Interchange Plus Pricing

Bringing Transparency to Credit Card Processing Fees

Industry Whitepaper by Marlon Harris, eMerchant Inc.

Most credit card processors simplify the complexity of *interchange* by bundling merchants' Visa, MasterCard and Discover rates into three-tiers (or buckets) of billing called Qualified Tiers, Mid Qualified Tiers and Non Qualified Tiers. Qualified rates are based on standard credit cards or Debit Cards that are presented by the buyer. Mid Qualified rates are typically based on Rewards Cards. Non Qualified rates come from the use of corporate cards, foreign cards, B2B cards and all other card types.

While this may appear to be a more simple approach, it actually masks the true cost of interchange. It means merchants will pay more than they should on almost all types of cards. To understand and appreciate *interchange-plus* pricing, also known as "cost-plus or pass-through pricing", it is important to understand what makes up interchange.

Interchange is the set of rules and fees that a merchant's processor (the "acquiring bank") pays to a customer's credit card company (the "issuing bank") when merchants accept Visa, MasterCard and Discover transactions. The goal of Interchange is to maintain equilibrium between the Issuing Bank and the Acquiring Bank. If interchange is too high, Merchants may not accept credit as a form of payment. If interchange is too low, Banks may not have enough incentive to issue credit into the marketplace.

Interchange Fees make up the bulk of what merchants pay in their overall credit card processing fees. These fees are collected from the Merchant by the Acquiring Bank and paid to the Issuing Bank (bank that issued the customer's card) for their role and risk in extending credit.

Level Playing Field

Every processor, independent sales organization (ISO), member service provider (MSP), and acquiring bank is subject to the exact same interchange fees. No organization is exempt from paying interchange… not even a utility company or Wal-Mart!

Why does this matter? Because it allows smaller merchant account providers, who focus their attention on providing excellent service to their merchants, to compete favorably with giant, well-known banks. A big bank has no pricing advantage over a smaller bank, broker or independent sales organization.

Furthermore, because all Merchant fees are based on Interchange, no Merchant has an advantage over another merchant in the marketplace with regard to their payment acceptance fees.

Interchange can be Complicated

Interchange-plus pricing is the most transparent way to charge for merchant account fees because the merchant will know *exactly* what Visa and MasterCard are charging. These interchange rates are not negotiable. What the Processing Bank charges as a mark up over interchange IS negotiable.

Interchange fees are based on 3 things:

1) The type of credit or debit card being presented
2) The type of product sold
3) The type of transaction (Internet or Card Not Present Transactions are deemed “riskier” than a retail, card present transaction)

CARD TYPES

Unfortunately, as of October 2010, there were 581 different card types for Master Card alone! Visa has 404 card types and Discover 112. While it is true that US merchants only see a small subset of these cards, it is almost impossible to keep track.

To further complicate matters, through the Discover Network you can also accept Diners Club International, JCB (Japanese Bank), China Union Pay (Chinese National Bank), BC Cards (Korean National Bank) and DinaCards (Serbian Bank).

TRANSACTION TYPES

Moreover, the interchange fees vary by how the transaction was executed. Retail environments where the card is present usually get preferred interchange rates while transactions transmitted online or through a gateway are deemed riskier and are charged premium interchange rates.

MERCHANT TYPES

Lastly, interchange can be affected by the Merchant Type. Supermarkets are usually afforded discounted rates over a doctor’s office or a store selling sporting goods. Other industries that get ‘special’ rates include the travel industry, utility companies and service stations. Each merchant is assigned an MCC Code (Merchant Category Code). The MCC is assigned by the Acquiring financial institution which categorizes the merchant by the product or services that are sold.

Some merchants qualify for discounts from VISA. Discounts are based on annual sales volume. The first threshold begins at $3 Billion in annual credit card sales.

TRUE COST

So, what are the interchange rates from, let’s say, VISA? First, Interchange Rates are public information. You can find them on Visa’s website or here http://www.emerchant.com/resources/visa-interchange-rates.pdf.

Here are some examples of the true interchange costs from Visa:

				ACTUAL INTERCHANGE	
CARD	CARD TYPE	TRANSACTION TYPE	MERCHANT	DISCOUNT RATE	TRANSACTION FEE
VISA	CPS Standard Debit	Retail	Hard Goods Retailer	0.95%	$0.20
VISA	CPS Traditional Rewards	Internet	Hard Goods	1.95%	$0.10

			Retailer		
VISA	CPS Signature Preferred	Internet	Hard Goods Retailer	2.40%	$0.10

Rates Effective October 2010.

Just to reiterate, this is just interchange; the fees that will be paid to the issuing bank (Cardholders Bank).

Actual Master Card interchange rates can be found here:
http://www.emerchant.com/resources/Mastercard-Interchange-Rates.pdf

MARK UP

When merchants work with their merchant account provider to set up interchange-plus billing, both parties agree on an acceptable markup over cost. This mark up is determined by the Processor in conjunction with the Merchant Account Provider.

The mark up over interchange can be affected by many variables:

1) Merchants processing volume
2) The perceived risk as seen by the processor
3) The credit worthiness of the Merchant
4) The value of all of the services being rendered to the Merchant

PROCESSING VOLUME

A Merchant who process $100K per month is in better position to negotiate preferred rates than a Merchant just starting out and expects to get a couple of sales each month. All Banks / Processors / Merchant Account Providers want processing volume. However, each needs to balance an acceptable profit that reflects their effort, financial investment, overhead, support and financial risk.

PERCEIVED RISK

A frequently misunderstood concept involves the Bank or Processor's risk. The question is usually asked by honest Business Owners wondering where the risk lies for the Merchant Bank. Most are 'shocked' when they hear the horror stories about other Merchants who operated their website for 30 days without delivering any products for example. Merchant fraud is real. Maybe it is a Merchant who is just trying to hang on before going out of business or maybe it is a Merchant with dire cash flow issues. Either way, the Bank is stuck refunding all those transactions back to the card holders. The card holder has little risk. The issuing bank has the risk of the consumer not paying their credit card bill but it is the Processor who covers the risk of unscrupulous, under-funded Merchants.

So, when a business sells products that have inherently high charge back rates or high customer dissatisfaction, the bank want to make sure their margin is sufficient to cover the perceived additional risk of the product type.

Restricted Product or Business Types include Continuity Merchants (Free Trial that turns into mandatory opt out billing), Get Rich Quick Schemes, Loan Modifications, products making unsubstantiated claims such as some diet pills. The list goes on and on.

CREDIT WORTHINESS

Banks determine their own risk acceptability. Merchants who have a history of going out of business probably will not be able to get 1) preferred rates or 2) any Merchant account, ever.

WOMB-TO-TOMB SERVICES

Some big banks are willing to sacrifice profit on the Merchant Account in exchange for a Business Loan, Line of Credit and other financial instruments all designed to make them your one stop shop. This technique is popular with some entities offering Accounting Software along with a Merchant Account. The lesson is clear. Bundled services are designed for the vendor NOT the business user. Never allow a bank or credit card processor to have access to your checking / savings account!

In summary, the mark up over Interchange will vary. The Processor or Merchant Account Provider will usually say it like this, "I can offer you Interchange plus 35 and $.15 over". Translated, this is what he said (assuming you are an internet merchant selling general hard goods), "If you accept a Visa Debit Card your rate will be 1.30% and $.35 per transaction". Use the chart above to verify this rate (.95% + .35% & $.20 + $.15).

You may hear the term "Basis Points" as well. Your mark up is 35 Basis Points. 1 Basis point is one one-hundredth of a percent or .0001. Therefore, as in the example above, if you are quoted 35 basis points over interchange, add .35% to the published interchange rate to find your true discount rate.

So you can negotiate the Discount Rate Mark Up 'over' Interchange and the Per Transaction Fee Mark Up 'over' Interchange. You cannot negotiate Interchange.

ASSOCIATION COSTS

Association fees are those fees charged by Master Card, Visa and Discover that are collected from the Merchant by the Acquiring Bank and paid directly to the association brands. These fees should be "passed through" without mark up and are NOT negotiable.

Dues & Assessments – Everyone must pay Dues and Assessments whether listed as a line item are not, the costs are real. Dues and Assessments are shown as a percentage of the sale. Fees go directly to the card associations to maintain and market their brand. Some processors overcharge or charge a premium for D&A and keep the difference. Look out! Actual Dues and Assessments as of October 2010 are as follows:

Master Card - .11%
Visa - .11%
Discover - .10%

Access Fees – Everyone pays Access Fees. These fees are listed as a per transaction cost and again, go to the card associations, again, for the purpose of covering overhead. They are as follows:

Master Card (Often called NABU Fee) - $.0185
Visa (Often called Access Fee) - $.0195
Discover (Often called Data Usage Fee) - $.0185

International Fees – Applies to transactions of non US issued card for goods and services purchased in the US by these cards.

Master Card (Cross Border Fee) - .40%
Visa (IAF or International Fee) - .45%
Discover (IPF or International Processing) - .55%

OTHER FEES

Here are a few additional "per occurrence" fees often seen with Interchange Plus Billing that ARE negotiable:

Chargeback Fee – Because the fee is negotiable doesn't mean there isn't a hard cost associated with this fee classification. There is usually some room.
Retrieval Fee – Occurs when the customer requests documentation prior to filing a Chargeback.
Statement Fee – Again, there is real cost associated with providing a paper statement or online reporting. Different banks and processors make some of these fees sacred cows and treat them as untouchable while others will waive at first request.
Annual Fee – Typically, a "fluff" fee, often disguised as a PCI Compliance Fee, Non Compliance Fee or the ever popular, I want to go on vacation with my family fee.

SAVINGS

Let's review a transaction on Tiered Billing and then again on Interchange Plus.

A $100 Sale is recorded and authorized in real time on a website. The merchant ships the item the next day and "captures and/or settles" the transaction. The day's transactions are batched out that evening. 48 hours later the funds are deposited into the Merchants checking account. From those funds, whether deducted prior to the deposit or at the end of the month, fees are charged.

EXAMPLE #1

ASSUMPTIONS

Billing – Qualified Rate of 2.15% and a $.25 Transaction Fee includes AVS
Test Transaction - $100
Merchant Type – General Retail
Transaction Type – Card Not Present / Internet (Not PIN Debit)
Card Presented – Visa Debit Card

MERCHANTS STATEMENT – BUCKET BILLING

Fee	Description	Beneficiary	Fees
Discount Rate	2.15% of the Transaction - Interchange is Hidden	Acquiring Bank pays Cardholders Bank Interchange Amount	$ 2.15
Dues & Assessments	0.11% per Visa Interchange Rates	Visa	$ 0.11
Access Fee	$.0195 per Visa Interchange	Visa	$ 0.02
Transaction Fee	For Processing and Address Verification, Interchange Hidden	Acquiring Bank pays Cardholders Bank Interchange	$ 0.25

Total Fees are $2.53

Now let's look at the same transaction on Interchange Plus billing assuming a 25 Basis Point markup or 25 one hundreds of a percentage point. This would be called "Interchange plus 25". All other assumptions are the same:

MERCHANTS STATEMENT – INTERCHANGE PLUS BILLING

Fee	Description	Beneficiary	Fees
Interchange Rate	1.60% per Visa Interchange Rates	Cardholders Bank	$ 1.60
Interchange Fee	$.15 per Visa Interchange Rates	Cardholders Bank	$ 0.15
Dues & Assessments	0.11% per Visa Interchange Rates	Visa	$ 0.11
Access Fee	$.0195 per Visa Interchange	Visa	$ 0.02
Service Rate	.25% or the "Plus"	Acquiring Bank	$ 0.25
Transaction Fee	For Processing and Address Verification	Acquiring Bank	$ 0.10

Total Fees are $2.23 or a savings of 30 basis points on every dollar processed through Visa, Master Card and Discover.

EXAMPLE #2

ASSUMPTIONS

Billing – Non Qualified Rate of 3.50% and a $.25 Transaction Fee includes AVS
Test Transaction - $100
Merchant Type – General Retail
Transaction Type – Card Not Present / Internet (Not PIN Debit)
Card Presented – Visa Signature/Preferred Business Card

MERCHANTS STATEMENT – BUCKET BILLING

Fee	Description	Beneficiary	Amount
Discount Rate	3.5% of the Transaction - Interchange is Hidden	Acquiring Bank pays Cardholders Bank Interchange Amount	$ 3.50
Dues & Assessments	0.11% per Visa Interchange Rates	Visa	$ 0.11
Access Fee	$.0195 per Visa Interchange	Visa	$ 0.02
Transaction Fee	For Processing and Address Verification, Interchange Hidden	Acquiring Bank pays Cardholders Bank Interchange	$ 0.25

Total Fees are $3.88

Now let's look at the same transaction on Interchange Plus billing assuming a 25 Basis Point markup or 25 one hundreds of a percentage point. This would be called "Interchange plus 25". All other assumptions are the same:

MERCHANTS STATEMENT – INTERCHANGE PLUS BILLING

Fee	Description	Beneficiary	Amount
Interchange Rate	2.10% per Visa Interchange Rates	Cardholders Bank	$ 2.10
Interchange Fee	$.10 per Visa Interchange Rates	Cardholders Bank	$ 0.10
Dues & Assessments	0.11% per Visa Interchange Rates	Visa	$ 0.11
Access Fee	$.0195 per Visa Interchange	Visa	$ 0.02
Service Rate	.25% or the "Plus"	Acquiring Bank	$ 0.25
Transaction Fee	For Processing and Address Verification	Acquiring Bank	$ 0.10

Total Fees are $2.68 or a savings of 120 basis points on every dollar processed through Visa, Master Card and Discover. That's 1.2% savings!!

ADVANTAGES OF INTERCHANGE PLUS BILLING

ADVANTAGE 1 – Cost Savings

Based on the examples above there are big savings to be enjoyed. If your website processes $100,000 per month of credit card transactions, that would be a savings of $1200 per month or $14,400 per year. You can see how Interchange Plus billing can save Merchants thousands of dollars.

ADVANTAGE 2 – Bank Accountability

Now the Acquiring Bank is held accountable for the rates. When you think about it, who determines whether the card being presented is a "Qualified" Card or a "Non Qualified" Card? In Tiered or Bucket billing the Acquiring Bank or the Processor determines at their sole discretion whether a specific card, regardless of interchange, is going to be billed at the higher rates "Non-Qualified" or the lower rates!

So yes, your conclusion is valid. Banks will toss marginal transactions into the Non Qualified bucket to increase their own margin and the Merchant has no way of knowing what specific card was presented. To further seal the case for Interchange Plus Billing, Visa and MasterCard don't acknowledge the terms Qualified or Non Qualified. This was made up by Banks for Banks and is sold as a "Simpler Program" for the Merchants. However, the only beneficiary is…. THE BANKS.

ADVANTAGE 3 – Fewer Rate Increases

Another advantage in holding Acquiring Banks accountable through Interchange Plus billing comes from rate increases. It often happens that Banks will raise the rates on Merchants in Tiered billing programs. However, it is nearly impossible for a bank to raise the agreed upon mark up without being in violation of the Merchant Agreement. And WHEN there really is an increase from the Card Associations, the banks cannot raise the rates beyond what the stated interchange rate is.

ADVANTAGE 4 - Reconciliation

One of the most overlooked advantages of Interchange Plus Billing is reconciliation. Calculating your rates becomes simpler, as does the accounting of your fees. Interchange charges are easily recorded and managed as are all other fees. You see each card type specifically listed giving owners' valuable data regarding customer metrics.

ADVANTAGE 5 – ASSOCIATION RATE INCREASES

Twice a year (in April and October), Visa and MasterCard decide whether or not to modify the existing "Interchange Rate Structure." *All* credit card processors reserve the right to pass any rate increases on to their clients. Unfortunately, many credit card processing companies take advantage of these opportunities by increasing rates at each Tier or Bucket. However, with Interchange Plus billing, your rate above interchange will not be changed. (Yes, there are, again, unethical Processors who might attempt to increase your rate, but it is very hard to disguise and increase on your primary rate. Unfortunately, periodic checks of your rates are a good business practice)

OTHER TRICKS OF THE TRADE

Merchants sometimes ask, "My non-qualified surcharge is only 1.60% and $0.10. Isn't this much lower than your interchange-plus business rate of 2.40% + $0.25?" The answer is, emphatically, *no*. If your merchant account provider is charging you a non-qualified surcharge, in order for you to calculate your actual non-qualified *rate*, you must add the surcharge to your base qualified rate. For example, a base qualified rate of 2.15% + $0.25, plus a non-qualified surcharge of 1.60% + $0.10, equals the actual non-qualified rate of 3.75% + $0.35.

Another popular method famously offered by the Big Named Banks is to charge surcharges for corporate, rewards, and foreign cards for the previous month's transactions on the current month's statement. They show the surcharges, and the number of transactions, but they do *not* show you the dollar amounts that those surcharges are calculated against. This makes it impossible to do the math and decipher the actual EFFECTIVE rate you are paying for these type cards. In my opinion this is neither transparent nor ethical. Nonetheless, with Interchange Plus billing you neutralize the tricks and bring transparency to your Merchant Statement.

Synopsis of Interchange Plus Billing

There are three types of credit card processing fees:

1. Association Fees – Fees charged by Master Card, Visa and Discover directly
2. Interchange Fees – Fees set by Master Card, Visa and Discover and are paid to the Card Holders Bank
3. Processing or Merchant Bank Fees – Fees charged by the processor to shoulder the burden of risk and cover overhead costs related to merchant support and services.

Interchange fees typically represents over 80% of the total fees paid. Interchange fees have a complex pricing structure, which are based on 3 things:

1. The type of credit or debit card being presented
2. The type of product sold
3. The type of transaction (Internet or Card Not Present Transactions)

Interchange Plus Billing offers 5 distinct advantages:

1. Cost Savings – Merchant takes advantage of lower cost cards presented to their business i.e. Debit Cards or non Rewards Cards
2. Bank Accountability – Association Fees and future interchange fee increases are treated as pass through fees and are not marked up.
3. Variable Rate Increases are impossible – Once you commit to a "Plus" amount or markup that's it with regard to the discount rate
4. Reconciliation – Merchant statements are simplified and transparent
5. Fee Classification – The bank no longer has the power to reclassify card types in order to place into more expensive tier

Interchange Plus Billing is the best plan available for most merchants today.

ABOUT THE AUTHOR - Marlon Harris is the Vice President of Sales and Marketing at eMerchant Inc. He has over 25 years of experience in Business-to-Business solutions and merchant services. He often speaks at User Conferences and eCommerce summits on the topic of Credit Card Processing and Payment Acceptance Solutions. A graduate of Purdue University he was a pioneer in the early days of the wireless industry having sold a successful manufacturing business.

ABOUT eMerchant - ***eMerchant, Inc.*** *is a premier Merchant Account Provider offering payment acceptance solutions to businesses throughout the United States since 2002. We specialize in eCommerce transactions providing online payment programs for some of the internet's most successful websites.*

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