

ETA 2008
Annual Meeting and Expo

Electronic Transactions Association Annual Meeting and Expo
April 15-17, 2008 • Mandalay Bay Resort & Casino • Las Vegas, Nevada

When Interchange Isn't Really Interchange, The Relevance of Interchange

Kurt Strawhecker – The Strawhecker Group
John Mayleben – Michigan Retailers Association
Darrel Anderson – TSYS Acquiring Solutions

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Interchange Overview

Kurt Strawhecker – The Strawhecker Group

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What are Interchange Reimbursement Fees?

- They are transfer fees between financial institutions
- Their purpose is to balance and grow the payment system for the benefit of all participants
- They are a necessary and efficient method to maintain a strong and vibrant payments network

(Source: Visa USA and MasterCard Inc)

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What are Interchange Fees?

Interchange Fees are a percentage amount of transaction volume plus, in most cases, a per item fee paid by an acquirer to an issuer

Example:

- Interchange fee = 1.7%
- Issuer deducts 1.7% from transaction amount
- Issuer pays the acquirer 98.3% of the total transaction amount

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Interchange vs. Merchant Discount Rate

- Merchants do not pay interchange reimbursement fees
- Merchants pay "Merchant Discount" to their acquirer
- This is an important distinction, because merchants buy a variety of processing services from acquirers
 - All of these services may be included in their merchant discount rate, which is typically a percentage rate per transaction
- It is generally understood that interchange fees are one component of the Merchant Discount Rate

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How is the Interchange Rate Set?

- Interchange Rates are set to optimize demand for the Associations or Card Brand system
- National Bank credit card strategies, competition, other payment systems and means of payment and costs and revenues of the payment system offered jointly by issuers and acquirers also impact the Interchange Rate
- Geographic regions, market segments and transaction types all factor in setting the Interchange Rate



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Why was Interchange Created?

- The Interchange fee structure enables thousands of bank card issuers and acquirers to conduct business with each other knowing that all bank card transactions will be honored
- Cardholders know, regardless of their issuer or the merchant's acquirer, they can use their bank credit and debit cards wherever those products are accepted
- The U.S. Court of Appeals found Interchange to be an efficient and necessary part of a four-party system



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How did Interchange Begin?

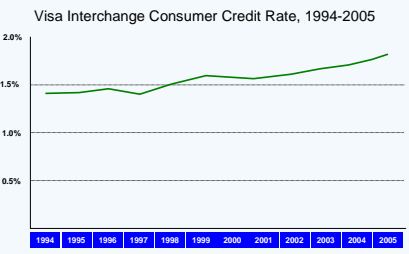
- Nearly all of the card programs in the first half of the 20th Century were closed loop systems
 - Diners and American Express
- Bank of America franchised the credit card concept to bank members, with different issuers and merchant ownership
- To expand nationally, Bank of America recruited other banks to issue and acquire for BankAmericard
- In 1971, BankAmericard established an Interchange fee to be paid by the merchant's bank to the cardholder's bank
 - Fee was initially set at 1.95% per transaction
 - MasterCard followed suit
 - Fee explained as compensation for the risk of card-issuing banks

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The cost of Interchange has increased by nearly 20% in the last 10 years

Visa Interchange Consumer Credit Rate, 1994-2005



Year	Rate (%)
1994	1.40
1995	1.45
1996	1.45
1997	1.40
1998	1.50
1999	1.55
2000	1.55
2001	1.55
2002	1.60
2003	1.65
2004	1.70
2005	1.80

Source: Visa U.S.A.

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Competition and Interchange Cost

- Issuing banks offer a variety of credit cards “with benefits”
- “Benefit” cards require more direct handling of transactions, and therefore, are associated with higher interchange rates
- Cardholders have become accustomed to special programs to complement their credit card usage
- More merchants are processing via the Internet in a non face-to-face environment producing increased risk exposure to the issuing bank

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The Impact of Interchange?

- All consumers, even those who pay with cash, pay more at the store because the interchange fees that merchants pay banks are passed on to all customers
- Merchants have little choice but to accept Visa and MasterCard products on the card brands’ terms
- Banks engage in a variety of practices to drive consumers to higher cost payment forms
 - Example: Many banks surcharge PIN-debit to
 - They engage in these tactics to maximize interchange fee revenue

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The cost of acceptance has tripled in the last 10 years

Interchange Fees per \$1,000 in Consumer Spending, 1995-2005

Year	Interchange Fees per \$1,000
1995	1.25
1996	1.50
1997	1.75
1998	2.00
1999	2.25
2000	2.50
2001	2.75
2002	3.00
2003	3.25
2004	3.50
2005	3.75

Source: The Nilson Report, Bureau of Economic Analysis, National Economics Accounts

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Merchants are getting smarter...

- Merchants can compare acquirer pricing
- Merchants are exposed to public interchange rates, numerous software applications and thousands of processing options via the Internet which equates to slim revenue opportunities for acquirers
- Now, merchants have just enough information to be dangerous

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Interchange Complexity

- Interchange is more sophisticated and complicated than ever before
 - There are in excess of 50 different Visa Interchange rates alone, with debit claiming over half of those rates
 - Understanding and applying the correct rate to your merchant accounts is significant to your Company's revenue potential
- If rates are applied incorrectly, your Company may be accepting higher interchange than expected and lose merchants as a result

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What can Acquirers and ISOs Do?

- Learn interchange rate structures and price your merchants accordingly
- Educate your sales force
- Stress your capabilities
- Provide merchants tools to view interchange
- Teach your merchants how to qualify their transactions to decrease their costs
- And more....

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Interchange from a Retailers Perspective


John Mayleben – Michigan Retailers Association

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Interchange from a Retailers Point of View




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What do Retailers Know About Interchange?

- A lot, but most of it comes from questionable sources
 - Google "credit card interchange fees"
 - More than 165,000 hits
 - Wikipedia even has a definition and elaborates
 - "In 2005 the number was \$30.7 billion, up 85 percent compared with 2001"



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It Was in the Paper, So It Must Be True

- A number of national associations are attempting to build momentum about interchange

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Americans pay about 3 times as much in credit card interchange fees as Europeans.

What would you call that?



Call that outrageous.

Angry about credit card fees?

Visit www.etaonline.com or call (800) 859-1400

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It's the credit card sucker punch consumers never see coming.



Interchange is the biggest credit card fee you've never heard of... and it's outrageous.


Card fees are the most controversial part of the credit card industry. Interchange fees are the largest part of the cost of a credit card. They are the fee that the merchant pays to the card issuer for processing the card payment. Interchange fees are the biggest credit card fee you've never heard of... and it's outrageous.

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National Surveys

- 82% of respondents chose either “strongly support” or “somewhat support” the following sentence...
 - “Card associations are engaged in price-fixing and anti-competitive behavior” in relation to discussions about interchange
 - Association for Financial Professionals Survey
- 50% of those same people also believe that they would suffer a “significant” decline in sales if they did not accept cards
- Clearly, a love-hate relationship!


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State Legislative Issues

- In 2007, numerous states attempted to prohibit the collection of “merchant fees” including interchange from the portion of the transaction relating to sales tax
 - Indiana
 - Florida
 - Kentucky
 - Nebraska
 - Nevada
 - New York
 - Washington


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State Legislative Issues

- Some states are also attempting to limit the cost of “interchange”
 - Tennessee
 - Bill introduced that would limit the card issuer to charging merchant no more than 0.75% per transaction for ALL processing fee
 - Washington
 - Bill introduced to prohibit financial institutions from charging interchange fees that are more than 1.5% of the transaction



What Does it all Mean to the Retailer in their Store?

- Most retailers can't begin to understand the complexity of interchange and the interplay in the industry between interchange and the number of cards now in consumers wallets
- More importantly, they don't care!
 - From their perspective, they bear the entire cost of all of these new schemes to get customers to carry cards (T&E, Rewards, Enhanced, Business, Corporate, Purchasing, Debit, Gift, etc.)



Learning About Interchange

- Learning about interchange is like teenage boys learning about sex, if you aren't talking about it, they WILL get the information from someone else and then you will then be playing defense!
- You should be talking about it and how your merchants can eliminate downgrades





How You Can Help Your Merchants Manage Interchange

Darrel Anderson – TSYS Acquiring Solutions

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Analysis Example

Number	Amount	Description	Fees	Total
		MONTHLY FEE		247.00
		ONLINE REPORTING FEE		20.00
		CHARGEBACK FEE		3,780.00
236		AUTHORIZATION FEE		50,387.48
285,052		AUTHORIZATION FEE		23,054.03
121,337		AUTHORIZATION FEE		14,473.86
7,752		NON-QUAL TRANSACTION SURCHARGE		28,953.92
92,047	-2,895,931.98			106,652.31
		Total Fees Due		

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Analysis Example

Merchant Statement

Processing Month: [REDACTED]
 Application Number: [REDACTED]
 Merchant Number: [REDACTED]
 Routing Number: [REDACTED]
 Deposit Account Number: [REDACTED]

Amount Due: \$ 286,334.89

Statement Due: 186,675.00
 Fees Due: 186,659.89
 Amount Due: 386,334.89

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Comparison Exercise

Acquirer A - Processor A	Acquirer A - Processor B
318,000 Transactions	318,000 Transactions
\$9,000,000 Monthly Sales Volume	\$9,000,000 Monthly Sales Volume
\$31 Average Ticket	\$31 Average Ticket
\$190,000 (2.06% Blended Interchange)	\$187,000 (1.71% + .10 – Blended Interchange)
\$28,953.92 (Non-Qualified Penalties)	\$19,350 (21.5 BP X \$9M – Discount Fee)
\$73,000 – (\$19 Per Transaction Fee)	\$8,325 (9.25 BP X \$9M – Brand Assessment)
\$291,953 (Total Fees)	\$214,675 (Total Fees)
\$.91 Per Transaction	\$.68 Per Transaction

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Questions?

