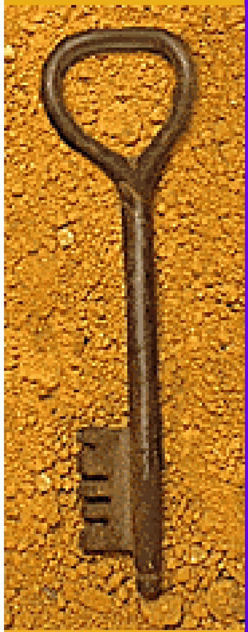
Credit Cards & the Public Sector

An Overview of Issues and Opportunities for Credit Card Acceptance in the Public Sector with Emphasis on Interchange, Pricing

Presented by Ed Compton, Director National Accounts
SunTrust Merchant Services/First Data Merchant Services

Agenda



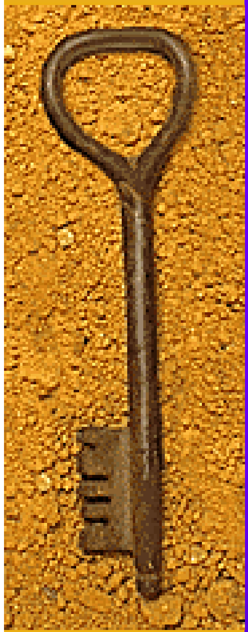
- Why Credit Cards?
- Pricing
- Interchange
- Assessment
- Transaction Flow
- Wrap Up/Questio

Why Credit Cards?

Both VISA and MasterCard currently have acceptance programs geared toward governments and universities.

They site:

- quicker receipt of payments
- payments that are guaranteed
- better availability of funds
- reduced cash theft
- savings in handling costs
- increases in revenues
- payment method flexibility
- customer convenience



Why Credit Cards?

Visa offers governments, universities, colleges and other types of merchants an “Emerging Market” rate for non-face-to-face transactions as an incentive to accept Visa cards.

The emerging markets CPS/Retail 2 rate is currently 1.43% of the transaction plus $.05, versus 1.85% plus $.10 for the same transaction at a non-qualifying merchant.

Visa and MasterCard have information available on line for the public sector.Visit…

http://www.mastercardintl.com/merchant/public_sector_main.html

and

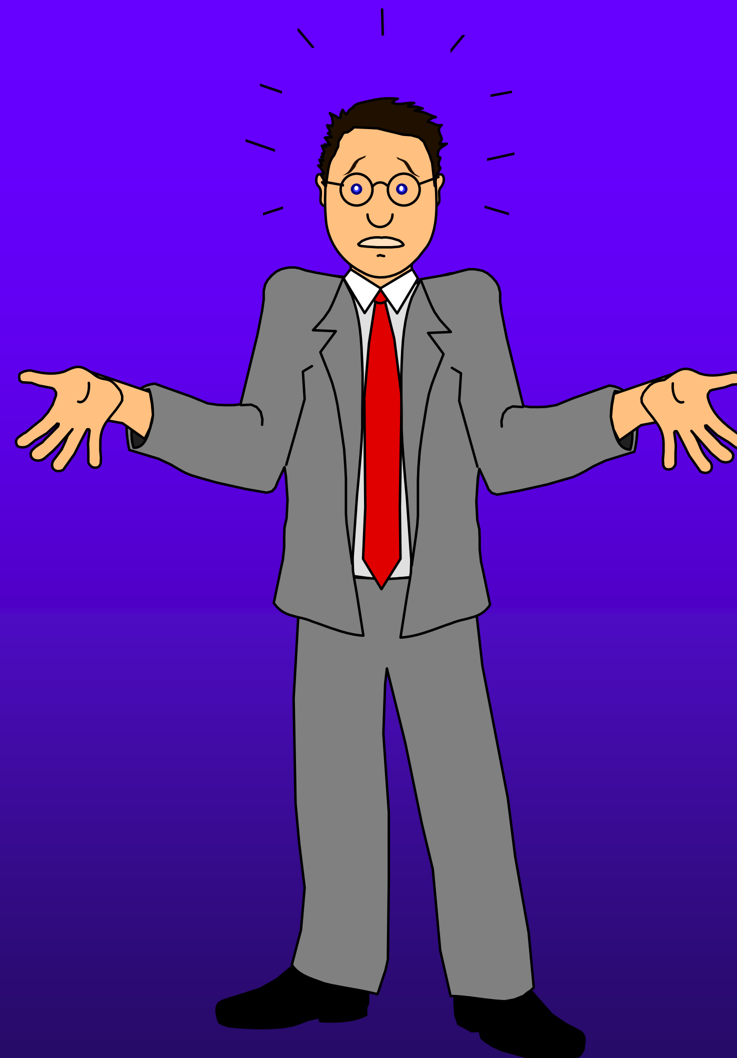
http://www.usa.visa.com/business/government/

So, why not?

Accepting credit cards isn't free. Merchants are charged fees, called Discount, by processors for this service. Traditional retailers can offset these costs by raising the price of their goods or services, and by gaining higher average sales or increased sales through credit card acceptance.

Governments and schools can't just raise prices to off- set Discount. And accepting cards doesn't increase your average sale or increase sales in general. You have a captive audience and - for the most part - pricing driven by other factors.

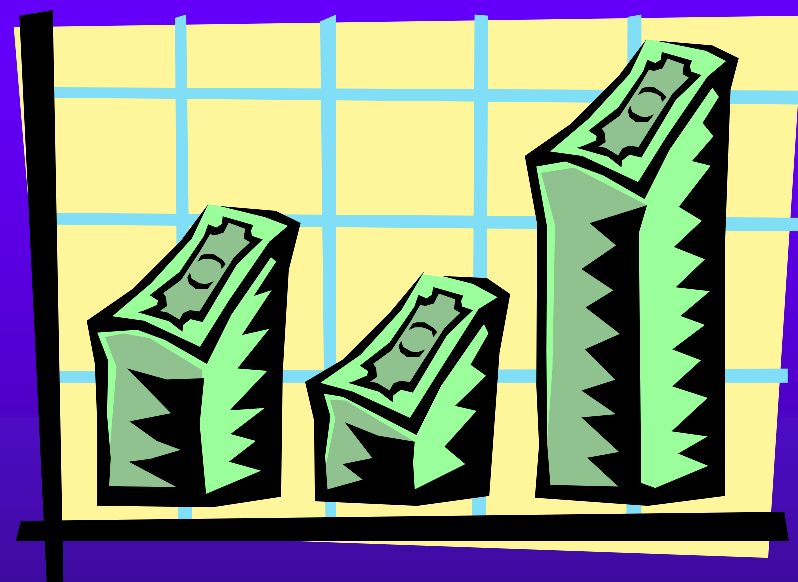
So what can you do?



So, why not?

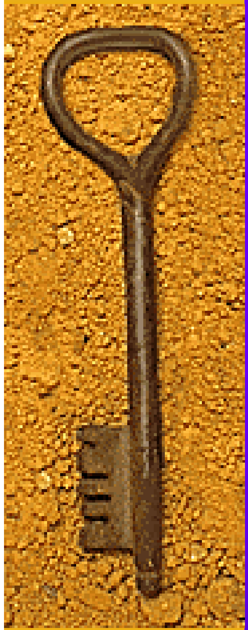
According to *The Wall Street Journal Online*, “many colleges, unable or unwilling to pay credit-card transaction fees of 1% to 3.5%, are wrestling with whether they should continue accepting credit cards…”

Some schools and other agencies are charging credit card users fees to offset costs, but that is heavily regulated and, in most cases, prohibited by the bankcards.



Acceptance Methods: Face-to-Face

- Traditional acceptance method
- Card is usually present
- Requires terminal, PC software or POS system
- Lowest risk = lowest rates
- Simple, easy to implement

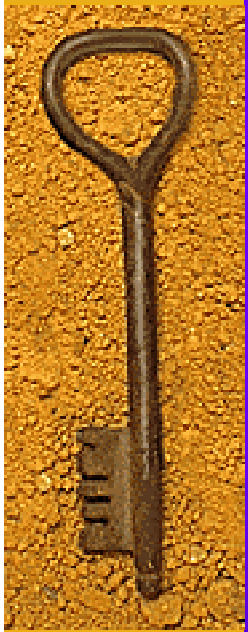


Acceptance Methods: Mail Order/Telephone Order

- Common transaction method
- Card is not present
- Can use terminal, PC software or other methods
- Higher risk = higher cost
- Address Verification Service (AVS) required to keep costs as low as possible
- Simple to implement, but has certain requirements
- Interactive Voice Response (IVR) an option

Acceptance Methods: Internet (AKA E-commerce)

- Fast growing method
- Card is not present
- Requires software, commonly called a "Gateway"
- Higher risk = higher cost
- Involves more to implement
- Has certain requirements



Steps to Card Acceptance

- Understand pricing and costs
  - Interchange
  - Discount Rate
  - Budgeting, etc.
- Decide how and where you want to accept
  - Location
  - Method
- Establish a merchant account
- Install
  - Equipment
  - Training
- Implement
- Reconcile and report
  - Tools

Pricing Structure

Pricing for credit card processing is structure in two major ways, either a blended rate or Interchange Plus (IC+).

Both methods of pricing consist of three components:

- Interchange - charged by the associations (Visa and MasterCard) on behalf of the issuing banks. Interchange is the same for <u>all</u> merchants.
- Assessments - charged by the associations, kept by the associations. Assessments are the same for <u>all</u> merchants.
- Discount - charged by the merchant’s processing bank (WMS). Their fee for the services they provide. Discount rates vary based on the type of business and transaction volume, etc. Discount can be calculated as a % of transaction amount or a flat transaction fee.

So…

Interchange + Assessments + Discount = Rate

Pricing Structure (continued)

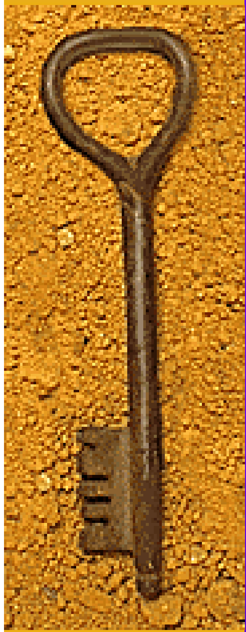
Blended Pricing

With blended pricing, an overall rate is determined based on what type of business is accepting cards, their average ticket and card volume. Interchange and assessments are paid out of the rate by the processor, and they keep the leftover. For example…

Assume a retail face-to-face blended rate of 1.80%. Use a $100.00 average ticket.

$100.00	sale
x 1.80%	discount rate
$1.80	cost

Intch Rate 1.54% + $.10 Intch Fee Visa Retail =	$1.63 (passed to issuer)
Assessment =	.0925% (kept by Visa)
Total IC and Assess. =	$1.73
Processor discount rate	$1.80 - $1.73 = 7¢
Processor gets 7¢	



Pricing Structure (continued)

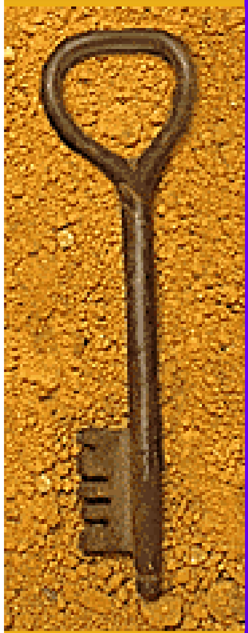
Interchange Plus (IC+)

With IC+ pricing, Interchange and assessments are charged and passed straight through to the issuers and associations, and the processor adds a per transaction charge. Using the same example…

$100.00 sale at an IC+ rate of IC plus 20¢

$100.00 sale
x 1.54% Interchange rate
+ $.10 Interchange fee
+ 0.0925% Assessment
1. 73% IC and Assessment
+ $0.20 Transaction fee
1.93% Cost to merchant

Processor gets 20¢

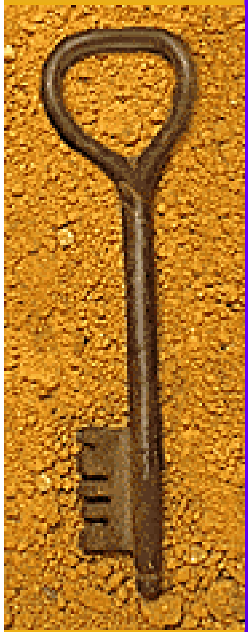


Interchange

Remember, Interchange is the amount paid by the merchant bank to the issuing bank on each transaction to compensate the issuer for the time it is out the money before recouping it from the cardholder, and the risk involved in the granting of credit. MasterCard and Visa independently establish the fees for their networks and may update them up to twice a year. All merchants pay the same interchange for the same types of transactions.

Credit card processors collect Interchange and pass it through to the Associations who pass it on to the issuers.

Some factors that affect Interchange are within the merchants’ control, but most are not.



Interchange (continued)

As of April 2005, there are more than 30 different interchange clearing rates for Visa and more than 35 interchange rates for MasterCard!

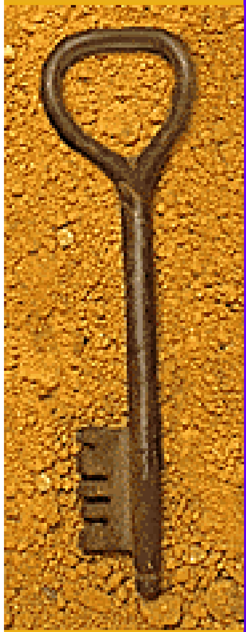
The proper rate for each transactions is determined by multiple factors such as card type, transaction method, authorization method, settlement time, merchant type, and more.

What seem like subtle differences in transaction can cause them to downgrade, or qualify at a higher interchange rate.

Interchange (continued)

Things that affect Interchange rates:

Merchant can control…	Merchant ***can not*** control…
Card Swiped	Type of Card
Settlement Time	Origin of Card
Authorized?	Method of Acceptance
Address Verification	Bad Magstripe - Keyed
Information Provided	



Interchange (continued)

Example transaction: $100 Sale*

<u>Scenario 1</u>

US Consumer Visa card, face-to-face transaction, swiped through machine, authorized…

Interchange rate of 1.38% plus $.05

$100 x .0138 = $1.38 + $.05 = **$1.43**

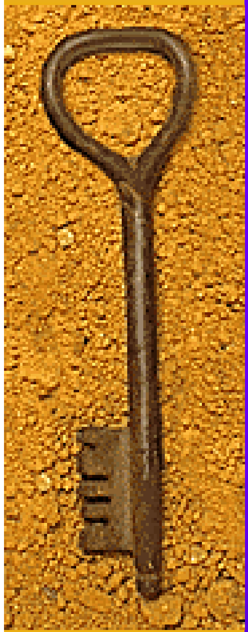
<u>Scenario 2</u>

US Consumer Visa Card, face-to-face transaction, **key entered** with AVS**,** authorized…

Interchange rate of 1.80% plus $.10

$100 x .0180 = $1.80 + $.10 = **$1.90**

(*Example shows Interchange costs only, not assessments or discount)



Card Types

There are numerous types of bankcards. Once you agree to accept a brand of card (i.e. Visa), you agree to accept all types of that card. Card types can include, but are not limited to…

•Consumer Cards

•Corporate/Business Cards

•Purchasing Cards

•Foreign Cards

•Check/Debit Cards

•Gift Cards

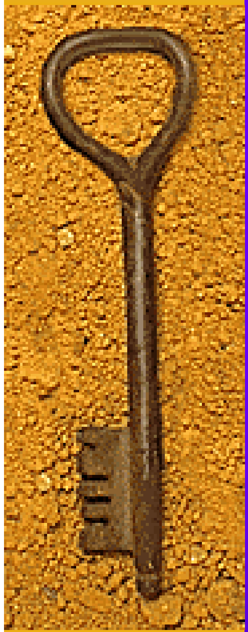
Important: Remember, different card types qualify at different levels!

Assessments

The second component of credit card costs is Assessment. Assessment is the fee Visa and MasterCard charge a merchant for their transaction. The associations use income from assessment to cover operating costs, marketing, etc. Assessment is the same for all merchants and is currently (.0925%) per transaction for Visa transactions and (.095%) for MasterCard.

Money Flow

	$100 Sales Slip	$100 Sales Slip	$100 Sales Slip	$100 Sales Slip	$100 Bill
Cardholder	Merchant	Acquirer	Association	Issuer	Cardholder
	$100 Merchandise	$98.37 (Credit to DDA account after IC+ trans. fee)	$98.48 Settlement ($98.57 less $.09 assessment)	$98.57 ($100 Less $1.43 interchange Income)	$100 Payment



Convenience Fees

Visa and MasterCard prohibit merchants from the following:

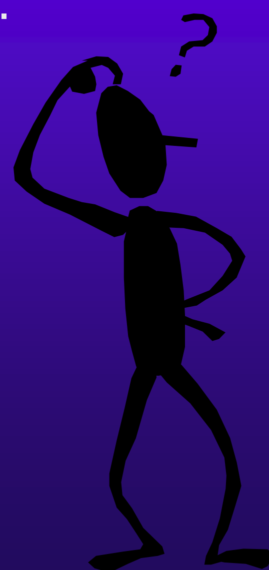
- ☒ establishing minimums or maximums for credit card purchases
- ☒ imposing a surcharge or fee for accepting a card
- ☒ establishing any special conditions for accepting a card
- ☒ establishing procedures that discourage, favor or discriminate against the use of any particular card

However, in under certain circumstances, merchants can charge convenience fees. Visa and MasterCard have subtle differences in their policies regarding convenience fees.

Let’s examine those in detail.

Convenience Fees (continued)

While the card associations (MasterCard or Visa) strictly prohibit passing credit card acceptance fees to cardholders, the associations do allow merchants to charge ***convenience fees*** to cardholders. Convenience fees are defined as fees that allow the merchant to recoup some of the costs involved in the use of technology as a way of providing the purchasers a more convenient method of payment. Currently convenience technology consists mainly of internet or Interactive Voice Response (IVR) methods of payment, ***but not*** simple phone, mail or face-to-face payment methods.



Convenience Fees (continued)

While each of the associations has a slightly different policy toward the charging of convenience fees, there are some basic similarities. Both Visa and MasterCard state the following:

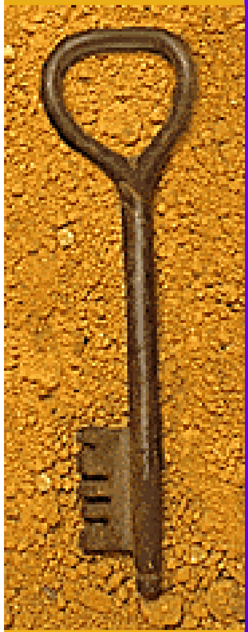
- The fees have to be for convenience, not offsetting the cost of accepting cards
- The fees must be charged to all payment types accepted via that payment method (e.g. if charging an internet convenience fee, and credit cards and checks are accepted over the internet, the fee must be charged to purchases using checks or credit cards, not just credit cards) and all card types
- The fees can not be used in mail/telephone or face-to-face payment methods as there is no perceived convenience in these methods
- There can be no discrimination based on card type as it relates to assessing the fees

Convenience Fees (continued)

MasterCard does allow the merchant to decide how to apply the fee and therefore allows the fee to be priced as a flat rate, a tiered rate based on purchase amount or a percentage of the purchase amount.

Visa is more restrictive and states that the fees may only be a flat rate applied to all purchases regardless of sale amount. NOTE: <u>Visa does not allow tiered or percentage based fees.</u>

Merchants accepting *both* Visa and MasterCard must adhere to Visa's more restrictive rules in order to be in compliance. Rules regarding convenience fees for other card types should be researched through the individual issuers (i.e. American Express and Discover).



Terms to Know

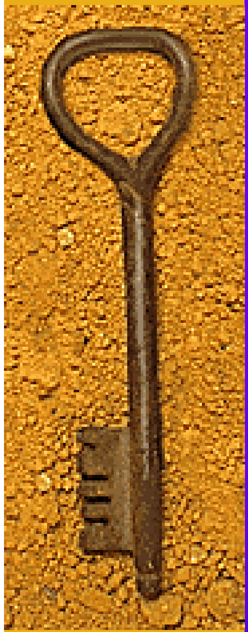
- **Acquirer/Acquiring Bank/Merchant Bank** – The bank that maintains the merchant relationship allowing the merchant to accept payment cards. A merchant has an account with the bank and each day deposits the value of the previous days card sales. Acquirers buy (acquire) the merchants sales slips and credit the tickets' value to the merchants account.
- **Issuer/Issuing Bank –** The bank that issues a payment card to a cardholder to make purchases with. Sometimes referred to as the Cardholder Bank. The bank extends credit to customers through payment card accounts. The bank issues the card and receives the cardholder's payment at the end of the billing period.
- **Bankcard Association –** A group of institutions formed for the purpose of sponsoring a bank card program and/or using a common processing and administrative center.

Terms to Know (continued)

- **Associations (MasterCard International and Visa International) –** Licensing, processing and regulatory agencies for bank card activities. The Associations dictate the rules and regulations that issuers and acquirers process under and set Interchange rates. All authorizations and transactions are passed through the Associations from the acquiring banks to the issuing banks in a process called Interchange.
- **Cardholder** – Any person who opens a card account and makes purchases using the card.
- **Credit Card** – A plastic card used to purchase goods and services on credit for which the cardholder is subsequently billed by the issuing member for repayment.
- **Credit Line** – The dollar amount of credit extended to a cardholder by the issuing bank.
- **Debit Card** – A card used to purchase goods or services that involves an immediate debit to the cardholders checking (or other) account.

Terms to Know (continued)

- **Online Debit** – Use of a debit card with a personal identification number (PIN) to process a transaction.
- **Offline Debit** – Use of a debit card without a PIN to process a transaction.
- **Authorization Code** – A number assigned by the issuing bank to a merchant sale that has been approved. Proof that a transaction has been properly approved.
- **Decline** – A response to an authorization attempt in which the transaction is denied by the issuer. The transaction should not be completed when a decline is received.
- **Referral** – A response to an authorization request from the issuer that a phone be made to the issuer for further information in order to either approve or decline the request.
- **Deposit** – The net value of a merchant's card sales that is credited to the merchant's account after the acquirer buy's the merchant's sales slips.

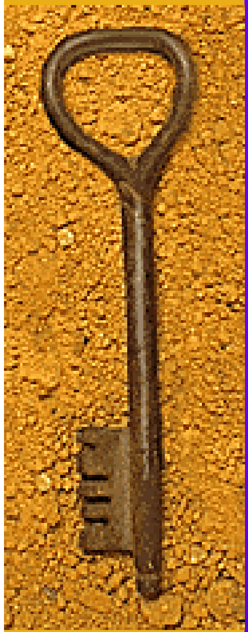


Terms to Know (continued)

- **Interchange** – The exchange of information, transaction date, and money among banks. Interchange systems are managed by Visa and MasterCard Associations and are very standardized so banks and merchants worldwide can use their systems.
- **Interchange Fees** – The amounts paid by the merchant bank to the issuing bank on each transaction to compensate the issuer for the time it is out the money before recouping it from the cardholder, and the risk involved in the granting of credit. MasterCard and Visa independently establish the fees for their networks.
- **Settlement** – Association – As a transaction moves from the merchant to the acquirer to the issuer, each party buys and sells the transaction. Settlement occurs when the acquirer and issuer exchange data and funds.

Terms to Know (continued)

- **Settlement – WMS/Merchant** – The process by which WMS collects discount and fees at month end. Settlement statements reflecting monthly activity are issued after month end settlement.
- **Discount** – The fee a merchant pays its bank (the acquirer) for processing transaction. The discount is usually a small percentage of the transaction amount.
- **Retrieval Request** – A request from an issuing bank, through the acquiring bank, to a merchant for a copy of the original sales ticket. A retrieval request must be responded to or the issuer has the right, through the Associations, to chargeback the transaction.
- **Chargeback** – A transaction that is challenged for various reasons by a cardholder or issuer. The transaction is routed back through interchange to the acquirer and may be debited to the merchant. A transaction can be presented to the issuer if found to be inappropriate by the acquirer or the merchant.



FDMS Overview

SunTrust Merchant Services LLC is a worldwide leader in electronic payment solutions and new commerce

First Data Merchant Services (FDMS®), a subsidiary of First Data Corp., the #1* card acquirer in the world and SunTrust formed a partnership to provide electronic payment processing services in March, 2002. FDMS settles more than 15 billion electronic payment transactions annually--worth over $650 billion in sales volume--for approximately 3 million merchant locations. Our processing portfolio is comprised of brick and mortar, Internet and mail/telephone order merchants of all sizes. With our partners, we provide merchant processing solutions in the United States, Canada, the Caribbean, Mexico, the United Kingdom and Australia.

* Rankings by The Nilson Report, Feb. 2002

Wrap Up and Questions

- Issues
- Pricing
- Interchange

Thank you!