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Payment Processing Industry: Processors Overcharge Merchants by Up to 50 Percent, According to Experts; A Closer Look at Industry Markup, Fee and Margin Inflation Practices

Industry Update

The payment processing industry is rife with improper pricing practices that target companies of all sizes, according to industry experts. Hidden fees and upcharges are so pervasive in the credit card processing business that a cottage industry of auditors and consultants has emerged to advise merchants on their processing options, identify improper practices, analyze statements and circumnavigate surreptitious fees.

The auditors say few business owners understand the processing industry's cost structures and jargon, which makes it difficult for merchants to differentiate between legitimate and illegitimate fees. Inflated processing fees and overbilling have a direct, ongoing impact on the profitability of card-accepting businesses.

Previously, *The Capitol Forum* has covered certain business practices of card processor Vantiv (WP), including how the company imposes shrouded surcharges on merchants and relies on contractual terms that make it difficult for merchants to terminate their relationship with the company. To better understand fee practices in the payment processing industry, we interviewed six processing experts and an attorney whose firm specializes in representing merchants in processing disputes.

Processor Overcharges

Processor overcharges can run up to 50 percent, experts say. Hidden fees and markups billed in myriad ways can result in businesses overpaying by 20 percent to 50 percent for card processing, according to experts *The Capitol Forum* interviewed.

"Sometimes it's through inflated rates rather than hidden fees," said Tom DeSimone, managing editor of Merchant Maverick, a website that reviews e-commerce products for small business owners. "It's common to see merchants paying 30 to 40 percent of their total processing cost in fees that could easily be eliminated by switching to a different payment processor," DeSimone said.

Robert Day, managing partner of weAudit.com, a processing auditing firm, estimates that 30 percent to 50 percent of processing charges for small to medium-size business result from unanticipated or "junk fees" or overbilling. "We estimate there are over 5 million U.S. merchants being overbilled in deceptive overcharges and fees each year, with an estimated total of $100 billion in potential savings that they are unaware of," said Day, whose firm works with small to global businesses.

"Lack of education on cost structures associated with accepting credit cards as payment has most businesses overpaying by 20 to 40 percent," according to an Accounting Today article published in May 2017.

"Seventy percent of merchants who come to me are paying too much. It may be an issue with the processing contract," said Phil Hinke, president of Merchant Fee Savers, an auditing firm.

A Close Look at Processor Strategies

Techniques for overbilling are varied and widespread, affecting small, middle-market and large, global businesses alike. Below we take a close look at some of the profit-boosting practices employed by the industry.

Pitching deals premised on fictitious savings. Processors often rely on the confusion surrounding their industry, so experts warn merchants against accepting any deals at face value. "Merchant processors frequently market their processing services using flawed savings analysis," said Hinke.

"Credit card processing fees are complex and processors have many tools at their disposal to build margin above negotiated processing rates in ways that are both clear and concealed," said Ben Dwyer, president of CardFellow.com, a web platform that matches merchants to processors who commit to specific parameters.

"Compounding the issue is that processors set pricing on a per-case, per-business basis. There are no standards, and shopping processors without first learning how fees actually work is financial suicide," Dwyer said.

Offering predatory rates to less savvy business owners. The processing rate offered to merchants typically consists of a percentage of sales volume plus a per-transaction fee.

From the money merchants pay to processors, some passes through to third parties such as the cardholders' banks to cover interchange costs and the card brands like Visa and Mastercard to pay for assessments. Assessments are numerous small fees applied to each transaction routed through Visa, Mastercard or Discover for the role they play in the payment process.

Processors take advantage of merchants' inability to distinguish between proper and inflated processing rates, frequently allowing them to charge less savvy business owners higher rates than are commercially reasonable, according to experts.

“A client of mine was recently offered a rate by a processor that was 0.60 percent of sales volume plus 11 cents per transaction over Visa, Mastercard and Discover’s fixed interchange rates and pass-through fees,” said Hinke of Merchant Fee Savers. “I told them that rate was horrible for a low risk merchant like a medical practice.”

“Savvy merchants might negotiate a processing rate that is 0.04 percent of total debit and credit sales,” explained Day, of weAudit.com. “Another merchant with the same exact type of business who is unaware of how processing works might have a processing rate that is 0.80 percent of total debit and credit sales,” said Day.

“That’s a huge spread and it has a great financial impact on the business,” said Day.

Crafting confusing statements. The processing industry’s complex billing structure provides hundreds of opportunities to overbill, impose hidden fees and inflate fixed interchange and assessment rates.

“Processor overcharges are often near undetectable,” said Jarett Livingston, vice president of IMG Audit a processing auditing firm whose clients are middle-market to global businesses. “In order to identify hidden fees and excessive rates, a business needs deep knowledge of how the industry works, awareness of processing rates for various industries, and the ability to scrutinize monthly statements and restructure fees with processors.”

“Merchant statements are full of many moving parts and pieces which in turn allows processors to increase their bottom line,” said Livingston, whose sentiments were echoed by Day of weAudit.com. “Processing statements are intentionally complex. They are essentially smoke and mirrors,” said Day, of weAudit.com.

Chris McNulty, president of Merchant PACT, an advisory company with expertise in payments industry, concurred. “The complexity and lack of transparency of merchant statements makes it difficult for a business owner to determine how competitive their deal really is without independent expert review and advice.”

“Most merchants just give up trying to figure this stuff out at a certain point, unfortunately,” said DeSimone of Merchant Maverick.

Increasing fees with poorly provided notice. Processing rates and fees can be updated at any time under most merchant service agreements—one reason why experts recommend analyzing all monthly statements to check for new fees and markups.

"Usually processors will notify the merchant in some way, shape or form," said Livingston. "But not transparently. The notices may only be printed on paper statements when most merchants get their statements online."

Withholding interchange rate information on statements to hide markups and adding hidden fees to the "interchange plus" pricing model. There are hundreds of interchange rates assigned to different card categories, such as type of card (basic, rewards, business, debit, credit or prepaid) and if the payment is made in person or not.

Interchange plus is a pricing model based on the assumption that the processor charges a negotiated rate for each transaction, and all other fixed interchange rates and third-party fees will pass through exactly as they are without markups. The pass-through rate is the interchange rate that is fixed and must flow from the merchant to the cardholder's bank.

The Capitol Forum reviewed several recent interchange-plus processing statements from various providers where card category interchange rates are omitted. The lack of transparency presents the opportunity for markups to interchange.

For example, in one statement we reviewed, instead of charging the expected 1.95 percent in interchange fees from each sale, the processor increased the charged amount by a half percent, resulting in a 2.45 percent interchange charge for each sale.

Vantiv surcharges on interchange are as high as 140 basis points, adding 1.40 percent to the pass-through rate, according to some Vantiv statements we reviewed. Vantiv merged with, and changed its name to, Worldpay earlier this year, but monthly statements still show Vantiv's name as the processor, according to auditors we spoke with.

"If the merchant is on true interchange plus there should not be any surcharges, inflated fees and hidden fees to worry about," said Hinke of Merchant Fee Savers, the auditing company. "However, there are no enforced terminology standards in this industry so 'interchange plus' can mean different things to different processors."

Dwyer of CardFellow highlighted how merchants on favorable interchange-plus pricing models may be subjected to padded interchange, especially since merchants are largely unaware of the correct interchange rates.

The card category, Visa CPS REWARDS 1, has a fixed interchange rate of 1.65 percent of sales plus 10 cents per transaction. In the line item example below, the merchant processed seven transactions totaling $1,781.90 which should have resulted in an interchange-plus charge of $30.10.

Instead, the merchant was charged $55.98, a hidden markup of $25.88. The line item appears on the statement as follows, which we recreated for clarity (notably absent is the true interchange rate assigned to each card type transaction code).

Card Type	Items	Sales	Charge
VS CPS REWARDS 1	7	$1,781.90	$55.98

Instead of the expected interchange of 1.65 percent and 10 cents, this merchant is paying 3.10 percent plus 10 cents on these seven transactions alone. This is a hidden markup of 145 basis points, or 1.45 percent over the interchange rate set by Visa.

In an email response to questions posed by *The Capitol Forum*, a spokesperson for Worldpay said, "We properly disclose the calculation of our fees to merchants, and we generally charge merchants less than the industry."

Adding a hidden markup over correctly disclosed interchange rates. *The Capitol Forum* reviewed Vantiv statements that correctly identify and show the interchange rates adjacent to the card category line item but do not disclose the surcharge.

"Disclosing the interchange rate did not prevent the processor from padding the charges," said Livingston of IMG Audit.

A merchant would incorrectly assume that the interchange rate shown on a line item was the rate used to compute total interchange charges for each category. The line items show the card category and the correct interchange rate followed by the number of items sold and total sales.

To expose the hidden surcharge, one must compute the interchange cost to the merchant based on the interchange rate shown. Only then is it apparent that the interchange charge billed exceeds the amount calculated.

Here is an excerpt from a recent Vantiv statement recreated for clarity. The statement shows correct interchange rates, but computation of the charges reveals invisible surcharges of 50 to 141 basis points or 0.5 to 1.41 percent.

Card Category	# of Items	Total Sales	Charge
VS CPS E-COMMERCE CK-DURBIN @ 0.05% + $0.22	52	$5,257.59	$40.75
VS CPS E-COMMERCE BASIC - DEBIT @ 1.65% + $0.15%	10	$1,341.21	$30.40
VS CPS REWARDS 2 - TRADITIONAL - ECOMM/CARD NOT PRESENT/RESTRNT @ 1.95% + $0.10	36	$4,590.96	$116.35
VS EIRF - 1220 @ 2.30% + $0.10	10	$1,116.14	$42.36
VS EIRF - CK DURBIN @ 0.05% + $0.22	21	$1,440.75	$25.65
VS EIRF DEBIT @ 1.75 + $0.20	3	$174.50	$6.13

Here we showcase the Vantiv interchange surcharge against straight interchange without markup. Interchange rates are composed of two parts, a percentage of the sales volume plus a per-transaction fee.

Card Category	# Items	Total Sales	Charge	Interchange without Surcharge	Interchange with Risk Based Pricing Surcharge
VS CPS E-COMMERCE CK-DURBIN @ 0.05% + $0.22	52	$5,257.59	$40.75	$14.07	0.55% + $0.22
VS CPS E-COMMERCE BASIC - DEBIT @ 1.65% + $0.15%	10	$1,341.21	$30.40	$23.13	2.15% + $0.15
VS CPS REWARDS 2 - TRDITIONAL -ECOMM/CARD NOT PRESENT/RSTRNT@ 1.95% + $0.10	36	$4,590.96	$116.35	$93.12	2.45% + $0.10
VS EIRF - 1220 @ 2.30% + $0.10	10	$1,116.14	$42.36	$26.67	3.70% + $0.10
VS EIRF - CK DURBIN @ 0.05% + $0.22	21	$1,440.75	$25.65	$11.82	1.459% +$0.22
VS EIRF DEBIT @ 1.75 + $0.20	3	$174.50	$6.13	$3.65	3.16% + $0.20

According to spokesperson for Worldpay, the company "follows risk-based pricing, which at its core is based on the concept of charging lower rates for low-risk transactions and higher rates for higher-risk transactions, such as 'card not present' or international transactions. Under card network rules, the merchant acquirer [processor] effectively guarantees the performance of the merchant with regard to transactions accepted by the merchant acquirer and is therefore responsible for losses incurred due to merchant non-performance with regard to these transactions."

"For example, if a merchant were to fail to refund 'card not present' losses from chargebacks [disputed charges], including those related to fraud, or failed to deliver goods and services after receiving payment, then the merchant acquirer is responsible for the associated loss. Since certain types of transactions, like 'card not present' and international transactions mentioned in our earlier response, typically carry greater risk of loss for the merchant acquirer; we generally charge more for these transactions," the Worldpay spokesperson told *The Capitol Forum* by email.

The Capitol Forum asked industry experts about the surcharge practice. While they generally agreed that Worldpay's statement was accurate and the reasoning sound for risky merchants, they frowned upon the billing methodology and wondered if risk-based pricing was applied to less risky businesses like veterinary clinics that have little chance of chargebacks. Regardless of the reasoning, "that does not justify hiding or masking the fee to look more like a pass-through cost," said McNulty of Merchant PACT.

"For the benefit of the merchant, there should be a clearly labeled line item for that surcharge so the business owner can decide if they want to shop their business for a better deal," said McNulty.

"There's no excuse to hide charges behind interchange. If a processor feels it needs to charge a business more due to risk, the processor should simply add the markup in the open," said Dwyer of CardFellow.

"It does not address why on many, many client statements I see basic swiped Visa cards have a lower surcharge or no surcharge, but swiped rewards cards have a significant surcharge," said Hinke of Merchant Fee Savers. "Both types of transactions are done in person by cardholders at the same business. What's the difference in risk to the processor that leads to a higher surcharge for rewards credit cards?" asked Hinke.

"If the processor is including these surcharges on an interchange-plus pricing plan (and thus actually adding it to interchange), that's unusual. These surcharges are normally only seen with tiered pricing," said DeSimone of Merchant Maverick.

Downgrading transactions from a less expensive processing category to a more expensive one and pocketing the difference. Many pricing plans offer bundled rates that promise to sort out all transactions into a few categories, each of which is assigned a set rate for processing.

These plans are generally marketed on the rate assigned to the lowest category but often a large portion of merchants' transactions are coded to fall into the higher, pricier categories. Processors, not merchants, control how transactions are classified. Bundled, or tiered, pricing is less favorable and the statements less transparent than interchange plus pricing models, experts say.

Billing additional interchange and fees one or more months after original transactions are billed. This tactic, called billback or enhanced billback, is one of the least transparent pricing models. All transactions are originally billed at an anticipated processing rate that the merchant negotiated and expects to be charged.

"I have spoken to processor salespeople who love billback statements because when they sign up a new merchant, that merchant generally does a cost comparison after the first month to see how much money he or she is saving after switching processors," Hinke wrote in a 2011 eCommerce article. “Unfortunately, the merchant does not realize that some of that month’s processing cost will not show up on the statement for up to two months.”

Later statements include a section for interchange and fees charged in arrears to previously billed transactions which can more than double the rate from what was originally billed. Analysis of the two statements along with computation of line items must be conducted to determine the effective rate charged.

Deceptively labeling and padding card brand assessment fees. Visa and Mastercard set and charge a variety of fixed “dues and assessment” fees which processors collect from businesses to pay Visa and Mastercard. There are myriad opportunities in the industry for fabricating and padding assessment fees charged by Visa and Mastercard.

“We have found a fee called ‘Network Acquired Fee’ on Vantiv statements,” said Day of weAudit.com. “Vantiv adds extra percentage points and puts the fee under the assessment billing section. However, Visa does not have an assessment with that name. Most merchants probably think it is the Visa Fixed Network Acquirer Fee. The names are close, but they are not the same” said Day.

According to a Worldpay spokesperson, “The Vantiv Network Acquirer Fee includes various network fees which are assessed to us via various methodologies. Pricing within the industry is complex, because of the multiplicity of parties in the ecosystem required to process a transaction. Nevertheless, we strive to provide significant value to our merchants at competitive rates and to also provide clear and transparent pricing to our merchants.”

“At the beginning of every client relationship, we inform merchants how fees and surcharges will be assessed, including pass-through fees from the card networks and other third-parties, as well as our own processing fees. If pricing is modified, merchants are provided with advance notice of such changes. We believe our billing clearly outlines interchange, surcharges and other third party costs to our customers,” a spokesperson for Worldpay said.

Livingston caught a markup of two Visa assessment fees on one of his client’s statements. “Bank of America Merchant Services pads the Visa Acquirer Processing Fee (APF) by charging a flat 2.69 cents for the APF fee for clients who are supposed to get straight interchange plus pricing,” Livingston said.

On cost-plus pricing plans, merchants expect processors will charge the negotiated processing rate and pass through interchange and card fees without padding. “The per transaction APF fee from Visa is set for credit cards at 1.95 cents and for debit cards at 1.55 cents,” Livingston said.

“The markup of a half a penny to one penny for each transaction can easily add up to hundreds of dollars a month for companies authorizing tens of thousands of cards every month, straight to Bank of America’s pocket,” said Livingston who works with businesses which have high transaction volumes.

Other experts have also noted Bank of America Merchant Services marking up the Visa APF fee, which is charged when a Visa credit or debit card is authorized, regardless of whether the card is accepted or declined. Bank of America Merchant Services processed more than 16.6 billion transactions in 2017 according to the March 2018 issue of The Nilson Report.

Visa brand dominates market share at 60 percent of combined credit and debit card purchases for goods and services, followed by Mastercard at 25 percent, according to a February 2018 The Nilson Report. The markup of ½ cent to 1 cent on the Visa APF fee, for all U.S. Visa transactions likely resulted $50 million to $100 million in revenue for the bank in 2017, considering that close to 9.96 billion transactions are on Visa credit and debit cards.

When *The Capitol Forum* asked Bank of America Merchant Services about the overcharge, a company spokesperson responded, “Bank of America Merchant Services does not charge the Visa Acquirer Processing Fee for credit or debit transactions at 2.69 cents for merchants on interchange plus pricing. Merchants on interchange plus pricing are charged at 1.95 cents for credit transactions and 1.55 cents for debit transactions.”

Livingston highlighted another example where a processor imposed a misleading fee labeled Visa Digital Enablement Fee that is not a true Visa pass-through fee. Mastercard does impose this fee at 0.010 percent of the sales price. The processor not only charged this fee for both Visa and Mastercard transactions, but also inflated the Mastercard fee to 0.015 percent. These two issues combined, the fictional Visa fee and inflated Mastercard fee, resulted in overbilling the merchant $369 on one merchant’s statement.

Livingston discussed an unidentified client with a domestic account who was incorrectly set up as having a global account resulting in overcharges of two percent of total Visa and Mastercard sales volume in global processing fees. With the additional global fee factored in, this merchant paid an overall processing rate of 4.5 percent of total sales, as opposed to the expected overall rate of 2.5 percent.

The overall processing rate is an all-in rate that incorporates all processing fees, interchange, charges, hidden fees, markups.

Withholding interchange credits for returned merchandise. Processors are issued interchange transaction credits when customers return merchandise, but instead of passing the credits along to merchants the processors can sometimes pocket the interchange credits for themselves.

“Processors will sometimes hold back the credit vouchers for themselves in order to add to their bottom line,” Livingston said. “This the reverse of what happens during a sales transaction where the merchant pays a specific interchange category rate to accept a card,” Livingston said. “The processor should be giving the credit back to the merchant, not holding on to it for themselves.”