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MCCs: The DNA of risk management in payments

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Merchant category codes (MCCs) are like a business's DNA. Small but packed with critical information, they shape everything from transaction fees to fraud detection. They provide a framework for payment processors to assess and manage risk, and just like DNA, they offer insights into how a merchant operates and what risks they might pose.

Rather than being a simple classification, MCCs give us a predictive view of a merchant's potential behavior. They help identify high-risk businesses, foresee potential compliance issues, and guide decision-making in real-time. In short, they are integral to how payment systems function, offering more than just a code, but a key indicator of a business's operational DNA.

How MCCs evolved into a risk management tool

MCCs were first introduced by the IRS in 2004 as a way to streamline tax reporting. They allowed businesses to be categorized based on the services and products they offered, making tax compliance easier.

Today, MCCs are far more than a tax classification; they are a cornerstone of risk assessment. Payment processors and card networks use them to:

- Identify potential fraud and policy violations
- Determine interchange fees (higher-risk categories often mean higher fees)
- Flag merchants that require enhanced due diligence

For straightforward businesses with a single service, MCC selection is simple. But for companies offering a mix of products or expanding their services, misclassification can introduce hidden risks.

Note that today, not everyone uses the same vocabulary. Mastercard, for example, refers to MCCs as Acceptor Business Codes, while keeping the commonly used abbreviation.

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Misclassification and hidden liabilities

Merchants usually self-report their MCC, but the classification is ultimately up to their acquiring bank or payment provider. In both cases, errors can occur; sometimes due to oversight, other times due to deliberate misrepresentation.

Example: How a small change can increase risk
An online merchant selling cosmetics decides to offer products in conjunction with a seven-day free trial that automatically changes into a monthly subscription. This merchant now needs to be recoded from a cosmetics merchant to a subscription merchant with the high-risk MCC 5968. The business is now operating in a restricted category, one that requires additional scrutiny and compliance checks.

Misclassifying high-risk merchants can expose acquirers to financial penalties, regulatory scrutiny, and even card scheme violations. Categories that often require closer examination include:

- **Services with high financial risks** – airlines, travel, ticket sales, furniture
- **Services with higher content violation risks** – marketplaces, sites with user-generated content
- **Services with customs regulations** – alcohol, tobacco, weapons, pharmaceuticals
- **Regulated industries** – online gambling, pharmaceutical sales, CBD, and cannabis

A single incorrect MCC assignment can mean a merchant is onboarded without the proper controls in place, creating risk exposure that only becomes apparent when problems arise.

Geographic challenges when MCCs fail across borders

E-commerce has blurred geographical boundaries, but regulations haven't caught up. Some goods, such as CBD or gambling services are legal in one country but restricted or outright banned in another. Without the correct MCC, payment processors might unknowingly facilitate transactions that violate local laws.

Example: A general retailer selling across borders
A merchant primarily selling alcoholic beverages operates under the general retail MCC. Chargeback issues arise with international shipping orders due to mailings being held or even rejected by customs. Additional requirements related to customs regulations, age verification, and shipping restrictions are known factors associated with MCC 5921 - Package Stores, Beer, Wine, and Liquor.

Ensuring merchants are assigned the right MCC from the start helps prevent these issues before they escalate into compliance failures.

Why accurate MCCs matter for financial stability

Incorrect MCC classifications don't just create compliance risks, they can also impact revenue. Acquirers set pricing and reserve requirements based on risk. A high-risk merchant assigned a low-risk MCC might initially pay lower fees, but when their true risk profile becomes clear, the financial hit can be significant.

Real-world consequences of MCC errors

- **Underpriced risk** – High-risk merchants paying lower fees than they should
- **Regulatory exposure** – Card schemes imposing penalties for incorrect MCC assignments

Acquirers need to strike a balance, ensuring that merchants aren't overcharged while also accounting for their true risk.

MCCs in card scheme compliance

Correct MCC assignment is a key component of card scheme compliance. Mastercard and Visa require high-risk merchants to be categorized correctly to ensure proper oversight and risk management. Misclassifications can lead to chargebacks, fines, and even merchant bans.

Best practices for MCC management

To minimize exposure and optimize risk assessment, acquirers should implement strict MCC verification processes.

1. Define your risk thresholds
Maintain an up-to-date list of MCCs considered high risk and ensure that underwriting teams are trained to spot problematic classifications.

2. Verify MCCs at onboarding
Instead of accepting self-reported MCCs, validate merchant data during or immediately after onboarding. Use third-party tools where necessary.

3. Monitor merchants continuously
Business models evolve. A merchant that was low-risk at onboarding may shift into high-risk territory over time. Ongoing monitoring helps detect these changes early.

4. Detect transaction laundering
Most card brand assessments stem from transaction laundering, often originating from low-risk MCCs. Analyzing transaction patterns can reveal hidden high-risk activities.

Always get it right with MCC Verify

Take a proactive approach to MCC verification with G2RS' MCC Verify, our AI-powered and expert-supported solution for correct MCC allocation. We help you strengthen your compliance posture, reduce risk exposure, and improve your overall portfolio stability. Contact us to learn more.

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