How to lower your payment processing costs and increase approval rates

Trustly

INTRODUCTION

As the cost of accepting cards reaches new heights, merchants are embracing alternative payment methods.

Whether it's an everyday purchase or a large expense, U.S. consumers reach for debit cards and credit cards more than any other payment method. For merchants accepting these card payments, the price of doing business is steep — and getting steeper.

In 2021, Visa plans to make its most significant fee hike in a decade. According to Digital Transactions, Mastercard, Discover, and American Express currently plan to move ahead with rate increases scheduled for July 2020. The new rates will hit businesses that are currently taking online, or mobile payments particularly hard. One of the most significant increases will be to card-not-present (CNP) transactions, or payments made online, by phone, or by mail.

But in a modernizing financial era, cards have new competition. Millennials and Generation Z consumers are flocking to alternative payment methods as their buying power grows. Nowhere is that trend more apparent than with online purchases.

Where online payments used to be synonymous with credit card payments, digital wallets, peer-to-peer (P2P) payments, and bank transfers are gaining traction. Fifty-one percent of Gen Z consumers (born between 1997 and 2012) don't plan to apply for a credit card at all, according to Billtrust.
They're not abandoning convenient payments. In Billtrust's survey, 46% of Gen Zers said they used mobile wallets 1 to 5 times per month while 13% paid with their phone 6 to 10 times per month. At the same time, financial technology companies have stepped in to create seamless, market-ready ways to pay and get paid.

In 2020, secure, reliable, and affordable e-commerce payments became even more essential because of the COVID-19 outbreak. Worldwide, millions of businesses were suddenly required to shut their brick-and-mortar locations. The demand for digital, contactless payment methods surged as in-store revenues took a nosedive.

With online payment options expanding — and growing in popularity — many U.S. merchants are taking a hard look at the costs, risks, and realities of accepting cards.

In this whitepaper, we'll examine the state of online payment processing in the U.S. You'll learn actionable ways to reduce your transaction costs, identify obscure fees, and lower your rate of declines and chargebacks.

The shortcomings of card payments in the digital age.

Despite being the most prevalent online payment method, cards pack on significant operational overhead and cost for merchants. Payment processing fees are often obscure and hard to quantify, but across multiple transactions, they can add up to a heavy line item that cuts away at profits.

Beyond payment processing fees, merchants face steep fees and fines for transaction errors that are often difficult to control. According to the Electronic Transactions Association, chargebacks are a problem for businesses worldwide. Not only is it time-consuming to dispute a chargeback case, but the consequences for not doing so can be severe. In addition to the costs and operational considerations, card-not-present (CNP) payments have some of the lowest approval rates of all transactions. A significant portion of rejections, however, are false positives related to issuer perceived, potential fraudulent activity.

Rapid changes in consumer payment trends and expectations.

“Cash, card, or check?” Until recently, retailers dictated which payment options were available to customers. Today, consumers are setting the pace of industry innovation. A younger, debt-wary generation is leading the way.

Millennials (born between 1981 and 1996) and Gen Zers (born between 1997 and 2012) are digital natives who treat credit products with caution. This generation poses some of the toughest challenges to the credit industry as it stands. Both groups prefer debit cards to credit cards, particularly when setting a default method for digital payments.

While millennials have an average of three credit cards, they still own fewer than past generations. They carry less credit card debt, and fewer than **50% of millennials** use their card at least once a week. And although **61% of Gen Zers** have a checking account, only 30% have a credit card, all according to Experian.

For younger consumers, the e-commerce experience isn’t an experiment, it’s an expectation. This year, Deloitte reported that **44% of Gen Z and millennial** consumers expect to use their phone for most of their payments in the future. And Millennials and Generation Xers (born between 1965 and 1980) account for roughly 72% of all U.S. digital banking users, according to Aite Group.

Less than half of millennials use their credit card at least

ONCE PER WEEK

Source: NerdWallet

69%

Say NFC/Contactless payments are more convenient than cash, and they are using them more during COVID-19.

Source: Morning Consult

Up-and-coping alternative payment methods for merchants

Alternative payment methods (APMs) are slowly transitioning from millennial-only to mainstream. There's a new universe of options that aren't dependent upon the global card networks — and are built to increase customer conversion.

By 2022, Worldpay predicts that bank transfers will be the most popular non-card based payment method in the U.S. Bank transfers offer distinct benefits for merchants. They're more secure and less expensive than card payments, and some providers offer no-chargeback guarantees.

Bank transfer was the #1 or #2 card-not-present (CNP) payment method in 19 out of 36 countries surveyed by Worldpay.

A new antidote to the shopping cart abandonment problem

Merchants continue to grapple with cart abandonment rates and lost sales online. According to Baymard, roughly 7 in 10 digital shopping carts are abandoned by customers. Research by Barilliance showed that a "long, confusing checkout process" and "concerns about payment security" consistently ranked among the top five reasons for abandoned carts.

The three drivers of cart abandonment were unexpected costs, how long it took to check out, and required fields and forms. Bank transfers work well for merchants that need to reduce friction and enhance security at the same time. Many solutions include one-click checkout and strong customer authentication (SCA) features, with customers logging into their bank accounts and entering their credentials from memory.

SECTIONS

We'll walk through four areas of payment processing research and break down the key findings in each category.

Card decline rates are costing you

Card issuers are more likely to reject digital transactions than physical transactions. In fact, Mastercard reports that card-not-present (CNP) transactions have an 81% approval rate. That doesn't sound so bad, until you compare it to the 98% approval rate for card-present (CP) transactions.

Although these rates vary by industry, it's easy to see why issuers are extra cautious. Without the cardholder and physical card present, card-not-present (CNP) transactions are, by their very nature, harder to verify. Each CNP payment attempt carries elevated risk for the entire card value chain — from the customer and merchant to the card acquirer, issuer, and network.
There are a variety of issues that can stop a payment in its tracks.

5x

The Home Depot sees 5x more decline rates in the card-not-present space

81%

Digital approval rate

Issuers are wary of card-not-present (CNP) transactions

Source: Mastercard Webinar Enhancing Approval Rates

9 factors that influence transaction approval rates

01 Incorrect personal or account information

02 Expired card

03 Insufficient funds

04 Network unavailability

05 The card issuer's "Do not honor" decline

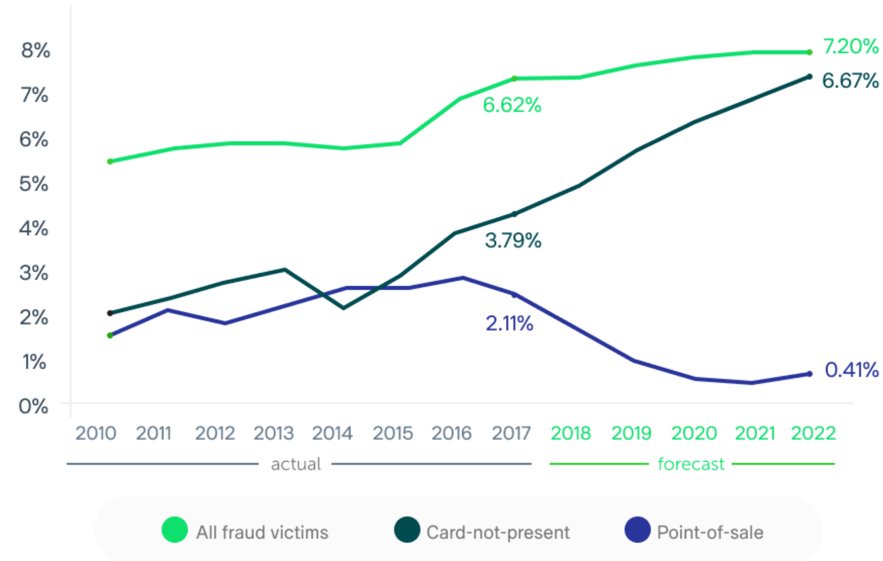
06 The merchant's fraud and risk mitigation tools

07 The card networks' fraud and risk mitigation tools

08 The payment processor's fraud and risk mitigation tools

09 Imprecise or inaccurate Merchant Category Code

Retail fraud attempts have doubled year-over-year and tripled since 2017



Source: Javelin Strategy & Research, 2018

Ecommerce is singled out for fraud attacks

Although some card declines are due to simple mistakes or cardholder error, there's a more insidious force working against e-commerce businesses. As the convenience and accessibility of online shopping has increased, so have criminal fraud attacks.

Fraud prevention tools are causing false positives

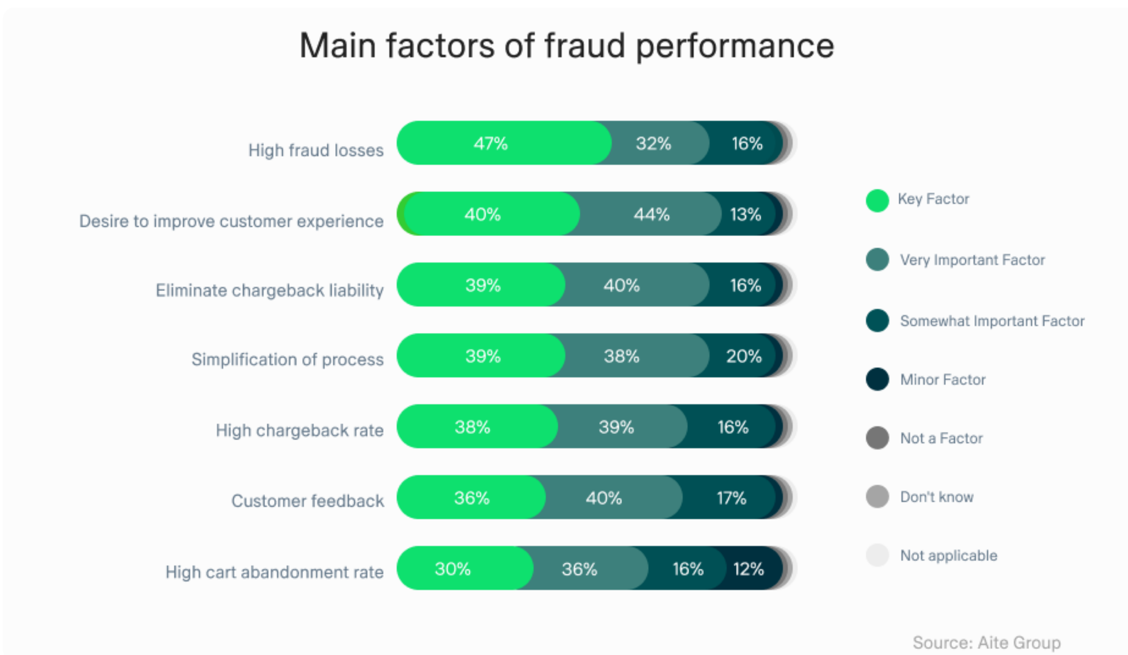
False positives, also called false declines, are card transactions that are legitimate payment attempts but get declined because they appear suspicious. Overly strict fraud prevention system rules and transaction flags are contributing to the problem.

Visa reported that 1.2 billion card-not-present (CNP) purchases are declined worldwide every year. But experts estimate that at least half of declines due to suspected fraud are actually legitimate transactions. And these errors, whether committed by humans or automated systems, can surpass the cost of fraud itself.

E-commerce fraud is an expensive problem, setting merchants back $6.4 billion each year. But Aite Group predicts that the cost of false positives will hit $443 billion by 2021. That's almost 70x more than losses from fraud itself.

The solution is equally time-consuming. The majority of e-retailers manually review between 50% and 100% of all their transactions, according to research by Aite Group and Clearsale.

More than half of merchants said their fraud prevention solution auto-declines 3.1% to 7.5% of all their transactions.



$3.13

For every dollar of fraud committed, U.S. retailers incur $4.14 of costs.

Source: LexisNexis 2019. Ture Cost of Fraud Study

$443 Billion

In card transactions are estimated to be falsely declined in 2021.

Source: Aite 2019. The E-Commerce Connundrum.

62% of merchants

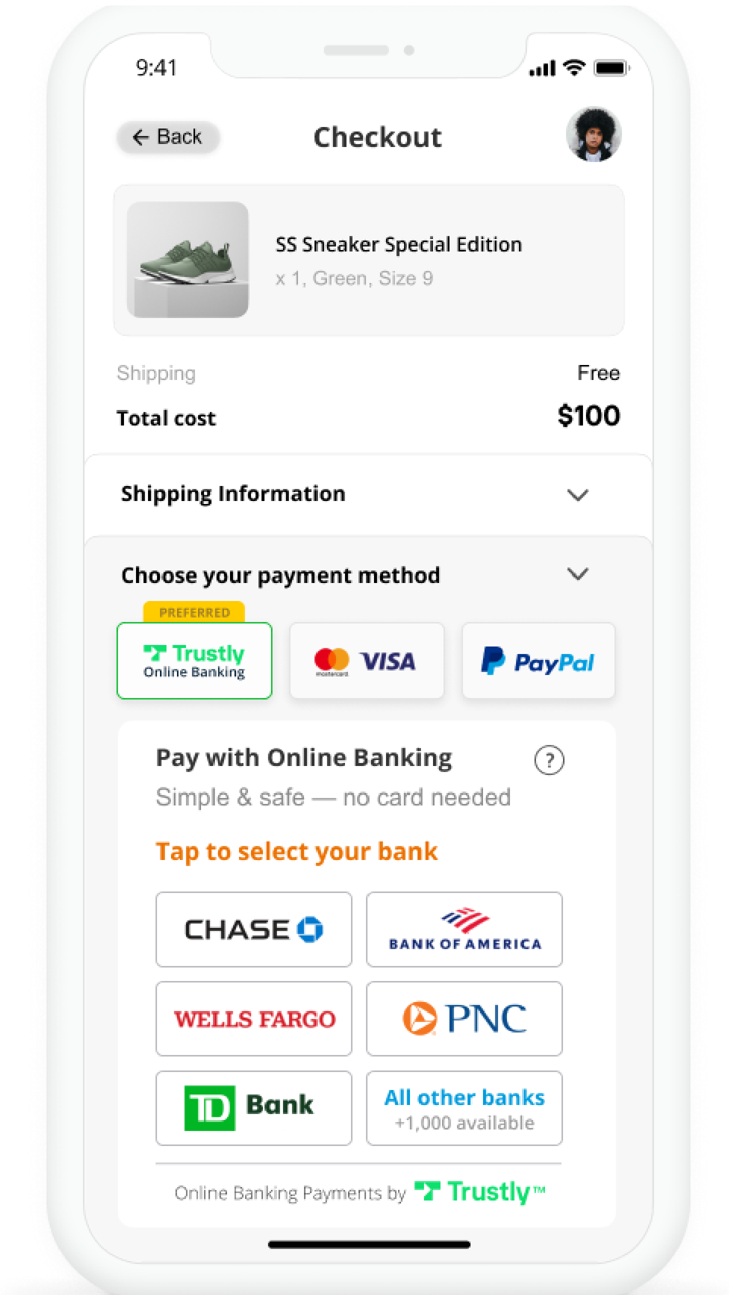
say their false decline rates are increasing.

Source: Aite Group & Clearsale. False Declines Industry Report.

The Open Banking Payments alternative

High approval rates are key to merchants' revenue optimization and improved consumers' experience. Businesses need a payment solution they can count on. Open Banking Payments are a valid alternative. They address all the shortcomings of the card schemas, which give rise to false positive declines and low card-not-present (CNP) approval rates by:

- Systematically enforcing strong customer authentication (SCA)
- Reducing the number of agents in the approval process
- Reducing the data-entry and human-error component
- Eliminating the impact of expiration dates on declines



SECTION 02

Chargebacks are hurting your bottom line

Chargebacks were implemented in the late 1970s as part of the Truth in Lending Act. They were designed to protect cardholders from liability associated with fraud, scams, and poor order fulfillment, among other bad practices. Four decades later, some merchants argue that chargebacks are a little too effective — to the detriment of legitimate and accurate transactions.

What is a chargeback?

A chargeback is a reversal of a transaction (here, a card transaction) or a sale that's refunded by the issuer if the cardholder disputes the charge. In many cases, if consumers buy merchandise, they aren't under any obligation to return the goods.

It's a complex, multi-step process to dispute a chargeback — and, for the merchant, it's expensive to lose.

There's a chain reaction of negative consequences when businesses receive a chargeback:

- There's usually a merchant chargeback fee even if the customer cancels the chargeback later.
- The merchant will lose revenue, goods, or both if they don't dispute and win their case.
- Merchants who receive too many chargebacks can have their merchant account frozen or closed. They may have to pay fines and be forced to switch to a high-risk merchant services account.
- If merchants exceed a certain number of chargebacks (determined by their payment processor, card issuer, and so on) they could be blacklisted from certain processors or account types.
- Winning a chargeback dispute doesn't improve a merchant's chargeback-to-transaction ratio.

Source: Mastercard Webinar Enhancing Approval Rates

How do chargebacks work?

Depending on which companies are involved, the chargeback process can look very different. Here is what typically happens when a customer files a chargeback, step by step:

01 The cardholder files a chargeback with their card issuing bank.

02 The issuer reviews the claim, adds any available details, and assigns a reason code to the case.

03 The merchant reviews the chargeback and submits defense documentation (like shipping receipts or communication records) if they decide to challenge it.

04 The acquirer reviews the chargeback information, removes the funds from the merchant's account, and forwards the details to them.

05 The merchant reviews the chargeback and submits defense documentation (like shipping receipts or communication records) if they decide to challenge it.

06 The merchant's evidence is forwarded to the issuer.

07 The issuer reviews the case and decides whether to accept or decline it.

08 If the verdict is in the merchant's favor, the funds are returned. If not, the merchant can decide to fight further. The second decision is final and cannot be appealed.

A breakdown of chargebacks costs

It's difficult to capture all the financial costs of a chargeback because data isn't readily shared by most merchants, card issuers, or card brands.

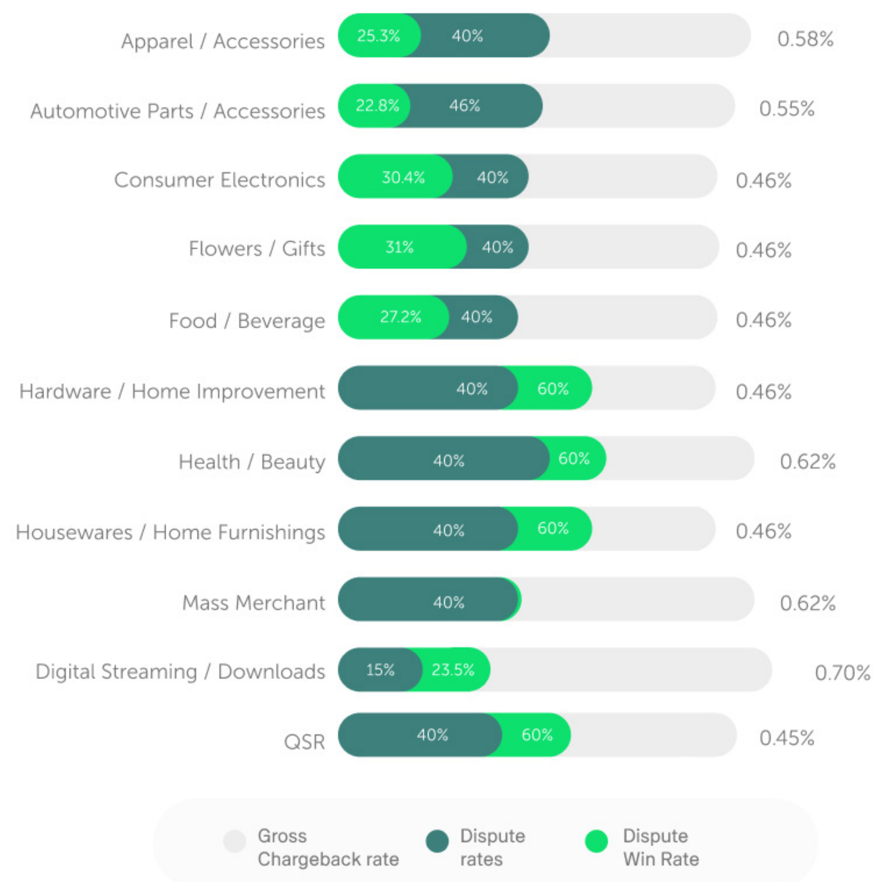
One estimate by Chargeback Gurus puts chargeback fees at $20 to $100, but that figure doesn't account for the work of acquiring the customer or operational costs to fulfill their order. A company could ultimately lose 2 to 3 times the transaction amount that was charged back.

Business that lose their disputes may have to relinquish or pay:

- The original transaction amount
- The product or service cost
- A dispute response creation cost
- A dispute response creation cost

Card-not-present (CNP) chargebacks cost business owners an estimated $246 per transaction

Source:Chargeback.com,Industry Dispute Ratios,



Source: Chargeback.com,Industry Dispute Ratios and Trustly estimates.

Chargebacks vary immensely by industry

Industry and vertical are great predictors of chargeback costs, so it's best to examine the data through this lens. Research from Chargeback.com and estimates from Trustly show the variance between industries when it comes to chargeback rates, dispute rates, and dispute winning rates.

The chart on this page exemplifies these variations with some verticals like "Digital Streaming" and "Health and Beauty" leading the charge at over 0.6% of revenue being charged back.

Chargebacks are worth fighting for

If a business can't keep its chargeback-to-transaction ratio down below the required level, it could be put on the MATCH list. MATCH stands for "Member Alert To Control High-Risk merchants." These businesses can't open a new merchant account while they're on the list. In most cases, the designation expires after five years.

Businesses should challenge incorrect chargebacks whenever possible. If not, the company could face:

- Lost business and/or profits
- Repeated instances of criminal or friendly fraud
- Increased payment processing rates
- A poor professional reputation
- Merchant accounts with restrictions
- Penalties for failing to acknowledge chargebacks

Open Banking solutions like Trustly guarantee all payments; no chargebacks or security breaches.

SECTION 03

Interchange fees are constantly increasing

Wholesale interchange and markup fees are an ever-growing cost center for merchants. They're controlled by the card networks, adjusted semi-annually,
and non-negotiable. To make matters worse, Visa, Mastercard, American Express, and Discover all plan to increase their rates within the next year, according to various sources like Bloomberg and Digital Transactions.

The Durbin Amendment limited interchange fees — with mixed results

The Durbin Amendment, passed in 2010, capped interchange fees on debit card transactions at $0.21 + 0.05% of the transaction amount. It excluded banks with less than $10 billion in assets to avoid undue burdens on community banks and credit unions.

The plan was for retailers to save on interchange fees and pass the savings on to customers. But for many market players, it had the opposite effect.
Before the amendment, small transactions were charged small fees, and large transactions came with large fees. Afterward, Visa and Mastercard began charging the maximum amount for small transactions.

Businesses with small transaction sizes saw payment processing costs increase. Meanwhile, large banks added new fees and reduced the number of free services to make up the lost revenue.

The average credit card processing fees range from

1.7% to 3.5%

per transaction

Source: Fundera. Credit Card Processing Fees: The Complete Guide

As of 2020, the Durbin Amendment limits interchange fees to

$0.21 + 0.05%

of the transaction.

Paying with plastic is about to get more expensive online

Interchange rates for card-not-present transactions are already higher than those for card-present transactions. According to CardFellow, the average rate for a swiped card is roughly 1.95% to 2% for Visa, Mastercard, and Discover transactions. For online retailers, the average rate is 2.3% to 2.5%.

The average cost for card-not-present (CNP) businesses is 2.3% to 2.5%.

Source: CardFellow

But some of the most dramatic fee increases are reserved for card-not-present (CNP) transactions. With a traditional Visa card, the fee for a $100 transaction will climb to $1.99 from $1.90. For premium Visa cards, the fee rises to $2.60 from $2.50 for the same transaction, according to Bloomberg.

The major card networks are fairly transparent about their interchange fees and the process for determining rates. The main factors include:

- The card brand (Visa, Mastercard, etc.)
- The type of card (debit, rewards, business credit card, etc.)
- How the transaction was made (swiped, keyed-in, online payment)
- The business and industry risk level

What many merchants don't know is that there are two mandatory fees that card networks levy, but they're only fully transparent about one of them.

Debit Keyed	
Visa Debit Keyed CPS	1.650% + 15¢
Visa Debit Keyed CPS Regulated	0.050% + 22¢
Visa Debit Keyed Prepaid	1.750% + 20¢
Visa Debit Keyed CPS Regulated	2.450% + 10¢
Visa Debit Keyed Business Regulated	0.050% + 22¢

Source: Payline Data

Assessment fees are buried by the card networks

It can seem like Visa, Mastercard, and other networks are running a stealth operation when it comes to assessment fees. (Assessment fees are also called card brand fees and card association fees). These are simply markup fees that are passed on to merchants and paid to card networks.

Interchange fee tables are freely available on the Visa and Mastercard websites. Merchants can easily follow rate changes and find consumer-friendly explanations of what they are. By contrast, card brands don't usually publish their assessment fees on their websites. Instead, these charges are often tucked away in a business's payment processing statement.

Assessment fees cost between 0.10% and 0.15% per transaction

Source: The Ascent

Because of the obscurity fostered by the card networks, it's much easier for payment processors to slip in extra charges, however small.

For instance, according to Merchant Maverick, Visa charges a relatively miniscule $0.0195 Acquirer Processing Fee (APF) on some credit transactions. Depending on the payment processor's rate structure, assessment fees may be combined or grouped under the "authorization" category. There, unauthorized charges can hide in plain sight.

Even when there isn't a major rate hike on the horizon, retailers must be vigilant to avoid being overcharged for their merchant account transactions. We recommend requesting a list of card brand fees and asking for costs to be itemized if possible.

You can't put a puzzle together without all the pieces

When it comes down to it, anticipating payment processing costs is both an art and a science. There are so many costs involved, from interchange and assessment fees to the processor's statement and service fees. Then there are unexpected revenue-drainers like card declines and chargebacks.

Some payment processing charges may be unavoidable, but there are other excellent options for retailers.

SECTION 04

The Open Banking Payments alternative

Open Banking payments are fraud-resistant

Millions of U.S. cardholders have had their personal data and credit card information stolen in vast data breaches with retail and financial giants. Perhaps that's why 77% of consumers said in a Deloitte study that security was one of the most important things when they were choosing a payment method. Consumers are feeling this vulnerability.

While card issuers experiment with how to strengthen their security capabilities, bank transfers with Trustly remain one of the safest payment methods available. Customer data is protected by strictly enforced, systematic two-factor authentication. Our network bypasses risky card networks entirely, so customers can make safe and secure payments any time.

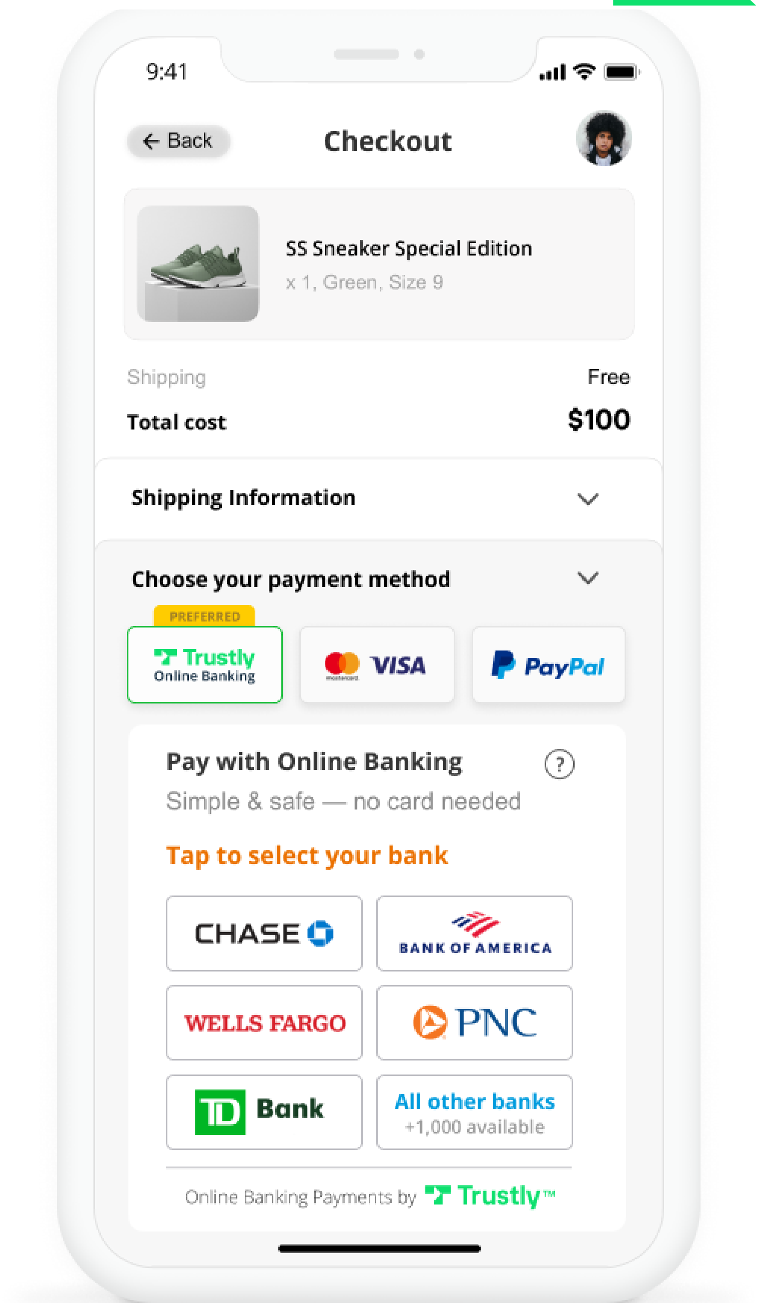
For 77% of consumers, security is one of the most important aspects of a payment method.

Source: Deloitte

Global consumers are already loving Open Banking Payments

According to Worldpay, over 50% of all online transactions will be made using alternative payment methods by 2021. That reality is approaching quickly. Global e-commerce merchants are realizing they must offer more digital payment options in order to compete effectively. Bank transfers already dominate in major markets beyond the U.S., ranking as the number one or number two payment method for consumers.

In the "now" economy, online shoppers demand equal measures of speed, convenience, and security. By opening up an array of ways to pay, enterprise-level companies are taking concrete steps to increase customer acquisition and speed growth worldwide.



No more abandoned shopping carts

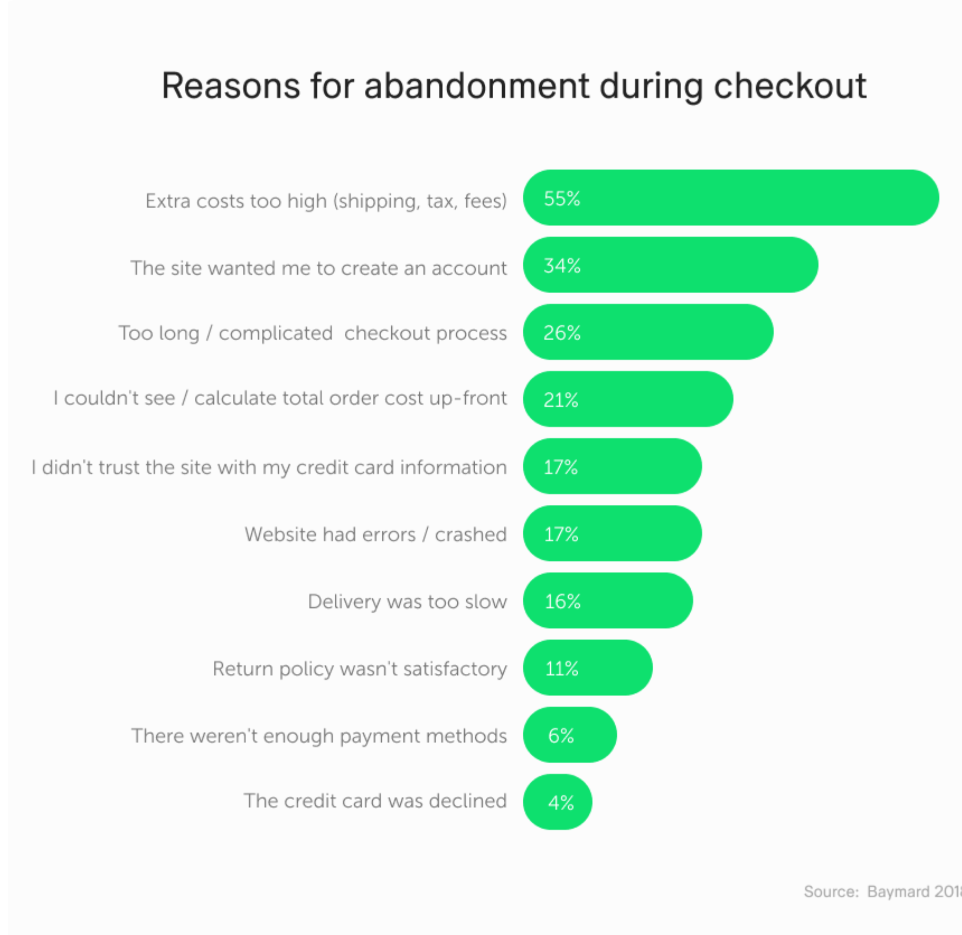
Payment security is a top priority when consumers are shopping online. It's enough to send customers hurrying to a competitor if they aren't convinced the checkout process is airtight. Asking customers to create an account is even more likely to make them abandon a transaction.

34% of shoppers

drop out during the checkout process because they're forced to create an account to complete their purchase.

Source: Baymard. E-Commerce Checkout Usability

With an Open Banking payment solution like Trustly, retailers can automate the registration process — and lose fewer customers. A shopper account can be created using the supplied details without interrupting customers in the middle of a transaction. And all payment information is protected with the highest encryption standards available.



Five Actionable Insights

Based on our research, here are five actionable steps that will help you decrease payment processing costs and improve customer satisfaction at the same time.

01 Accept a wider range of payment methods

Make sure you're tailoring your payment experience to your target audience. You could open up a new segment of buyers just by offering one or two alternative payment methods.

02 Evaluate your current approval process

In order to improve your approval rate — and reduce transaction costs — assess your fraud prevention system. Do an internal review or consult with an e-commerce risk mitigation consultant.

03 Prepare for the next chargeback

Determine whether you're paying the card processing rates you think you are. Take one of your monthly statements, add up all charges, and divide it by your net sales. See where your effective rate falls within your industry.

04 Calculate your effective rate

Determine whether you're paying the card processing rates you think you are. Take one of your monthly statements, add up all charges, and divide it by your net sales. See where your effective rate falls within your industry.

05 Review your monthly payment processing statements

Now that you've identified potential hidden fees, examine your statements every month. Coupled with your effective rate, you can determine whether your payment processor is still the right fit for your business.

Why choose Trustly?

At Trustly, we envision a world in which Open Banking payments are fast, simple, and secure for everyone — merchants, consumers, and banks alike. Customers pay from the account of their choice and don't worry about dangerous security breaches. With our PayWithMyBank product, merchants enjoy a lower cost payment method without the inherent risks and costs of card payments. Trustly helps businesses increase consumer trust and loyalty.

01 Lower processing rates than debit and credit cards

While card interchange fees and markup costs rise and rise, Trustly provides a reliable, low-cost payment offering. Our unique Open Banking Payment solution is free of confusing rate structures, contractual jargon, and unnecessary charges.

02 Guaranteed payments and high approval rates — no chargebacks

Each year, businesses incur significant costs to prevent chargebacks, e-commerce fraud, and false positives. Trustly's Open Banking Payment solution offers superior approval rates with no card expiration, no mysterious decline reason codes, and no chargebacks. Request and receive your funds and get back to the work that matters.

03 Enterprise-grade bank connector technology & security

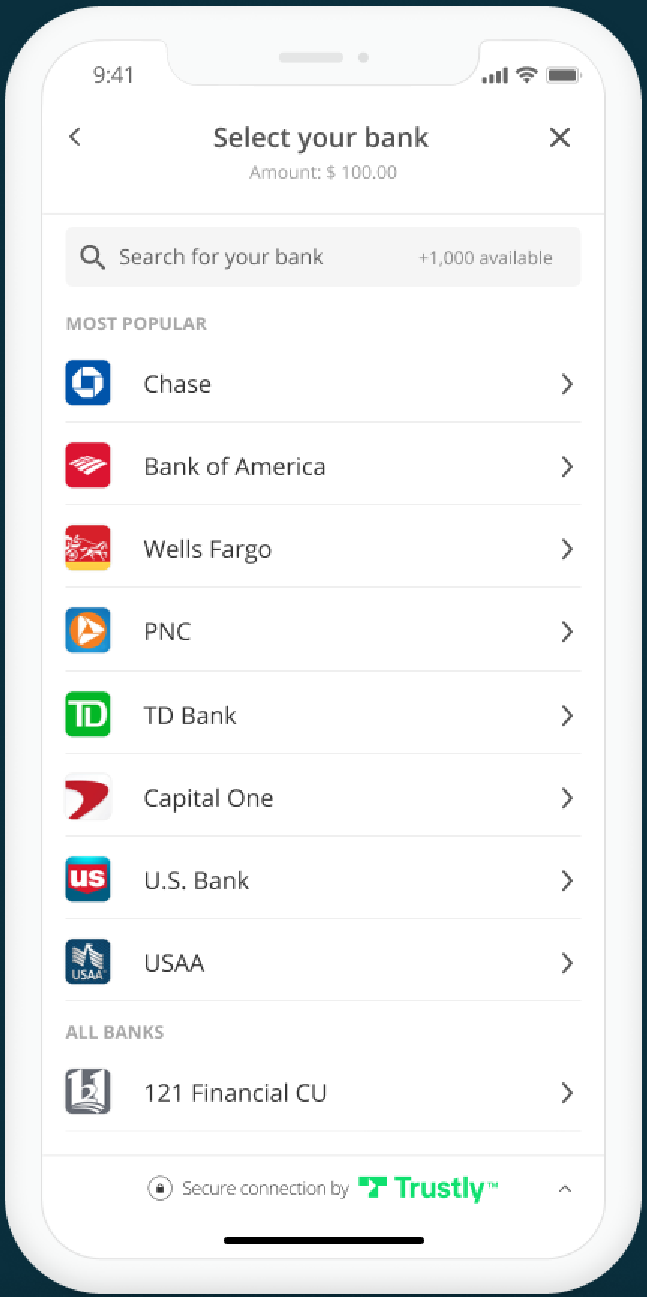
Covering more than 99% of U.S. bank accounts, consumers can make a payment straight away without the need to register for an account or download an app. Trustly's payment automatically tokenizes account data, securing the payment for the merchant, consumer, and financial institution. And with Trustly's enterprise-grade bank connections at more than 4,300 financial institutions and growing, we make clean, fast, and secure payments possible.

04 Built to safeguard merchant and account holder information

We've merged intelligent payments with a seamless user experience and dependable customer support. Merchants and consumers alike can depend on our software for safe and secure transactions. Our system uses split-tokenization to switch out sensitive payment data for randomized numbers that are useless to fraudsters. And Trustly enforces the highest encryption standards possible.

05 Ready for contactless mobile payments

Trustly's iOS and Android easy-to-deploy software development kits (SDKs) make it the perfect addition to your payment lineup in a post-COVID-19 environment. Consumer safety and trust should inform merchants' payment orchestration, and our mobile-ready solution fully supports contactless payments, stored value, and digital-wallet transactions.



Thank you

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