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8 ways to optimize interchange and scheme fees

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INTRODUCTION

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Interchange fees are the greatest cost of electronic payment processing. That's why it makes sense to keep an eye on what these costs are and how you could better manage them for your business.

As a quick refresher, interchange fees are set by the card schemes, deducted from the merchant's revenue (via the acquirer), and settled to the issuer. Scheme fees are also set by the card schemes, although these are settled back to the scheme itself.

Although Checkout.com does not set interchange or scheme fee rates, we are in close contact with all parties in the payment processing journey. That means we are in a good position to provide guidance on cost management in this area. With our central mission to make your payments perform, that also means getting your costs under control. Our payments experts are best placed to make careful decisions about how to route your payment traffic to secure the right business outcomes.

This guide is a quick overview of strategies you can employ to cut down on overspending.

CHAPTER 1

INTERCHANGE FEES

1. Location, location, location
2. Ensure you're always getting the correct interchange for your MCC
3. Secure transaction technology: authentication and AVS
4. Additional transaction data
5. Timely settlement

CHAPTER 2

SCHEME FEES

1. Excessive retries
2. Chargeback fees
3. Tokenization

INTERCHANGE FEES

How are interchange fees set?

Interchange fees vary according to a range of factors. What you need to know is: there are hundreds of variables for transaction types, and each transaction request will incur charges according to the categories it falls in.

For that reason, there's rarely a straightforward way to accurately calculate your projected charges. However, card schemes publish their interchange rates online, which you can find with a little digging.

That said, the main factors that impact interchange fees are:

- **Scheme:** for instance, Visa or Mastercard
- **Type of card:** such as a premium credit card or a standard debit card
- **Program:** the financial product which the payment account falls into
- **Location:** national regulations affect local processing costs
- **Merchant Category Code (MCC):** the type of business you conduct indicates the level of risk associated with processing your transactions

That means the fees you'll face as a merchant depend on who you are, where your business is registered, and how careful you are with your payment strategy.

Higher volume can mean lower fees

Certain card schemes offer better rates to merchants who drive a high level of payment traffic. If you are close to the volume threshold for more favorable rates, it may be worth encouraging your customers to pay with cards of that particular scheme. On the other hand, limiting payment methods can impact conversion for some business types, so proceed with caution.

Given that interchange charges vary per card type and payment channel, it's worth weighing up different ways to accept payments. For more on that take a look at our **guide to payment methods.** But, for now, let's focus on right-sizing your card processing fees.

How to manage interchange fees

You'll be aware that interchange++ is a pricing model in which interchange fees are directly passed on to merchants (in addition to the acquirer's fees, payment gateway fees, **and other costs)**. For this reason, it's in your interests to keep interchange fees at the level that makes sense for your business.

Read on for the most effective ways to right-size those interchange costs.

01 LOCATION, LOCATION, LOCATION

Cross-border card processing tends to come with higher interchange fees compared with domestic. Therefore, it is usually beneficial to route transactions domestically, where possible. Merchants can optimize interchange fees by choosing a payment services provider (PSP) which offers local acquiring in many global regions. Checkout.com carries out domestic processing in almost 50 countries – this helps to improve acceptance rates, as well as right-size fees.

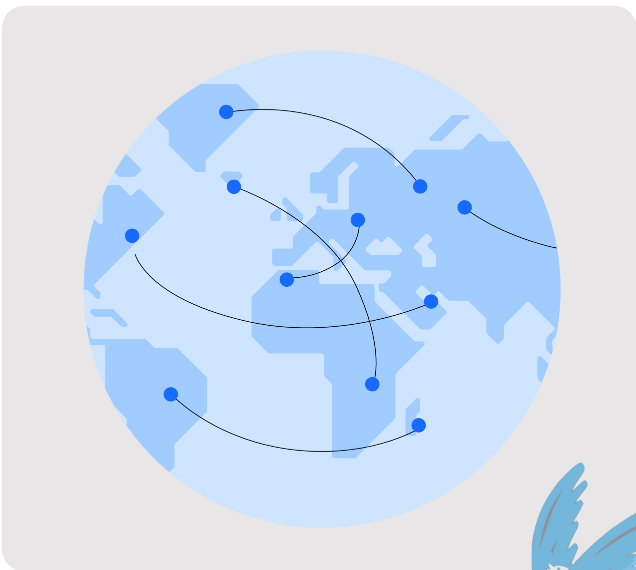
Card-not-present (also known as “card-absent”) transactions can benefit from somewhat greater routing flexibility compared with card-present (in-person) transactions. If your business operates in several countries, it may be preferable to route transactions through a particular location using a local legal entity. Note that this would have implications on taxation, so costs should be weighed holistically.

So, depending on the jurisdictions and types of transactions that you process, your business may be able to realize a lower average interchange fee through prudent card-not-present routing.

Under Visa’s rules, for example, US merchants can list additional countries as official outlets in addition to the main center of business in certain situations. For instance, a transport operator such as a cruise line should indicate the country from which the first leg of travel begins.

Therefore, you should check whether you are submitting the correct location for your transaction requests, as individual regions will incur differing fees. As ever, you will need to check the sales tax and regulatory implications of submitting transactions in each global region.

You also need to pay careful attention to scheme rules. Visa, for instance, states that a merchant cannot simply have a mail-forwarding address or a director located in a certain region in order for a location to qualify as an additional country of business operations.



EXAMPLE: EUROPEAN VS UK ROUTING

A common scenario we advise to merchants who have both UK and EEA entities is to ensure the UK-issued cards are routed through the UK entity, and EEA-issued cards are processed through the EEA entities.

This ensures the UK cards get UK Domestic rates and the EEA cards get Domestic or Intra EEA rates instead of Intra Non-EEA "Brexit" rates. It must be noted that Mastercard and Visa have different views on which countries are within the EEA. That means you need to check each scheme's particular categorization of countries.

	CONSUMER RATES	PREFERENTIAL RATES
CONSUMER DEBIT	1.15%	0.20%
CONSUMER CREDIT	1.50%	0.30%

In both cases, the preferential rates are 0.2% for consumer debit and 0.3% for consumer credit as opposed to 1.15% and 1.5%. Depending on your credit/debit split, you could therefore achieve between 0.95% and 1.2% reduction in interchange for applicable consumer card traffic.

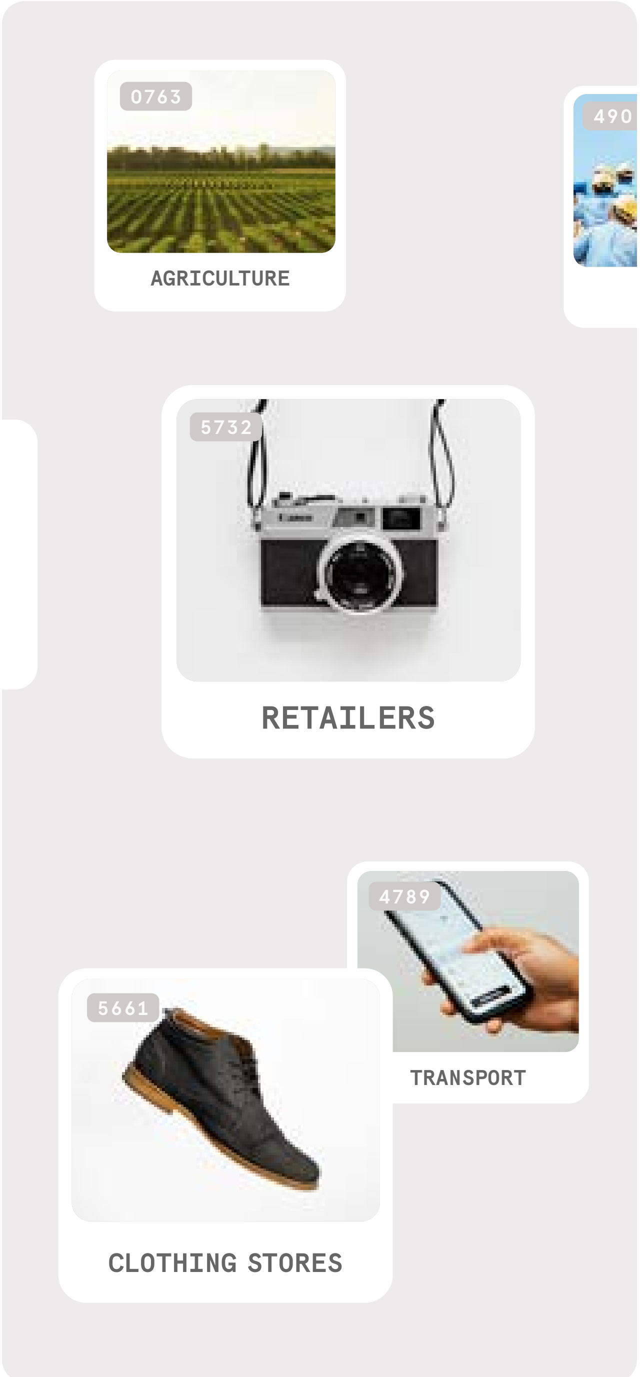
02 THE CORRECT INTERCHANGE FOR YOUR MCC

In our guide to Merchant Category Codes (MCC), we explained that card schemes charge different rates depending on the merchant's particular line of business. Broadly speaking, businesses operating in higher-risk industries will incur greater fees.

Your PSP needs to thoroughly understand your business to ensure you're assigned the correct MCC. Confusingly, each scheme has its own MCC criteria. These are updated regularly, making it pretty challenging to ensure you're using the correct MCC for every scheme. Misclassification could result in fines from the card schemes.

That's why it takes a team of us at Checkout.com to focus on scheme compliance at local and international levels. We also ensure our merchants qualify for any relevant MCC-specific rates, through registration (where necessary) and data provision requirements.

If your organization is a charity, then you could benefit from scheme-specific exemptions. For instance, Visa's interchange fees can be waived for an assigned period on UK domestic transactions for approved charities.



03 SECURE TRANSACTION TECHNOLOGY: AUTHENTICATION AND AVS

It's in everyone's interest that your transactions are processed securely. Indeed, schemes are willing to financially incentivize transactions processed with a high level of security. The reason is simple enough: fraudulent card use leads to financial loss.

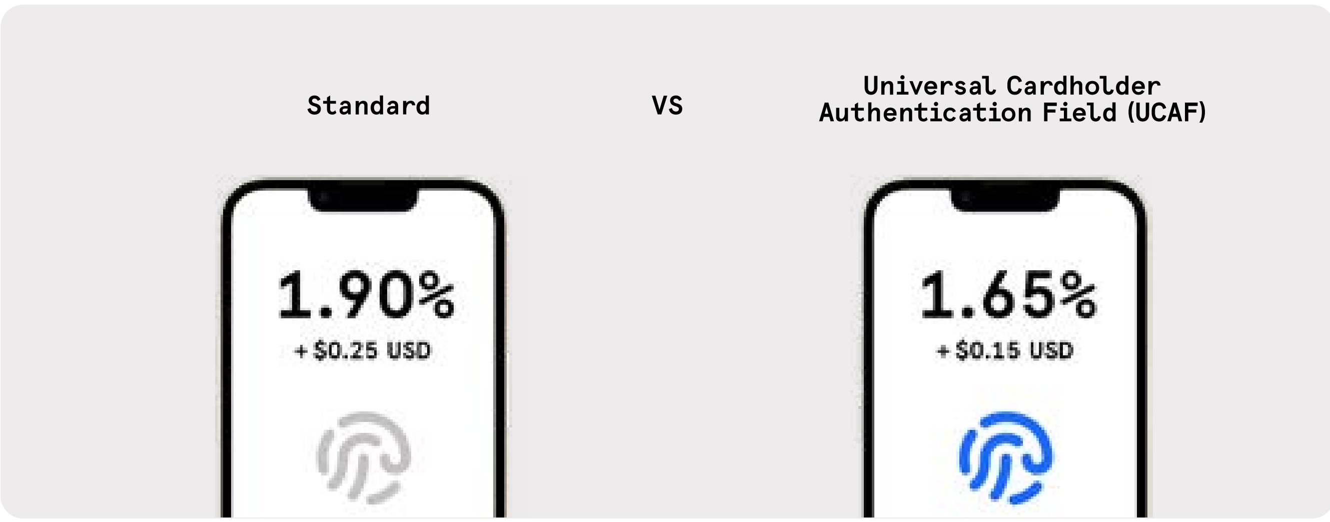
Additional authentication protocols can secure better rates. For instance, you can use 3DS to help with fraud filtering, and send a signal to the relevant card scheme that your payment request is more secure.

In the US, for example, there is a five basis point reduction in Visa Consumer Debit (non-regulated) ecommerce rates if 3DS is used.

It's generally better to include the ZIP code (or international equivalent) with your transactions.

In the US, Visa and Discover will downgrade the interchange category (i.e. impose higher rates on certain transactions) without it.

Collecting address details from your customer means you can make use of [Address Verification Service (AVS)](). In the US, this means you could avoid the Visa Transaction Integrity Fee of $0.10 USD on certain card payments. Note that the Transaction Integrity Fee can be applied for reasons other than AVS absence: it's applied on transactions which do not qualify for Custom Payment Service (CPS) rates. Speak with your PSP advisor on fee management for more information on this.



Fees for unregulated Mastercard debit transactions when 3DS authentication is used

04 ADDITIONAL TRANSACTION DATA

The way you submit the payment request to your payment gateway can impact the final total of your interchange fees. If you are only sending us the bare bones of information per payment request, you may not be able to access the most cost-effective processing. As well as improving your acceptance rate, supplying additional data can secure preferable processing rates.

For example, when you submit additional Level 2 or 3 data on certain commercial card transactions in the US, you can qualify for a lower interchange fee.

Put simply, this involves submitting extra information about the transaction, such as the customer code, sales tax amount, and merchant postal code (Level 2) or the unit of measure, product code, freight amount, and line item details (Level 3 data, commonly used in B2B transactions).

There are different levels of interchange fee reduction, depending on the purchase amount and MCC. As these are particular to each merchant's individual circumstances, it's worth discussing with your PSP directly to see what can be arranged.

05 TIMELY SETTLEMENT

You should look to submit a settlement request as soon as possible after the payment is authorized. If you don't, the transaction may be downgraded, and incur a higher interchange fee. The window to aim for is 24 hours after the authorization. Some merchants choose to set up daily batch settlement requests in order to mitigate this.

In certain circumstances, daily batching is not necessary to avoid a penalty fee. The requirements vary by region or country. An example of where timely settlement can save you money on interchange is Mastercard domestic processing in Japan, where there is a 0.05% lower interchange rate if the transactions are settled within three days.

HOW ARE INTERCHANGE FEES CHANGING AROUND THE WORLD?

Historically, US credit card processing fees have not been subject to limits, unlike in the EEA (European Economic Area). However, US regulation on credit card fees is possibly on the horizon, pending a proposed new law known as the Credit Card Competition Act 2023. To find out more on interchange fee regulation in the US, take a look at our explainer on the Durbin Amendment.

Meanwhile, in the UK, the Payment Systems Regulator may propose a 0.2% cap on card-not-present debit transactions from EEA-issued cards to UK businesses, and a 0.3% limit on the equivalent consumer credit transactions.

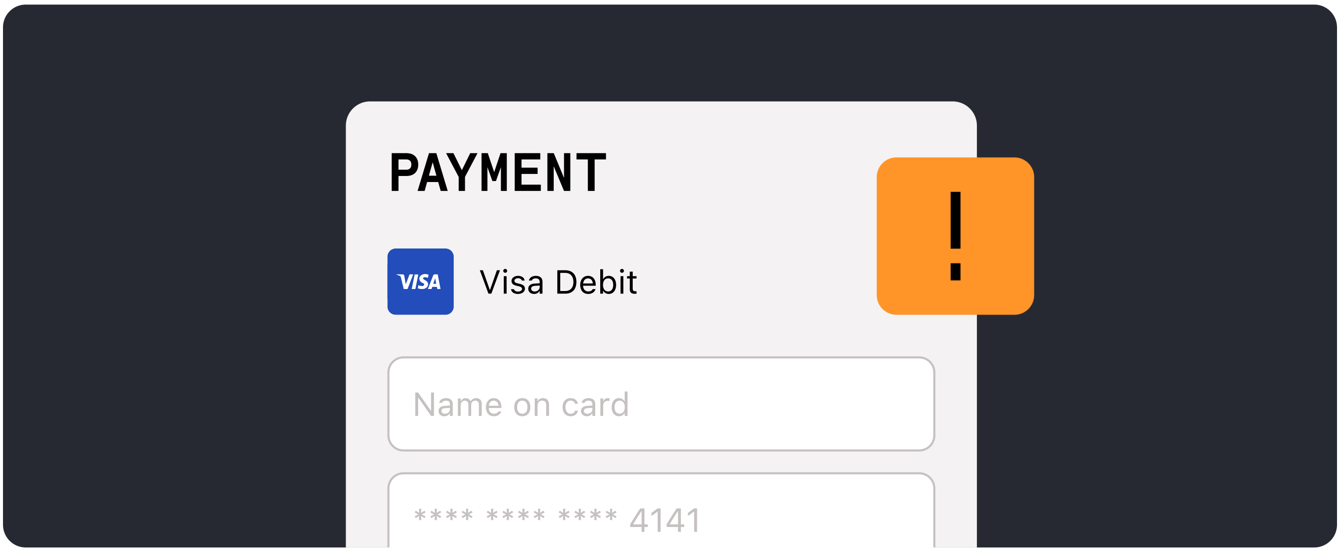
SCHEME FEES

Keep on top of avoidable scheme fees

In order to maintain the security and network availability of payment rails, schemes will charge for certain processes that take place. It's worth being aware of the instances where you'll face additional costs for payment processes which you could avoid.

01

EXCESSIVE RETRIES



When you retry a card payment, you pay a fee. When you retry payments over and over, you pay more fees. Retrying the exact same payment request more than 15 times within 30 days (with Visa), will incur additional scheme fees.

In order to avoid wasteful spending on retries, you need to pay close attention to the response code you see when a payment is declined.

For instance, repeatedly attempting a transaction request for an invalid account will never be authorized, yet you will be charged $0.10 USD or $0.15 USD by Visa, depending on the payment location.

In our recommendation codes documentation, you can read more about which codes not to retry, and which ones mean a retry may be viable.

02

CHARGEBACK FEES

Chargebacks arise when a customer disputes a payment and the merchant does not successfully challenge it. You may not realize how widely these can impact your card processing costs, so it's important to interrogate your business strategy for handling and preventing these.

There are several costs associated with chargebacks, namely:

1. The cost of the payment reversal (the disputed payment amount)
2. A fee per chargeback (which can be $15-$100 USD each)
3. Costs associated with being on a dispute monitoring program (if your dispute ratio is too high)

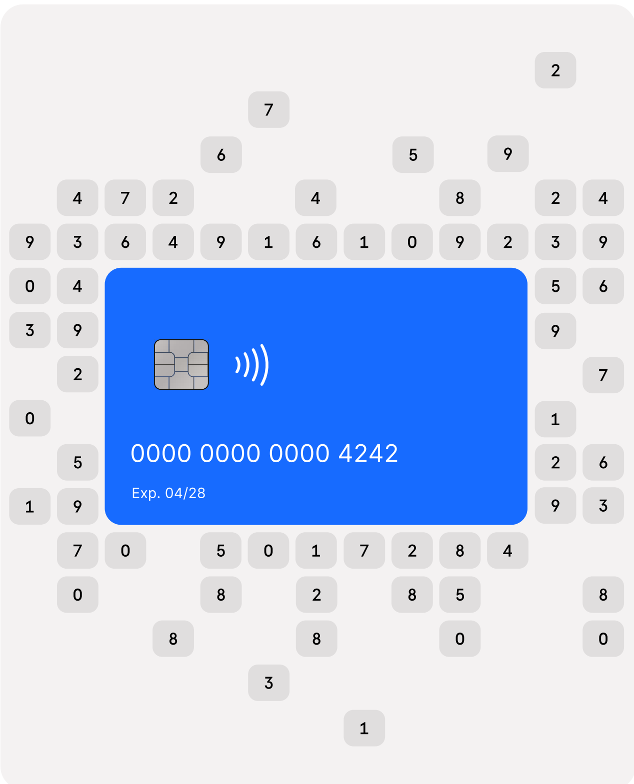
The second and third of those listed above are scheme fees. As payment disputes most frequently arise from claims of fraud, you need to ensure you're doing enough to prevent fraud.

It's also important to offer customer support that resolves payment concerns before your customer contacts their issuer to request a chargeback. You can read our in-depth guidance on chargebacks for more information about the causes, effects, and ways to reduce their frequency.

03 TOKENIZATION

Since 2014, major card networks have been promoting network tokens as a must-have in card payment processing. The schemes argue network tokenization – where the payer's full primary account number (FPAN) is shielded from interception by bad actors – helps to improve payment security.

Whether or not your business is willing to use tokens for payments deserves careful consideration. Although there is a "per token" charge, tokenization can achieve lower "secure" interchange rates in some scenarios.



Another way to look at this is that card schemes will charge a penalty (of up to 10 basis points) on card-not-present transactions that are not tokenized. For instance, UAE Visa domestic transactions that do not qualify for industry-specific rates incur 0.05% more interchange if they are not tokenized.

Furthermore, there is a reduction of 10 basis points 0.10% on Visa US Domestic Consumer Credit if the transaction is tokenized.

You will not always avoid extra fees from tokenizing your payments. Therefore, it's important to check the circumstances under which you'll incur additional fees for non-tokenized payments, via your PSP.

CONCLUSION

Handling complex payment processing fees

If you've learned one thing from this guide, it's likely that interchange fees are complicated. The charges you'll face are highly dependent on your individual circumstances, and the types of payments your customers make.

Scheme fees can be even more complex, as these are not generally published online. The price you pay for card processing can change according to your payment strategy, which means there are usually steps you can take to anticipate and manage costs.

It's worth a discussion with your payment services provider, to see how you can optimize payment processing costs.