

Credit Card Companies Change Rules on Convenience Fees

By Jim Plunkett

This article highlights new programs that allow governments to pass along a credit card “convenience fee” to customers in face-to-face transactions.

Background. In a retail environment, a transaction fee is charged to the merchant whenever a customer makes a purchase using a credit card. Merchants are prohibited by the credit card companies from passing this transaction fee to the customer who uses the credit card, so merchants typically hide this fee in the price of their goods or services. Thus, all customers bear the burden of the fee. This is appropriate because merchants have control over the price of their goods and customers are making voluntary payments (i.e., they are not required to make the purchase).

In contrast, in most governments, fees are set by ordinance or statute and 100 percent of the fee must be collected by the government, which leaves no room to budget the transaction fee. In addition, government taxes are “involuntary payments,” that is, the citizen does not have the choice to make the payment. Furthermore, many local governments collect payments for another level of government. For example, in Minnesota, cities and counties collect fees for the State Division of Driver & Vehicle Services and Department of Natural Resources, and in Missouri, county tax collectors collect revenues for cities and towns.

State and local governments, wrestling with how to budget the transaction costs for credit cards, began passing along the transaction fee to card holders. Visa and MasterCard became aware that this had become widespread practice, and in 1993 began enforcing their bylaws which prohibit passing along transaction fees to cardholders. To enforce this policy, Visa and MasterCard ordered

their member banks to cut off service to those governments passing along the transaction fee.

Following these actions, the GFOA and other state and local government associations entered into discussions with Visa and MasterCard concerning their policies for government-sector transactions. The state and local government side of the debate put forward a number of arguments. A key argument on the government side was that taxpayers who choose to pay their taxes by credit card should pay the cost of the transaction. Taxpayers who choose another payment means should not pay the transaction fees of those who use credit cards.

Visa and MasterCard also put forward a number of arguments to support their position. Their main argument was that an important precedent would be set if governments were allowed to pass along transaction fees. If governments are able to pass the credit card transaction fee along to credit card users, then the private sector also would seek the same privilege.

This standoff continued until 1996 when Visa and MasterCard began to allow governments to charge a “convenience fee” to customers who pay by credit card on the Internet or through an automated phone system. Recently, in November 2007, MasterCard decided to allow governments to charge a convenience fee to customers who pay by credit card in face-to-face transactions. American Express adopted a similar policy in January 2008.

The Programs. MasterCard and American Express each have a convenience fee program for participating government entities (or their third-party agents collecting fees for them). Participants in the MasterCard program must meet the following requirements:

- Participants that store or process MasterCard account data for Internet-based transactions must provide evidence of compliance with the MasterCard Site Data Protection (SDP) program’s underlying Payment Card Industry (PCI) Data Security Standard to their payment processing company.
- Participants using a third party for storage and processing of MasterCard account data must document this on their registration form so MasterCard can ensure that the third party is SDP compliant.
- Cardholders must be notified of the convenience fee at the time of payment and be given the opportunity to opt out of the sale. In no case may the entity collecting payment be allowed to charge the fee without disclosure to the cardholder prior to finalizing payment.
- Payments and convenience fees must be processed under a merchant category code that is eligible.
- A customer service phone number must be transmitted to citizens on their monthly statements.

Note: Additional requirements from both MasterCard and American Express may apply and you should check with your payment processor or third-party service provider before assessing a convenience fee.

What Public Sector Entities are Eligible to Participate?

The MasterCard Program is open to the following educational institutions and public sector merchant categories:

- Government services: offices, departments and facilities that provide general support services for the government. This is a very broad based category including such entities as motor vehicle departments, parks & recreation departments, public safety departments (police/sheriff & fire), natural resources departments (hunting & fishing licenses and watercraft and snowmobile registrations), municipal airports, marinas, health services, convention centers and licensing boards, subject to approval by MasterCard.
- Government entities that administer and process local, state, and federal fines. Local, state, and federal entities that engage in financial administration and taxation.
- Local, state, and federal courts of law that administer and process court fees, alimony, and child support payments.
- Elementary and secondary schools for tuition and related fees, and school-maintained room and board.
- Colleges, universities, professional schools, and junior colleges for tuition and related fees, and school-maintained room and board.

What You Need to Know. First, credit card companies differ in their rules on when governments can pass on a convenience fee to their customers. The table below summarizes the current rules.

When Can Governments Pass on a Convenience Fee to Customers?

Credit Card Brand	Type of Transaction	Type of Payment
MasterCard	All types	Tax and non-tax payments
Visa	Automated phone system and Internet	Tax and non-tax payments (non-recurring payments only)
	Face-to-face	Tax payments only
American Express	All types	Tax and non-tax payments
Discover	All types	Tax and non-tax payments

Second, MasterCard and American Express do not allow a convenience fee to be assessed on their brands and not on Visa and Discover Cards. Since Visa does not allow a convenience fee for face-to-face, non-tax payments, this means that if a government accepts Visa cards, then it cannot charge a convenience fee on any credit card in face-to-face transactions.

Third, there are two types of companies that you can work with to take advantage of these convenience fee programs: credit card processing companies and third-party service providers. Credit card processing companies underwrite you, set you up, and deal with any issues that result from transactions with your citizens. Credit card processing companies also directly deposit your funds usually within 24 hours and no later than 48 hours.

Third-party service providers partner with credit card companies to do your payment transactions. Some third-party service providers have invested substantially in information technology that may offer your government advantages such as

interfacing with your citizen database. Because third-party service providers usually do not process your payments, they have to set up up their own merchant accounts with a payment processor, collect your money, and then transfer your funds to you, which adds additional costs and usually delays collection of your funds at least an additional day and as much as 10 days. If you choose a third-party processor, make sure you ask how quickly your funds will be deposited.

Fourth, MasterCard has strongly recommended that the convenience fee be processed as a separate and unique transaction (what they call “Best Practice”), and not be included in the total charge for the good or service. This helps minimize the amount of customer service inquiries and effectively insulates the municipality from accounting issues related to the fee.

Authorization and settlement of two separate transactions with one card swipe requires new technology. A payment processor that offers this technology collects the convenience fee in one account and the resident’s payment in another,



remitting payment to the government quickly and separately managing transaction fee payments in their own deposit account. Alternatively, payment processing companies that offer traditional retail terminals require governments to collect the fee themselves and then pay their credit card processor.

Previous articles about public sector credit card payments usually ended with a statement like:

“Until the transaction fee debate is resolved, governments should conduct a cost/benefit analysis to determine if accepting credit card payments make sense for them.” However, a new era in local government payments and customer service for their citizens has begun. Because of the position MasterCard and American Express have taken, state and local governments can now accept credit and debit cards without having to absorb the cost of credit card transaction fees.