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Minnesota Department of Public Safety



Proposal to the Legislature

Credit and Debit Card Acceptance, Driver and Vehicle Services

February 2009

MINNESOTA DEPARTMENT OF PUBLIC SAFETY



Office of the Commissioner

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February 6, 2009

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Traffic Safety

State Fire
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The Honorable Bernard Lieder
The Honorable Michael Beard
Minnesota House of Representatives
Transportation Finance and Policy Division

The Honorable Steve Murphy
The Honorable Michael Jungbauer
Minnesota Senate
Transportation Budget and Policy Division

Dear Colleagues:

As directed by 2008 Minnesota Laws Chapter 287 Article 1, Section 117, the Commissioner of Public Safety shall submit a proposal to the chairs and ranking minority members of the Senate and House of Representatives Committees with jurisdiction over transportation finance identifying a method that allows the Department of Public Safety, its Deputy Registrars, and Driver's License Agents to collect fees by credit or debit card.

The proposal must identify the total estimated statewide cost of the processing fees paid to either a vendor, financial institution, or credit card company. The proposal must consider options to finance the acceptance fees through either (1) state fee increases necessary to finance (i) the costs of credit and debit card processing fees paid to a processing vendor, (ii) the administrative costs of the department to implement the acceptance of credit and debit cards, including hardware and software costs of the department, its deputy registrars, and agents, and (iii) associated ongoing administrative cost increases, or (2) an agreement with a vendor that allows the addition of a convenience fee to each transaction to be paid directly by customers who choose to utilize credit or debit cards.

The report is enclosed for your review.

If you need further information, please do not hesitate to contact me or Patricia McCormack, Director of the Driver and Vehicle Services Division at (651) 201-7580.

Sincerely,

Michael Campion, Commissioner

cc: Legislative Reference Library

EXECUTIVE SUMMARY

Because electronic payment options have become ubiquitous in today's society, many citizens are disappointed to discover that they cannot use a credit or debit card to pay their taxes or fees at an office run by the Department of Public Safety's Driver and Vehicle Services division (DVS) or one of its agents. However, at rates ranging from 0.7% to 2.7% of the net transaction cost, the cost of processing credit and debit card transactions is higher than the cost of processing cash and checks. As committed as DVS is to providing a customer-friendly environment, neither DVS nor its agents can simply absorb the additional costs of credit and debit transactions.

A credit card study group assembled by DVS has identified two possible solutions to the cost issue: (1) raise taxes and/or fees to allow absorption of the additional transaction processing costs; or (2) pass along the costs as "convenience fees" to customers who pay by credit or debit card. Both of these solutions have drawbacks.

With regard to the first potential solution, DVS does not believe that an increase in taxes and fees would be prudent at this time. Based on what DVS has learned about credit and debit card usage rates, it has concluded that a tax and fee increase would force all DVS customers to bear the cost of a convenience used by a minority of those customers. DVS also notes that the proceeds of most transactions are split among multiple bank and treasury accounts, some public and some private. If taxes and fees were raised and processing costs were absorbed, the legislature would need to give DVS the authority, where lacking, to recover proportionate shares of the transaction processing costs from those accounts.

As for the second potential solution, Visa – which issues 60 to 65 percent of the credit cards issued – does not allow convenience fees to be imposed at the point of sale. Eliminating Visa as a payment option could drastically reduce the number of customers who would pay by credit or debit card. Anecdotal information suggests that convenience fees also act as a deterrent to credit and debit card use. Thus, if DVS does not accept Visa cards and it charges a convenience fee for use of other brands' cards, relatively few customers might actually utilize the credit/debit card payment option. Nevertheless, this is the more viable of the potential solutions.

LEGISLATIVE CHARGE

The Department of Public Safety (DPS) presents this proposal as directed by the Legislature during its 2008 session. The legislative charge states:

CREDIT CARD PAYMENT STUDY; PROPOSAL.

(a) By February 1, 2009, the commissioner of public safety shall submit a proposal to the chairs and ranking minority members of the senate and house of representatives committees with jurisdiction over transportation finance. The proposal must identify a method that allows the Department of Public Safety, its deputy registrars, and driver's license agents to collect by credit or debit card, motor vehicle registration taxes under Minnesota Statutes, section 168.013; motor vehicle certificates of title and related document fees under Minnesota Statutes, section 168A.29; motor vehicle sales tax under Minnesota Statutes, sections 297B.02 and 297B.025; and driver's license and Minnesota identification card fees under Minnesota Statutes, section 171.06.

(b) The proposal must identify the total estimated statewide cost of the processing fees paid to either a vendor, financial institution, or credit card company. The proposal must consider options to finance the acceptance fees through either (1) state fee increases necessary to finance (i) the costs of credit and debit card processing fees paid to a processing vendor, (ii) the administrative costs of the department to implement the acceptance of credit and debit cards, including hardware and software costs of the department, its deputy registrars, and agents, and (iii) associated ongoing administrative cost increases, or (2) an agreement with a vendor that allows the addition of a convenience fee to each transaction to be paid directly by customers who choose to utilize credit or debit cards.

(c) The commissioner of public safety, with the assistance of the commissioners of finance and administration, shall develop a request for proposals from vendors, to be issued by January 1, 2010, to implement the acceptance of credit and debit payments by the Department of Public Safety, its deputy registrars, and agents. The department shall consult deputy registrars and driver's license agents in developing the request for proposals.

Act of May 8, 2008, ch. 287, art. 1, sec. 117, 2008 Minn. Laws 884, 952-53.

PROCESS

In preparing this proposal, DPS strove to ensure that it considered the perspectives of all those affected by the acceptance – or non-acceptance – of credit and debit cards in connection with DVS transactions. To that end, DPS assembled a study group comprised of representatives of DVS' deputy registrars and driver's license agents, county government, Minnesota Management and Budget, and DPS.

Beginning in July 2008, the study group met monthly to investigate options for credit and debit card acceptance and to discuss their priorities and concerns. Representatives of the state's designated depository attended most of the meetings to provide technical information and share their expertise. The study group also conferred by telephone with representatives of Visa and MasterCard.

The following individuals participated in the study group:

Frank Ahrens, Department of Public Safety
Dan Boytim, Department of Public Safety
Keith Carlson, Minnesota Inter-County Association
Kevin Corbid, Washington County
Mary Ellison, Department of Public Safety
Jerry Engebretson, Minnesota Management & Budget
Dan Floyd, Department of Public Safety
Molly Malone Hintz, Deputy Registrar, Rochester
Joe Howe, Minnesota Management & Budget
Marna Johnson, Department of Public Safety
Jared Jordal, Department of Public Safety
Rima Kawas, Department of Public Safety
Marc Klein, Department of Public Safety
Joan Kopcinski, Department of Public Safety
Linda Long, Department of Public Safety
Ron Mavetz, Minnesota Management & Budget
Donna McAulay, Department of Public Safety
Patricia McCormack, Department of Public Safety
Dave Morris, Department of Public Safety
Thomas Nash, Department of Public Safety
Larry Ollila, Department of Public Safety
Dawn M. Olson, Department of Public Safety
Jeffrey Schmitz, Deputy Registrar, Hennepin County

In addition to the work done by the study group, DVS staff consulted staff from several other states' driver and motor vehicle bureaus. The purpose of these discussions was to gather information about those states' experiences with credit and debit card acceptance.

CONTEXT

DPS' Driver and Vehicle Services Division (DVS) and its agents collect approximately \$1 billion in state revenue annually. The funds from these transactions not only support DVS' operations, but they also support such vital state functions as the construction and maintenance of bridges and roads, mass transit, undercover criminal investigations and witness protection, veterans' services, traffic safety, remote electronic alcohol monitoring, critical habitat preservation, and services to survivors of brain and spinal cord injuries.

In Fiscal 2008, in addition to collecting motor vehicle sales tax on all motor vehicle sales and motor vehicle registration tax on 5.5 million motor vehicles, DVS collected fees for 1.4 million vehicle titles, 1.68 million driver's licenses, and 143,000 driver-related reinstatements. Although some vehicle transactions – such as vehicle registration renewals – may be conducted over the internet or through the mail, most transactions take place in person, at 268 sites operated by DVS or its agents. These sites fall into three categories:

Site type	# of sites	Types of transactions handled
Deputy registrars	68	Motor vehicle only
Combined deputy registrar/ driver's license agent offices	105	Driver's license applications and motor vehicle
Driver's license exam stations (operated by DVS staff)	95	Driver's license exams (and applications at some sites)

The deputy registrar and driver's license agent sites are in many cases part of county and city offices; 73 of the offices are owned and operated by private parties. A few of these sites handle only motor vehicle and driver's license transactions. However, many also provide other services or goods – from bait or fishing licenses to birth certificates or engagement rings. Some, but not all, have account relationships with the same bank that provides banking services to the state.

State and local government agencies have authority under Minnesota Statutes, sections 16A.626, 383B.116, and 471.381, to accept payments by credit and debit cards and other electronic means. These statutes also authorize the agencies to recoup the costs of electronic payment processing via a "convenience fee" or "service charge." The statute governing state agencies provides that the payer must be notified of the fee before the transaction is processed; however, the statutes governing counties and municipalities contain no parallel requirement. *Compare* Minn. Stat. § 16A.626(d) (2008), *with id.* §§ 383B.116, subd. 6, 471.381, subd. 2. Moreover, no statutes govern these issues with respect to private parties who collect taxes and fees on behalf of the state.

At present, DVS accepts credit and debit cards only for: (1) vehicle registration renewals conducted online; and (2) motor vehicle and driver's license transactions conducted in Hennepin County service centers and driver's license transactions conducted in the Sherburne County office. For the former group of transactions, DVS charges a handling fee of \$1.75 for each vehicle registration renewal paid online to defray the added costs of electronic payment processing as an encrypted secure transaction. About 85 percent of the online customers pay by credit card; the others utilize the automated clearing house option, whereby their bank accounts are electronically debited.

With respect to the latter transactions, all deputy registrars and driver's license agents have the option of accepting credit cards, provided they meet the following criteria established by DVS:

- Transaction costs must be absorbed by the deputy/agent, not passed on to the customer;
- The deputy/agent must be able to document compliance with Payment Card Industry security standards;
- All information requested by the DPS security officer must be provided and approved; and
- The deputy/agent's financial reconciliation process must be approved;
- The deputy/agent must sign a memorandum of understanding and comply with all technical requirements.

To date, Hennepin and Sherburne counties are the only deputies/agents that have applied and received approval to accept credit cards, and they have, to date, absorbed the added cost of those transactions. If credit or debit cards are to be accepted at all DVS and agent offices, DVS believes there should not be any disparities between what a customer would pay in a Hennepin County service center and what he or she would pay for an equivalent transaction at a DVS exam station in Rochester.

When DVS customers come to renew their driver's licenses or vehicle registrations, many do expect to be able to pay by credit or debit card. Electronic payment for goods and services has become so commonplace that many people no longer carry much cash or a checkbook. Although some deputy registrars/driver's license agents have automated teller machines in or near their offices, not all do, and customers sometimes have to make a second trip to complete their transactions.

In addition to eliminating this "frustration factor" for customers, many DVS deputies and agents believe that the acceptance of credit and debit cards would reduce the administrative and economic burden of bounced checks. Yet, as is discussed in the next section, credit and debit card acceptance has significant fiscal implications.

FINDINGS

Four major credit card associations dominate the marketplace: American Express, Discover, MasterCard, and Visa. Sixty to 65 percent of the cards issued to consumers bear the Visa brand. However, an estimated 75 percent of consumers hold more than one of the four major card brands. According to representatives of the state's depository, Visa card transactions typically comprise 65 percent of all credit card transactions, 30 percent are usually MasterCard, and the remainder are split between Discover and American Express.

Although the card associations stress that any form of payment results in expense to the merchant, credit card and debit card transactions unquestionably cost more to process than those paid by cash or check. In reality, consumers who pay by cash or check are helping to foot the bill for those who pay by credit and debit card, because the higher transaction costs for the latter are rolled into the price of groceries, gas, and virtually everything else bought in the private sector. If this same model were applied to taxes and fees mandated by law, the citizen who currently pays \$35 in cash for the annual registration tax on his or her 12-year-old car would have to pay a higher tax because a fellow citizen chooses to pay the \$699 registration tax on her or his new luxury car by credit card, thereby incurring a transaction cost in a range between \$11.18 and \$18.87.

Cost of Credit Card Processing

The pricing schemes for credit card transaction processing are complex. In general terms, however, the merchant pays the following fees for each transaction:

- an interchange fee, calculated as a percentage of the net transaction cost;
- a second, flat-rate interchange fee;
- a sales volume assessment fee, calculated as a percentage of the net transaction cost; and
- a flat-rate bank fee.

The first three fees are shared by the card association and card issuer, while the last goes to the bank that processes the transaction.

Each of the card associations follows this overall pricing structure, though the particular rates vary from brand to brand. One might assume that the interchange and bank fees would be the same for two Visa cards, but certain cards (such as so-called "rewards" cards and corporate purchasing cards) can carry higher transaction fees. This makes calculating the precise amount of the transaction fee at the time of sale exceedingly difficult.

Using pricing information obtained from several sources, DVS analyzed the potential fiscal impact of accepting Discover, MasterCard, and Visa credit cards.¹ (A summary of DVS' analysis is attached as Appendix A.) Assuming receipts of \$956,239,000 in Fiscal 2009, effective transaction processing rates ranging from 1.60 to 1.80%, and that half of DVS' customers would choose to pay by credit card, the estimated total of credit card and bank transaction fees would be in the range of \$7,648,263 to \$8,604,201. This analysis is also based upon the assumption that the cost of transaction processing would not be directly passed on to customers who pay by credit card (as in a convenience fee). As explained in greater detail below, additional costs can be associated with a "payment processing solution" or with the administration of a convenience fee structure. If the same assumptions are applied to a payment processing solution model, the cost of credit card acceptance could reach \$12,909,227, or 2.7% of the net transactions charged.

DVS has had difficulty estimating what the rate of credit card use might be, particularly given these troubled economic times. Among the states DVS interviewed in the late summer of 2008, rates of use ranged from approximately 25 to 40 percent. The Hennepin County service center estimates its rate of use hovers around 35 percent. It is generally believed that consumers are less likely to pay by credit or debit cards if the cost of processing transactions is passed on to them via convenience fees.

Cost of Debit Card Processing

The pricing for debit card transaction processing is even more complicated than that of credit cards because there are two main categories of transactions, each of which has its own set of pricing structures. Which pricing structure governs depends upon whether the customer enters a personal identification number (PIN) at the point of sale. Some debit cards can be used with or without a PIN; some cannot be used with a PIN; and some require the use of a PIN.

For transactions where the customer does not enter a PIN ("non-PIN-based"), the fees are similar in structure to those charged for credit card use: There are percentage-based interchange, flat-rate interchange, percentage-based sales volume, and flat-rate bank fees. The fees for PIN-based transactions include a percentage-based interchange fee and flat-rate interchange, switch, and bank fees. However, unlike credit card and non-PIN-based debit card transactions, many of the major debit networks cap the fees for PIN-based transactions, typically at rates ranging from \$0.50 to \$0.65 per transaction.² The two networks that handle roughly half of the transactions in Minnesota do not cap their fees. Merchants do not have a choice of

¹ DVS based part of its fiscal analysis on pricing information provided by representatives of the state's designated depository, which does not currently process American Express transactions. Thus, DVS did not include American Express in its analysis.

² Some specialty debit networks have lower transaction caps – one reportedly as low as \$0.28 – but these cards are used infrequently in Minnesota.

which network processes their PIN-based debit card transactions; the network is determined by the card issuer.

On the whole, the percentage-based transaction rates for both PIN-based and non-PIN-based debit cards are lower than those of credit cards, but the per-item rates are considerably higher. Thus, debit cards can be less costly than credit cards for large-dollar transactions such as the titling and registration of a new vehicle – especially when the transaction is PIN-based and the charges are capped – but sometimes are as costly or costlier on lower priced items such as driver’s license transactions. The following table uses some representative card rates to illustrate this point:

Transaction Type	Tax/ Fee	Transaction Processing Costs		
		Credit Card (1.55% + \$0.16)	Non-PIN- based debit (0.895% + \$0.34)	PIN-based debit (0.75% + \$0.27; cap of \$0.60)
Duplicate driver’s license	\$13.50	\$0.37	\$0.46	\$0.37
Class D driver’s license	\$24.00	\$0.53	\$0.55	\$0.45
Registration tax, 2004 vehicle with base value of \$22K	\$148.00	\$2.45	\$1.66	\$0.60
Registration tax, 2009 vehicle with base value of \$48K	\$611.00	\$9.63	\$5.81	\$0.60

The potential fiscal impact of debit card acceptance cannot be calculated precisely. DVS could not identify the average rate of debit card use in a cash/credit/debit environment, though anecdotal information suggests that it is considerably lower than the rate of credit card use. Likewise, DVS could not ascertain what percentage of debit card transactions, on average, are PIN-based versus non-PIN-based.

Despite these unknowns, DVS used representative pricing information to estimate the potential maximum fiscal impact of both non-PIN-based and PIN-based debit card use. (Copies of the analyses are attached as Appendix B.) With the same basic assumptions as were used in the credit card calculation, DVS concluded that the fiscal impact of debit card acceptance could be as great as \$5,977,917 for non-PIN-based transactions, or \$3,586,537 for PIN-based transactions. Again, these rates could be higher if DVS utilized a payment processing solution, or if transaction processing costs were passed along to customers in the form of convenience fees.

Payment Processing Solutions

In order to accept credit and debit cards, DVS would need to find solutions to several challenges. First, DVS would need to ensure that the proceeds of credit card transactions are credited to the proper accounts, while simultaneously ensuring that the correct transaction costs are paid to the card associations.

Under the pricing models described above, the credit card association credits the gross proceeds to a bank account designated by the merchant a day or two after the transaction takes place, and it also settles the interchange and sales volume transaction fees by debiting that same account. The bank or processor typically collects its fees once per month. The problem with this scenario, however, is that the proceeds of DVS transactions rarely go into only one account.

For example, consider a relatively simple transaction, involving a customer who applies for a duplicate certificate of title:

<u>Transaction Item</u>	<u>Amount</u>	<u>Funding Allocation</u>
Duplicate title fee	\$7.25	\$3.25 to vehicle services operating fund; \$4.00 to general fund
Technology surcharge	\$1.75	to DVS technology account
Filing fee	\$8.50	to deputy registrar's account

If this transaction took place today with the customer paying cash, the deputy registrar would deposit the money to the deputy's bank account. One to two days later, Minnesota Management and Budget would "sweep" the bank account and transfer amounts totaling \$9.00 to the designated state treasury funds (the general fund, the vehicle services operating account, and the driver and vehicle services technology account); the \$8.50 filing fee would remain in the deputy's bank account. If the transaction were paid by credit card, however, the \$9.00 might be swept from the deputy's bank account before the credit card association had deposited the transaction proceeds, possibly resulting in an overdraft. Moreover, unless the customer pays a convenience fee to cover the cost of processing the transaction, there must be a system in place to ensure that the transaction costs are paid from the proper accounts or funds when the deputy's bank account is debited. This could entail substantial expenditures for system programming and additional staff.

To address similar situations, banks and transaction processors have developed products that this proposal generically labels "payment processing solutions." With such a product, the merchant or the merchant's customer pays a set percentage to the bank or processor in lieu of the credit or debit card transaction fees described above, without regard to the type of card used in the transaction. In exchange, the bank or processor assumes all responsibility for paying the applicable fees to the credit card association and debit networks, and it deposits the net proceeds of the transaction in the amounts and to the bank accounts specified by the merchant.

A member of the credit card study group reported that one company offers a payment processing solution to governmental agencies under which it charges a flat rate of \$3.95 on all Visa debit card transactions and, on all other transactions, charges 2.45% with a minimum charge of \$1.50. Under the latter fee structure, every transaction totaling less than \$61.22 – which represents the majority of driver's license transactions and a sizable number of vehicle transactions – would be subject to the \$1.50 minimum. For the average Class D driver's license renewal of \$24, that \$1.50 minimum translates to a rate of 6.25%. If that same renewal were paid with a Visa debit card subject to the \$3.95 flat fee, the rate would soar to 16.46%.³

The rates for these payment processing solutions seem to hover between 2.3% and 2.7%. Therefore, assuming that half of DVS customers paid by credit or debit card and estimating receipts for this fiscal year of \$956,239,000, the potential fiscal impact of such a processing solution would range from \$10,996,749 to \$12,909,227.

Equipment Needs

Accepting credit and debit cards would require DVS and its agents to have certain items of equipment, possibly including:

- internet-connected terminals or PCs at each work station where credit and debit cards are accepted;
- “wedge”/“swipe” devices, through which credit and debit cards are swiped to extract account information;
- PIN pads, into which customers enter their personal identification numbers for PIN-based debit card transactions; and
- receipt printers.

Some banks or other payment processors will provide the necessary equipment at “no charge” to the merchant. (The payment processing solution described above, for example, includes all equipment in its \$3.95/2.45% fees.) However, the cost of the equipment tends to be reflected in higher transaction fees.

Given the wide range of pricing structures and packages available, it is difficult to make any broad generalizations about what equipment costs might be involved if DVS and its agents accepted credit and debit cards. However, DVS has amassed much information that would aid it in carefully evaluating responses to a Request for Proposals and in assessing their fiscal impact.

³ Using the same general criteria that it used to assess the fiscal impact of credit card and debit card acceptance, DVS calculated that the impact of accepting credit cards and non-Visa debit cards with this payment processing solution could reach \$12,576,330, or 2.6304% of the net transactions charged. If half of customers paid with Visa debit cards, the impact would be \$16,985,000, or 3.5525% of the net transactions charged. (A copy of this analysis is attached as Appendix C.)

Card Association Rules

The four major credit card associations have a myriad of rules governing merchants' acceptance of their cards. Several of those rules – pertaining to convenience fees, cash discounts, and transaction amount limits – have particular significance to DVS.

All of the card associations allow merchants to pass along the costs of credit card processing to customers in the form of convenience fees on payments made through “alternative payment channels,” such as over the phone or internet. However, only three of the four card associations – all but Visa – allow convenience fees to be assessed at the point of sale.

Visa does permit governmental agencies to impose convenience fees on in-person payments of personal income and property taxes, but it has steadfastly refused to extend the program to motor vehicle and driver's license taxes and fees. Although Visa's representative emphasized in a telephone conference that the association had entertained and rejected similar requests from state motor vehicle agencies, DVS nevertheless submitted a letter in which it asked Visa to extend the tax payment program to DVS transactions. Visa rejected the request, observing that it “permits consumer fees on selected tax transactions *because tax authorities are often prevented by law from paying fees on card payments*” (emphasis added). (Copies of DVS' letter and Visa's response are attached as Appendix D.)

All of the associations require that any convenience fees charged be uniformly imposed without regard to card brand. In other words, a merchant could not charge a two percent or \$2.00 convenience fee on MasterCard transactions but only 1.5% or \$1.50 for Discover transactions.

All four of the card associations permit merchants to offer discounts to customers who pay by cash or check. However, none allows merchants to set dollar floors or ceilings for credit card use. For example, a merchant may not refuse to accept credit cards on transactions of less than ten dollars or more than \$1000. The card associations do allow merchants to accept credit cards for certain categories of transactions but not others. For example, a gas station presumably could accept cards for fleet sales but refuse to accept them for purchases made by individuals.

ANALYSIS AND RECOMMENDATION

The major barrier to DVS' acceptance of credit and debit cards is the question of who would pay the higher costs of processing the transactions. As a fee-based agency, DVS cannot absorb the costs. Given the wide dollar range of taxes and fees collected, DVS' agents cannot absorb the costs, either. For instance, the cost of processing a credit card payment for an average 2008 model's registration tax would easily exceed half and perhaps all of a deputy's \$4.50 filing fee for that transaction.

In broad terms, there are two options: raise all taxes and/or fees to offset the added costs of credit and debit card processing, or charge those costs directly to the customers who choose to pay by credit or debit card. Even if DVS opted to accept only debit cards, the choices would in essence be the same; the costs involved would simply be lower. Regardless of which option is chosen, DVS believes it must be implemented uniformly at all sites, so that citizens will pay the same amount and be able to use the same forms of payment for the same type of transaction, regardless of which office they visit.

OPTION 1: ACCEPT CREDIT CARDS AND DEBIT CARDS; RAISE TAXES AND FEES

If the decision were made to spread the cost of processing credit and debit card transactions across all of DVS' customers, what would be the fairest, most effective, and most efficient way to do it? Several alternatives were discussed by the study group.

Filing fee increase. Some have suggested that the deputy registrars' and driver's license agents' filing fees should be raised to offset the costs of credit card processing. Thus, every customer would be charged an additional, flat amount (as part of the filing fee) to cover the costs of credit and debit card processing. This would place a disproportionate share of the burden on those whose required taxes and fees are relatively lower. For example, if the registration renewal filing fee were increased by \$4, the citizen whose registration tax is \$35 would pay the same increase as the citizen whose registration tax is \$699, even though it would cost considerably more to process a credit card payment for the \$699 tax and though that citizen presumably would be more able to absorb the cost.

Historically, filing fees have been set at levels that reflect DVS and its agents' actual costs of providing services to citizens. For example, the filing fee for registration renewal is the same (\$4.50) regardless of the amount of registration tax owed, because it reflects the approximate cost of recording a transaction in the DVS information system and issuing new tabs to the customer. The other filing fees similarly reflect the actual administrative costs of providing DVS services, and their fundamental character should not be altered.

Percentage-based increase of all taxes and fees: “cash discount” model. As noted above in the “Findings” section, all four of the card associations allow merchants to offer “cash discounts” to customers who pay by cash or check. DVS has concluded that this is not a viable option for several reasons.

First, a cash discount program would require an across-the-board increase in taxes and fees to ensure that DVS and the other agencies that receive DVS-collected funds would receive enough to sustain their levels of service to taxpayers. It would be difficult to determine how much of an increase would be warranted. As unclear as it is as to how many customers would use credit and debit cards, how many customers would take advantage of a cash discount is an even murkier issue.

Second, DVS lacks the statutory authority to offer “discounts” on taxes and fees. Even if such authority were created, any discount presumably would need to be approximately equal to the amount it would cost to process the same transaction by credit card. That would necessitate calculating a different discount for every dollar amount collected by DVS – in other words, several hundred discounts. This would lead to tremendous confusion among staff and customers alike. It would also make the task of auditing transactions even more difficult.

Finally, every tax and fee in DVS’ information system and every formula by which taxes and fees are calculated would need to be reprogrammed with discounted and non-discounted amounts. The cost of this undertaking would be exorbitant.

Percentage-based increase of all taxes and fees: “roll-in” model. Some members of the working group expressed a preference for raising all taxes and fees by the same percentage and simply “rolling them into” the fee and tax totals charged to citizens. Ideally, the precise percentage would be determined after DVS has negotiated the best possible rates and has reevaluated its fiscal analysis in light of those rates. Based upon the pricing information it gathered, and based upon the assumption that approximately 50% of customers would use credit or debit cards in a convenience fee-free environment, DVS estimates that this increase could be on the order of 0.8% to 1.35%.

An across-the-board fee and tax increase might satisfy those customers who expect to pay by credit or debit card, regardless of the brand of card they wish to use. Some also believe that it would reduce the burden of chasing after customers who have tendered checks backed by insufficient funds. However, DVS cannot support increasing its fees or taxes merely for the benefit of those customers who choose the convenience of paying by credit or debit card. If the legislature deemed such an increase to be warranted, DVS would need statutory authorization to recover proportionate shares of the credit and debit card processing costs from transaction proceeds, including those allocated to private entities and individuals.⁴

⁴ The vast majority of funds collected by DVS are not appropriated to DVS and, as noted above, many of the fees and taxes collected are credited to two or more funds or recipients. In many instances, DVS does not have the requisite authority to withhold credit or debit card processing fees,

OPTION 2: ACCEPT CREDIT CARDS AND DEBIT CARDS EXCEPT VISA; IMPOSE CONVENIENCE FEES

Requiring customers who pay by credit or debit card to bear the added costs of those transactions is, without a doubt, the most equitable way to fund the acceptance of credit and debit cards. However, the process could bring its challenges.

First, because Visa will not allow merchants to impose convenience fees on point-of-sale transactions and has unequivocally rejected DVS' request for a variance, DVS could not accept Visa cards. Since Visa issues 60 to 65 percent of the credit cards in the marketplace, many – probably most – DVS customers who walk in the door expecting to pay by credit card would still go away frustrated. As one deputy registrar representative put it at a working group meeting, “We probably would be trading one set of problems for another.” For instance, if 40 percent of customers want to use credit or debit cards, but only 35 to 40 percent of them can,⁵ the merchant is offering an option that only 14 to 16 percent of all customers will utilize.

Second, convenience fees could create a disincentive to credit card use, which would mean an additional reduction in the percentage of customers who would benefit from the option, though the precise amount of that reduction is unknown. What is clear is that the 14 to 16 percent of customers mentioned in the preceding paragraph would be further reduced by the percentage who decline to pay a convenience fee.

Third, DVS would need to utilize a payment processing solutions product in order to implement a convenience fee structure. DVS has neither the staff nor the information and accounting systems to administer the calculation, collection, and reconciliation of transactions on which convenience fees are charged.⁶ With a payment solutions system, DVS staff or agents would simply input the amount of the transaction into a terminal, the vendor's system would calculate the convenience fee, the staff/agent would inform the customer of the amount before the credit or debit card was swiped, and once the customer approved the transaction, the vendor would assume all responsibility for maintaining the security of the transaction and paying the transaction fees.⁷

for example, from the proceeds of the deputy filing fee or from a scholarship contribution made in connection with the purchase of collegiate license plates. *See, e.g.,* Minn. Stat. § 168.129, subd. 6 (2008) (authorizing commissioner of public safety to retain only one percent of scholarship contributions for “administrative costs”).

⁵ Although 75 percent of Americans apparently hold more than one of the four major card brands, members of the study group seemingly agreed that many people do not carry more than one card at a time.

⁶ In addition, even if DVS's system could handle the convenience fee calculations, DVS would have to have additional audit safeguards in place to ensure that convenience fees were being calculated and collected properly. This might require additional legislation or rulemaking authority, particularly since, as noted above, there are no statutory limitations governing electronic payments vis-à-vis private parties who collect taxes and fees on the state's behalf.

⁷ Minnesota Management and Budget staff members are of the opinion that the state's current banking contract could be amended to allow DVS to utilize a payment processing solution. In that

CONCLUSION

There are no easy solutions to the dilemma of credit and debit card acceptance. The costs of processing such transactions are considerable. The state either must raise taxes and fees to pay those costs or pass them along to the citizens who choose those payment methods.

DVS does not support an increase in taxes or fees that effectively would force all customers to pay for a convenience that may be used by relatively few. Unlike shoppers who can choose among stores and products, Minnesota's citizens do not have the luxury of comparing prices on driver's licenses or vehicle registration tax.

DVS acknowledges that under a convenience fee model, it would be unable to accept the card that is most prevalent in the marketplace, and citizens who hold one of the other three card brands may be dissuaded from using their cards. This is not ideal. Nevertheless, offering customers the ability to use a credit or debit card does afford them more choices than they currently have, and DVS believes that it is the more equitable and viable of the two possible options.

event, the Request for Proposals that DVS is currently required to issue by January 2010 would be unnecessary.

Appendices

Credit Card Analysis				
FY09 estimated receipts:	\$ 956,239,000			
Number of transactions:	8,600,000			
Assume all DVS transactions can be paid by credit card				
Assume credit card usage to be 50%				
Assume 7,000,000 motor vehicle transactions				
Assume 1,600,000 driver license transactions				
Assume Visa has 65% of credit card use				
Assume all others have 35% of credit card use				
Illustration 1				
VISA	Interchange cost*	Bank cost**	Total	
65%	1.425%	\$ 0.13	Cost	
	\$ 4,428,582	\$ 363,350	\$ 4,791,932	
Other	Interchange cost*	Bank cost**	Total	
Brands	1.545%	\$ 0.18	Cost	
35%	\$ 2,585,431	\$ 270,900	\$ 2,856,331	
***	All			
	interchange cost	All Bank cost	Total	
	\$ 7,014,013	\$ 634,250	\$ 7,648,263	1.600%
Illustration 2				
VISA	Interchange cost*	Bank cost**	Total	
65%	1.520%	\$ 0.14	Cost	
	\$ 4,723,821	\$ 391,300	\$ 5,115,121	
Other	Interchange cost*	Bank cost**	Total	
Brands	1.630%	\$ 0.19	Cost	
35%	\$ 2,727,672	\$ 285,950	\$ 3,013,622	
***	All			
	interchange cost	All Bank cost	Total	
	\$ 7,451,492	\$ 677,250	\$ 8,128,742	1.700%

Illustration 3					
	VISA	Interchange cost*	Bank cost**	Total	
	65%	1.608%	\$ 0.15	Cost	
		\$ 4,997,305	\$ 419,250	\$ 5,416,555	
	Other				
	Brands	Interchange cost*	Bank cost**	Total	
	35%	1.725%	\$ 0.20	Cost	
		\$ 2,886,646	\$ 301,000	\$ 3,187,646	
	***	All			
		interchange cost	All Bank cost	Total	
		\$ 7,883,951	\$ 720,250	\$ 8,604,201	1.800%
* Includes percentage-based interchange and sales volume assessment fees					
** Includes per-item interchange and bank fees					
*** Above totals are for credit card transactions only. Use of debit/check cards and cash/check will reduce the total cost based on the number/type of transactions paid by debit/check cards, cash, and check					

Non-PIN Debit Card Analysis				
FY09 estimated receipts:	\$ 956,239,000			
Number of transactions:	8,600,000			
Assume all DVS transactions can be paid by a non-PIN debit card				
Assume non-PIN debit card usage to be 50%				
Assume 7,000,000 motor vehicle transactions				
Assume 1,600,000 driver license transactions				
Assume Visa has 65% of debit card use				
Assume all others have 35% of debit card use				
Illustration 1				

Illustration 3					
	VISA	Interchange cost*	Bank cost**	Total	
	65%	0.9315%	\$ 0.35	Cost	
		\$ 2,894,894	\$ 978,250	\$ 3,873,144	
	Other				
	brands	Interchange cost*	Bank cost**	Total	
	35%	0.9340%	\$ 0.36	Cost	
		\$ 1,562,973	\$ 541,800	\$ 2,104,773	
	***	All			
		interchange cost	All Bank cost	Total	
		\$ 4,457,867	\$ 1,520,050	\$ 5,977,917	1.250%
* Includes percentage-based interchange and sales volume assessment fees					
** Includes per-item interchange and bank fees					
*** Above totals are for non-PIN debit card transactions only					

PIN Debit Card Analysis					
FY09 estimated receipts:	\$ 956,239,000				
Number of transactions:	8,600,000				
Assume all DVS transactions can be paid by a PIN debit card					
Assume PIN debit card usage to be 50%					
Assume 7,000,000 motor vehicle transactions					
Assume 1,600,000 driver license transactions generate \$27,559,000 in revenue					
For 49% of all transactions, assume no caps apply to any transactions, regardless of type					
For 51% of all transactions, assume that caps would apply to all motor vehicle transactions but would not apply to any driver's license transactions					
Illustration 1					
Uncapped					
fees	Average transaction cost		Cap		Total
49%	0.680%	\$ 0.2575	\$ -	Cost	
MV	\$ 1,547,181	\$ 441,613		\$ 1,988,793	
DL	\$ 45,913	\$ 100,940		\$ 146,853	
Capped					
fees	Average transaction cost		Cap		Total
51%	0.725%	\$ 0.2700	\$ 0.6150	Cost	
MV			\$ 1,097,775	\$ 1,097,775	
DL	\$ 50,950	\$ 110,160		\$ 161,110	
**		All Transaction Cost	All Cap	Total	
MV	\$ 1,547,181	\$ 441,613	\$ 1,097,775	\$ 3,086,568	
DL	\$ 96,863	\$ 211,100	\$ -	\$ 307,963	
Total	\$ 1,644,044	\$ 652,713	\$ 1,097,775	\$ 3,394,531	0.710%
Illustration 2					
Uncapped					
fees	Average transaction cost		Cap		Total
49%	0.695%	\$ 0.2650	\$ -	Cost	
MV	\$ 1,581,310	\$ 454,475		\$ 2,035,785	
DL	\$ 46,926	\$ 103,880		\$ 150,806	
Capped					
fees	Average transaction cost		Cap		Total
51%	0.753%	\$ 0.2760	\$ 0.6375	Cost	
MV			\$ 1,137,938	\$ 1,137,938	
DL	\$ 52,917	\$ 112,608		\$ 165,525	
**		All Transaction Cost	All Cap	Total	
MV	\$ 1,581,310	\$ 454,475	\$ 1,137,938	\$ 3,173,722	
DL	\$ 99,844	\$ 216,488	\$ -	\$ 316,332	
Total	\$ 1,681,153	\$ 670,963	\$ 1,137,938	\$ 3,490,054	0.730%

Illustration 3						
	Uncapped					
	fees	Average transaction cost		Cap	Total	
	49%	0.735%	\$ 0.2775	\$ -	Cost	
	MV	\$ 1,672,321	\$ 441,613		\$ 2,113,933	
	DL	\$ 49,627	\$ 108,780		\$ 158,407	
	Capped					
	fees	Average transaction cost		Cap	Total	
	51%	0.790%	\$ 0.2850	\$ 0.6400	Cost	
	MV			\$ 1,142,400	\$ 1,142,400	
	DL	\$ 55,518	\$ 116,280		\$ 171,798	
	**	All Transaction Cost		All Cap	Total	
	MV	\$ 1,672,321	\$ 441,613	\$ 1,142,400	\$ 3,256,333	
	DL	\$ 105,144	\$ 225,060	\$ -	\$ 330,204	
	Total	\$ 1,777,465	\$ 666,673	\$ 1,142,400	\$ 3,586,537	0.750%
	** Above totals are for PIN-based debit card transactions only					

Credit Card/Non-Visa Debit Card Analysis					
Payment Processing Solution -- Company X					
FY09 estimated receipts:	\$ 956,239,000				
Number of transactions:	8,600,000				
Assume all DVS transactions can be paid by credit card or non-Visa debit card					
Assume 7,000,000 motor vehicle transactions, totaling \$928,680,000					
Assume 1,600,000 driver's license transactions, totaling \$27,559,000					
Assume credit card/non-Visa debit card usage to be 50%					
Assume total effective rate is 2.45%					
Assume minimum transaction charge of \$1.50, applicable to all transactions < \$61.22					
Assume all motor vehicle transactions total more than \$61.22 (effective rate applies)					
Assume all driver's license transactions total less than \$61.22 (\$1.50 min. applies)					
	Motor Vehicle		Applicable Rate	Total Cost	
		Est. receipts	Rate	Cost	
		\$ 464,340,000	2.4500%	\$ 11,376,330	
	Driver's License		Applicable Rate	Total Cost	
		Est. number of transactions	Rate	Cost	
		800,000	\$1.50	\$ 1,200,000	
				Total	
			***	\$ 12,576,330	2.6304%
***	Above totals are for credit card and non-Visa debit transactions only. Use of Visa debit cards and cash/check will reduce the total cost based on the number/type of transactions paid by Visa debit cards, cash, and check				

Visa Debit Card Analysis					
Payment Processing Solution -- Company X					
FY09 estimated receipts:	\$	956,239,000			
Number of transactions:		8,600,000			
Assume all DVS transactions can be paid by Visa debit card					
Assume 7,000,000 motor vehicle transactions, totaling \$928,680,000					
Assume 1,600,000 driver license transactions, totaling \$27,559,000					
Assume Visa debit card usage to be 50%					
Assume total effective rate is \$3.95 per transaction					
		Est. number	Applicable	Total	
		of transactions	Rate	Cost	
	Motor vehicle	3,500,000	\$3.95	\$ 13,825,000	
	Driver's license	800,000	\$3.95	\$ 3,160,000	
				Total	
			***	\$ 16,985,000	3.5525%
*** Above totals are for Visa debit transactions only. Use of credit cards, non-Visa debit cards, and cash/check will reduce the total cost based on the number/type of transactions paid by those alternate means					

MINNESOTA DEPARTMENT OF PUBLIC SAFETY



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Bureau of Criminal
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State Fire Marshal

Driver and Vehicle Services

445 Minnesota Street • Saint Paul, Minnesota 55101-5195
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www.dps.state.mn.us

December 15, 2008

Mr. Doug Frantz
VISA
900 Metro Center Blvd.
Foster City, CA 94404

Dear Mr. Frantz:

As a follow-up to our discussion in October, I am writing to request that VISA expand its convenience fee "pilot program" to include driver and motor vehicle transactions handled by the staff and agents of the Minnesota Department of Public Safety.

Driver and Vehicle Services (DVS) and its agents collect more than \$1.1 billion in state revenue on an annual basis. In Fiscal Year 2008, in addition to collecting motor vehicle sales tax on all motor vehicle sales and motor vehicle registration tax on 5.5 million motor vehicles, DVS collected fees for 1.4 million vehicle titles, 1.68 million driver's licenses, and 143,000 driver-related reinstatements. Currently, vehicle registration renewals are the only transactions for which DVS accepts VISA credit cards, because they are conducted online. DVS charges a convenience fee for each such credit card transaction. About 85 percent of those who pay their registration taxes online are using credit cards.

Some members of the Minnesota Legislature believe that DVS should accept tax and fee payments by credit card. However, other legislators believe just as strongly that taxpayers who pay by cash or check should not have to foot the bill for those who pay by credit card. It's an issue of fundamental fairness: Though certainly there are expenses associated with processing cash and checks, the expenses associated with processing credit cards are unquestionably higher.

DVS finds itself in a difficult position. We are already operating on razor-thin margins, and the state is facing a catastrophic deficit and plummeting revenues. We cannot simply absorb the credit card transaction fees as a cost of doing business. We see only two viable options for DVS at this time:

- Maintain the status quo and accept no credit cards at the point of sale; or
- Accept credit cards and charge a convenience fee.

With respect to the first option, DVS recognizes that its customers often expect to be able to pay taxes and fees with credit cards when they come to one of our offices. We would like to spare them the inconvenience of having to retrieve cash or a check and, perhaps, to make a second trip. However, we also recognize that we will not "lose the sale" if a taxpayer does not have cash or a check with him or her.

Paying a vehicle's annual registration tax, the sales tax on the purchase of a motor vehicle, or a driver's license fee is not discretionary. These taxes and fees are required by law and must be paid within a

specified time frame if the taxpayer wishes to drive on public roads. The taxpayer cannot take his or her business to another "merchant." In these respects, motor vehicle and driver's license transaction taxes and fees are wholly indistinguishable from property taxes and income taxes.

That brings us to the other option: Accept credit cards but charge convenience fees on all transactions, including those at the point of sale. As you know, three of the four major card issuers – all but VISA – allow convenience fees to be added to point-of-sale transactions. While we acknowledge that VISA issues about 60% of the cards in the marketplace, we tend to believe that the ability to offer additional payment options to more than 40% of our customers is nevertheless preferable to maintaining the status quo. Our preference, certainly, would be to offer the credit card payment option to 100% of cardholders – but we would need VISA's cooperation to do that.

We respectfully request that VISA extend its Tax Payment Program to include DVS, so that we may charge convenience fees on motor vehicle-related taxes and on all the fees that DVS collects at the point of sale. We believe this is a "win-win" proposition. VISA would capture transaction fees that would otherwise elude it. DVS would be able to offer taxpayers more payment options and, at the same time, recover the associated costs in an equitable manner.

I would be happy to address any questions or concerns you may have regarding our request. I am requesting that we receive a response by January 12, 2009 so that we can provide your response in our report to the Minnesota Legislature. You may telephone me at (651) 201-7580 or e-mail me at Patricia.McCormack@state.mn.us. Thank you for giving this matter your thoughtful consideration. I look forward to hearing from you.

Sincerely,



Patricia McCormack, Director
Driver & Vehicle Services



January 12, 2009

Patricia McCormack, Director
Driver & Vehicle Services
Minnesota Department of Public Safety

Dear Ms. McCormack,

Thank you for your request to be included in Visa's Tax Payment Program. As you may be aware, this program is limited to certain qualified tax payments; driver and motor vehicle transactions are not eligible for the program. We are not, at this time, extending the program to additional transactions types. The Tax Payment Program permits consumer fees on selected tax transactions because tax authorities are often prevented by law from paying fees on card payments. For mandatory taxes such as individual income taxes, 81% of states are required to collect 100% of the payable amount.¹

Except for participants in the Tax Payment Program, merchants may not charge convenience fees in a face-to-face environment at the point of sale under Visa Operating Regulations. Convenience Fees can be assessed by a merchant in specific card not present situations. For more information on Convenience Fees, please contact your Visa acquirer or refer to the Visa Operating Regulations (www.visa.com/merchant) in section 5.2.E.

We recognize that the State of Minnesota is operating under fiscal constraints. However, many studies indicate that there are cost savings by accepting payment cards, especially for states attempting to migrate payments from in-office, manual payments to online, electronic payments. In a 2007 study of electronic payments, states often mentioned cost savings as a reason for accepting electronic payments, particularly credit and debit cards.² States cited the following as some of their cost savings:

- Increased payment collection/reduced delinquent account balances
- Interest income from improved fund availability
- Reduced cost of "bad" checks
- Reduced costs of collecting and processing payments
- Reduced costs of handling and holding cash and checks

^{1,2} "Acceptance and Use of Electronic Payments for State Taxes and Fees" Prepared for:
The Council of State Governments, Financial Services Working Group, April 25, 2007, Dwight V. Denison
Merl M. Hackbart, Juita-Eleana (Wie) Yusuf, Jay H. Song, University of Kentucky, Martin School for Public Policy
and Administration

Page 2

In addition, many merchants consider the convenience of collecting payments by debit or credit card outweighs the cost of processing the transactions.

Please be assured that we have given your request our careful consideration. If you have any questions, please contact me at chwilson@visa.com

Sincerely,

A handwritten signature in black ink, appearing to read 'Charlie Wilson', written in a cursive style.

Charlie Wilson
Sr. Business Leader
eCommerce/Authentication

Visa Inc.
901 Metro Center Boulevard
Foster City, CA 94404-2775
USA
Mailstop: M3-5C