticket	< \$100	> \$1,000	Larger tickets tend to be more prone to chargebacks
Processing limit	<\$25,000/mo	>\$50,000/mo	Greater processing volumes must be underwritten more carefully
Forward liability	0 days	> 30 days	Delays between transaction and product delivery lead to buyer remorse
Guarantor's credit	credit score >700	credit score < 650	Personal credit very important in evaluating small business merchant acct.
Age of business	Bus. > 5 years old	New business	New businesses much more likely to go out of business
Capital	Cash Reserves	Little or no reserves	Chargebacks may deplete your cash on hand
Product/service	Easy to explain	Innovative bus. plan	New bus. plan may be difficult for underwriter to grasp
Sales tactics	passive	aggressive	Out bound telemarketing are among the most aggressive sales tactics

All else being equal, a riskier merchant account can expect to pay higher fees. Additionally, you should expect the approval process to take longer and plan your application process accordingly. Lower and higher risk acquiring banks are identified below in Exhibit 3.

### Exhibit 3-Common Merchant Processing Banks

#### Risk Averse Acquirers\*

Bank of America  
Wells Fargo Bank  
US Bank  
5<sup>th</sup> 3<sup>rd</sup> Bank  
Chase Bank

#### Aggressive Acquirers

Merrick Bank  
Harris Bank  
HSBC  
First Bank of Delaware  
WoodForest National Bank

\*Many banks are capable of working with both types of merchants through outsourcing

Finally, when selecting a payment processor, make sure the engine they are utilizing is a well known and large. Such processing engines include:

- First Data Corporation
- Global Payments
- Total Systems (TSYS)
- Paymentech
- Elavon



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- III. Payment Card Industry Compliance.** This paper describes why all merchants should be compliant with the Payment Card Industry's Data Security Standards and the guidelines small merchants should follow.
- **Overview**
  - **Risks**
  - **Level 4 Requirements**

### **Payment Card Industry (PCI) Compliance**

All merchants must be PCI compliant. PCI compliance refers to a merchant's compliance with the industry's Data Security Standards (DSS) which are promulgated to protect cardholder data. Not only do you want to protect cardholder data to ensure your customer data is secure but should you be hacked and found to be operating outside of industry standards then you could be liable for significant fines from the Card Networks as well as required to notify all impacted customers; certainly a very expensive and embarrassing situation.

The size of your business dictates the required administration and validation needed to comply with the industry's Data Security Standards. From Visa's website, you can validate your level, however as most merchants are Level 4, we have indicated those requirements and attributes below.

Level 4: Merchants processing less than 20,000 Visa e-commerce transactions annually and all other merchants processing up to 1 million Visa transactions annually

#### **REQUIREMENTS**

- Annual Self Assessment Questionnaire (SAQ) recommended
- Quarterly network scan by an Approved Scan Vendor (ASV) if applicable
- Compliance validation requirements set by acquirer

The full definition of all four levels can be found at the following site:  
[http://usa.visa.com/merchants/risk\\_management/cisp\\_merchants.html](http://usa.visa.com/merchants/risk_management/cisp_merchants.html)

While the requirements for PCI compliance vary radically depending on the type of merchant and method of processing, keys to remember are:

All merchants must complete an SAQ. These are managed by the PCI Security Standards Council and can be found at:

<https://www.pcisecuritystandards.org/saq/index.shtml>



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The PCI Security Standards Council was founded by American Express, Discover, JCB, MasterCard and Visa. The Standards Council is an open global forum launched in 2006. Basic rules for small merchants include:

- PIN data, magnetic stripe data, CVV data must never be stored in any format.
- If cardholder data is stored, it must be encrypted and if physical copies are kept, they must be in locked cabinets.
- Any third party storing, transmitting or processing card data must be PCI compliant and listed as PCI compliant on the following site:  
[https://www.pcisecuritystandards.org/security\\_standards/vpa/](https://www.pcisecuritystandards.org/security_standards/vpa/)
- If your card processing equipment, PC or software is connected to the Internet, you should install a commercial grade firewall and get scanned quarterly by an approved scan vendor (ASV).





- IV. **Merchant Equipment/Hardware and Processing Selection.** This paper describes the processing terminals and their costs for a retail merchant. It also describes Internet Payment Gateways and shopping carts for eCommerce sites. Finally, this paper briefly describes best practices for eCommerce sites.
- **Terminal Hardware and costs**
  - **Internet Payment Gateway**
  - **Shopping Carts**
  - **eCommerce sites**

### Merchant Equipment/Hardware and Processing Solutions

All merchants need a processing solution. Although there are too many different types of solutions available to include them all, it is appropriate to highlight two of the most common for small merchants; i) the credit card terminal for retail, mobile and restaurant establishments and ii) the Internet Payment Gateway for eCommerce, mail order and phone order merchants.

The credit card **terminal** has been around for several decades and has allowed merchants to automatically transmit credit card drafts to their merchant acquirer each day. The transmission can be done via a land line (or POTS line), WIFI, an Internet connection or a wireless device. Most terminals today have an integrated printer and card reader and are capable of storing multiple applications such as Gift card, Check Services or multiple merchant ID's. **NEVER LEASE A TERMINAL.** The overall expense is far in excess of the resale value and you will pay for the terminal many times over during the term of the lease. Some sales professionals rent terminals and that may be a good way for you to test drive the terminal and ensure it is worth your investment.

### EXHIBIT 4-Common Terminal Functions and Cost

Terminal Type	Functionality	Price Range
Dial Terminal	debit, credit, PIN debit, multi-app	\$199-\$350
High Speed Terminal	debit, credit, PIN debit, Multi-app, gift card	\$250-\$500
WIFI Terminal	debit, credit, PIN debit, multi-app, gift card	\$400-\$700
Wireless device*	debit, credit, PIN debit	\$100-\$600
Wireless Terminal*	debit, credit, PIN debit	\$450-\$850

\*wireless terminals have monthly connectivity fee typically around \$20.00/month.

Larger merchants, restaurants, hotels, professional offices, self storage facilities, grocery stores, doctor's offices, dentists, self service petroleum retailers and specialty retailers often need integrated point of sale devices that are unique to the business type. Regardless of the device you select make sure it is PCI DSS compliant (See Payment Card Industry Compliance section)

Internet Merchants need an **Internet Payment Gateway** and a shopping cart integrated into their site. The key is to consider your payment gateway integration as you are designing your site and not as an afterthought.

Shopping carts track items customers pick to buy from your site until they proceed to the "checkout". Shopping carts act as a front end which passes information via a secure connection to the payment gateway. It's critical to know the cart's functionalities before you choose the cart and that it will integrate into the payment gateway you have selected. Most new eCommerce sites can utilize free shopping carts, however a premium cart may cost approximately \$250 - \$300.



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A payment gateway is a third-party company that connects your e-commerce site to your merchant processor and can provide your customers with real-time feedback about the status of their credit card authorization. A payment gateway also allows you to collect & utilize security features such as the Card Verification Value (CVV2) on the back of the card and validate the cardholder's address with an AVS check. Both of these features provide an additional layer of security.

The payment gateway service then channels the requests and transfers relevant financial information through the Card Networks and communicates via the Internet to your merchant account provider. It then sends back confirmation or denial codes to the shopping cart software.

Be sure to include the following informational pieces on your website:

- Your refund policy. Even if 'all sales are final'
- The descriptor which will appear on your cardholder's statement, such as your card will be billed as "Scottsdogbiscuits.com". By choosing your URL as your descriptor you provide your customers an easy way to find you when they receive their credit card statement several weeks after their transaction. When selecting your descriptor, keep in mind, that processors typically have a space constraint. Though each processor may vary slightly, typically 21 or 22 characters is the maximum length.
- Terms and conditions (if any)
- Your privacy policy

Common Gateways are listed below in Exhibit 4

#### EXHIBIT 4

Gateway	Description	Pricing
Authorize.NET	Very simple to setup and widely used in the USA	Modest
USAepay	Simple to setup and widely used in the USA	Modest
eProcessing Network	Simple to set up. Integrated with many wireless devices	Modest
Cybersource	High level of fraud detection and identification	High
PayPal Payflow Pro	Formerly from Verisign. Good for High volume merchants	High

Here again, you should get some advice and direction from your merchant services sales professional. In closing, by building your website with your eCommerce solution in mind, you lessen the expense and time to take to build the site and ultimately build a site that is easier to navigate and more likely to generate transactions.