INTERCHANGE 101

What is Interchange

- The foundation of the entire Bankcard Processing industry's cost structure.
- Interchange is the **wholesale price**, charged by Card Issuing Bank, for Authorization and Settlement of a credit card transaction.
- In addition to Interchange, each transaction is assessed "Dues and Assessments" to Visa/MasterCard/Discover.
    - Mastercard Dues add $.0185 and .11% to each transaction
    - Visa Dues add $.019 and .11% to each transaction
    - Discover Dues add .10% to each transaction.
- **It is set, published and priced the same for all processors, regardless of size or volume.**
- It is extremely complex and constantly changing.
- Understanding interchange and its evolving nature is critical to a deep understanding of the Merchant Bankcard industry.

How Complex is Interchange?

- Interchange is comprised of roughly 125 categories.
- Visa now has 22 credit categories, 21 debit , 12 corporate, & 19 international.
- MasterCard has 20 credit, 14 debit, 9 corporate, and 8 international.
- What is not part of interchange?: American Express, Diners, JCB

Interchange is no longer just retail versus key entered with downgrades to non-qualified.

There are 3 factors that determine the category a transaction will fall into:

1. The merchant's industry type, example: Fast food, Colleges, Warehouses, Gas stations, Internet Merchants, Catalog Merchants.
2. The type of Card processed, example: Traditional credit cards, Corporate, rewards based, purchasing, Check Cards.

3. How the card is processed, example: Swiped or keyed-in, present, not-present.

There are strict qualifications for certain categories that are attributed to merchant category, merchant actions and transaction size. For most categories, the interchange cost is a combination of a percentage rate and a transaction fee.

Pricing Strategies

There are 3 basic pricing strategies utilized by the processing industry.

1. Tiered Pricing

Attempting to explain the ever-growing list, currently 125 categories is rather complex. Therefore most processors will bundle the rates into a few categories such as Swiped, Keyed and non-qualified. This pricing method is called "Tiered Pricing".

2. Interchange Plus Pricing

Interchange fees, interchange plus pricing, cost plus pricing and interchange pass-through pricing are defined as the practice of pricing a merchant the exact interchange (Visa / MasterCard charges bank to bank plus assessment) with an added discount and transaction fee. Until recently only the largest of corporations were given the opportunity of this pricing, all other merchants have been under a blended or tiered program.

3. Billback Pricing

Billback or Enhanced Billback is a pricing method that essentially blends interchange plus and tiered pricing. Billback has a "qualified" rate that is tied to a specific interchange category. All cards presented to the merchant that pass through at a higher rate are surcharged at the higher rate plus a set percentage of profit for the processor. Billback allows the merchant to believe he is receiving a set rate when in fact most transactions will fall in at much higher rates (with an extra profit to the processor).

Interchange

Bundled categories represent an easier way for most merchants to understand the different rate types. For most merchants a limited amount of volume will ever fall into the specialized categories, so bundling does make sense. For a merchant who has few downgrades, bundling often provides the same bottom line as if the merchant had been quoted and setup with every available category. Bundling of rates also may mean that some or all of the transaction fee is eliminated.

- A small volume merchant may prefer an easy to understand Bundled Rate. A large volume merchant may have more to gain by having an unbundled rate or interchange + pricing deal.
- A large volume merchant who is trained to process correctly and is set-up correctly can ensure that every transaction qualifies for the best category available.

Each transaction must meet one or many different factors in order to qualify for a specific category. Some factors determine if the transaction will be completed (example a restaurant tip), while other factors determine the rate and transaction fee that will be assessed. There are a handful of industries that have been assigned a special rate category. In some cases, preferred rates were established for these merchants to attract them to accept credit cards, such as Warehouse Clubs & Supermarkets. In other cases the rules reflect the unique transaction flow for a particular industry, such as lodging and car rental where authorization is needed at check-in days before a transaction is settled at checkout. As a result of new technologies, such as Mobil Speed passes rates have been created for Gas Stations, Fast Food Restaurants, and convenience stores. Fast Food and Gas Station transactions are normally completed without a signature, but are deemed more secure than a mail order or internet transaction, mostly due to the preset limit on the transaction.

Some other industries that qualify for special rate categories are: airline, Cable TV, Government, Motion picture theaters, Travel agents & Utility Companies.

The 2nd Factor: Types of Credit Cards:

The marketing departments of Visa and MasterCard have created an endless list of names for virtually the same product. Some examples are Purchase, Corporate, Business, Fleet as well as combinations like Corporate Purchase. The difference between the various Commercial cards are defined by the reporting features available to the cardholder. Commercial cards are designed to help companies maintain control of purchases while reducing the admin cost associated with authorizing, tracking, paying and reconciling those purchases.

An example would be something called level 3 data, where the merchant’s invoice number for a transaction appears on the customer’s statement.

For a merchant there is no benefit other than the ability to enter and transmit the additional transaction information, which may be a requirement for the customer to make the purchase. The interchange rate for these commercial cards is different than the swiped rate. It is common for the industry to bundle them into a non-qualified rate since, in most cases the interchange cost is higher than the swiped rate.

Check Cards and Debit Cards

From both the customer's and merchant's perspective Check Cards, Bank Cards, and Debit Cards are often confused since they share some of the same characteristics. However, PIN Based Debit and Check Cards are very different.

Pin Based Debit: These transactions are routed through a Debit Network such as NYCE, MAC, STAR, Interlink and are authenticated by the cardholders pin #. The transaction is immediately debited from the card holders account.

Check Cards, or Offline Debit, or signature based Debit: These transactions are routed through the Visa/MC authorization and settlement system. Transactions are settled nightly and authorized by the cardholders signature. Due to the decreased risk factor, these transactions are at a lower rate structure. Keep in mind here, the money is not loaned, it is money that is already in one's checking account.

For the merchant, the differences start with the fact that accepting Pin Debit requires a pinpad, which must be used by the customer to enter their pin. The pinpad is normally a separate device, but can sometimes be integrated into the terminal.; Pricing for Pin Debit is not governed by Visa/MC interchange, but rather by the interchange of the individual debit networks!

Check Card transactions can fall into a number of Check Card Categories. Visa/ MC established a set of Check Card Rates that are priced significantly lower than all other consumer credit cards. These new categories provide yet another way for processors to create unique rate offerings.

The third factor in determining what a merchant will be charged is based on the method of entry and what data is entered at the time of entry.

Swiping Versus Non-Swiping

The first and most obvious Interchange factor is whether the credit card is physically present at the Point-of-Sale. Whenever a credit card is swiped through an electronic terminal or card reader, an indicator is transmitted to Visa/MasterCard along with the rest of the data, recording the fact that the information was received directly from the credit card's magnetic strip. Without this indicator, the transaction is not eligible to qualify for any of the swiped Interchange categories.

The technology of reading magnetic stripe information has been incorporated into more and more products. Mag-stripe readers can be found in computer keyboards, as attachments to cellular phone, on PDA's, etc. Whereas it is relatively easy to capture the information from a magnetic stripe, it is another thing to properly transmit the information to Visa/MasterCard in a way that will allow it to qualify. It is possible, and in fact common, for a merchant to believe that they are qualifying for the best swiped rates, when in fact the transactions are downgrading. Merchants should be encouraged to test transactions and have their processor verify their qualification levels instead of assuming that a swipe will always qualify.

Address Verification System (AVS)

In an effort to combat the fraud that is a result of non-face-to-face transactions, Visa/MasterCard created the Address Verification System which attempts to verify the address and zip code of the customer that is using the credit card. Whenever a card is key-entered, the processing system should be set up to prompt the merchant to enter the billing zip code (where the cardholder receives their statements) and the numerical portion of the address of the cardholder.

If this information matches what the card issuing bank has on file, the system will qualify that transaction for an AVS rate category. Visa also looks for an invoice number.

Key Entered Versus Card Not Present

Visa/MasterCard both make a distinction between a card that was key entered due to a bad magnetic stripe as opposed to a transaction where the cardholder is not present, such as in mail/phone/internet orders. To confirm the fact that Interchange is sometimes needlessly confusing, the wholesale rates for Key Entered and Card Not Present (MasterCard calls them Key-Entered and Merit I) are the same! Therefore, in an effort to clear the confusion, we suggest that the merchant follow one simple rule that will ensure the merchant qualifies for one or the other. Whenever a card is not swiped, enter the information required for AVS as well as an "order number" for every transaction. The order number can be any length but it must not be used twice in one batch.

Specific Industries

In the case of Industries such as Lodging and Car Rental, data elements such as Check-In and Check-Out dates, Folio numbers and length of rental are examples of the required information that is sent to Visa/MasterCard along with the credit card data. Of course, in order to qualify for these categories, the merchant must use Industry specific software or terminal applications which will prompt for the extra information as well as properly send it to Visa/MasterCard.

The qualification of every transaction is influenced by many factors. Merchants must not only be aware of these factors, but also must understand which factors supersede others. In many cases, the only way to truly understand how a merchant can minimize their interchange costs is to critically examine their bankcard statement. What categories are the transactions falling into? Are there better categories that can be achieved, and by what means?

Going through this analysis can be a lengthy process and will require the cooperation of the processor, however the cost savings can make the process well worth it.

CVV2, CVC2, CID?

Finally, Visa, MC, Discover and AMEX have developed different security codes for each brand. The CVV2, CVC2 and CID codes are three different acronyms for the same credit card security feature. (VISA refers to the code as CVV2, MasterCard calls it CVC2, and American Express calls it CID). The acronyms refer to an additional three or four digit number included on every Visa, MasterCard and American Express credit card. In the case of Visa and MasterCard, the number is the last 3 numbers found on the back of the credit card on the signature panel. These numbers are usually preceded by the either the full credit card number or just the last 4 digits of the card number. American Express prints their 4 digit code above the credit card number on the front of the card on the right side.

The CVV2, CVC2 and CID numbers can be used as additional verification for card-not-present transactions. At the present time, there are no rate benefits for verifying the credit card, nor will the merchant be prevented from completing the transaction if the codes are not submitted or are not correct for Visa and MasterCard. The main advantage to obtaining a CVV2, CVC2 or CID match is for overall security. As most mail/phone/ecommerce merchants know, the large portion of the burden of preventing credit card fraud falls on the merchant. Requiring a code match can deter many fraudulent transactions. In the event that a chargeback does occur, a code match is helpful, however it is not the sole determining factor in whether a merchant will successfully defend itself against the dispute.

Both Visa/MasterCard have indicated that there may come a time that qualification categories or chargeback rules will be altered to either encourage or reward a successful code match. However, at this point in time, the CVV2, CVC2 and CID numbers are simply a tool that is available for use by the merchant. Other verification and security measures, such as "Secured By Visa" and "MasterCard Secure Code", are also being developed and used by the Card associations. The effectiveness and merchant adoption rates will ultimately determine how Visa/MasterCard emphasize and reward these security programs. Until then, it's better safe than sorry. Finally, in case you were wondering, CVV = Card Verification Value, CVC = Card Verification Code and CID = Cardmember ID.