

# Interchange

What it is. How it works.



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What it is. How it works.

And why it is fundamental to the Visa payments system.



It wasn't so long ago that consumers were limited to making purchases with cash and checks. But the search for a more convenient, secure and rewarding way to pay gave rise to the technology of electronic payments and Visa. Today, electronic payments have become an integral part of society and have aided the development of economies around the world. The success of electronic payments is dependent upon cardholders, merchants and financial institutions participating equally in the payments system. And interchange — the transfer rate exchanged between the merchant's and cardholder's financial institutions each time a Visa payment product is used — plays a critical role in motivating all participants to keep electronic payments secure, reliable and convenient.

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## The World's Best Electronic Payment System

Today, Visa connects hundreds of millions of people, governments and businesses in more than 170 countries. Whether paying for fuel or groceries, taking money out of an ATM when traveling, or buying supplies to increase sales inventory, using Visa makes payment faster, safer and easier for millions of people around the world.

Here are just some of the tangible benefits Visa delivers:

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### Benefits to Consumers

- Convenience: Secure access to funds anytime, almost anywhere
- Security: Safer than cash or checks; includes consumer protections
- Acceptance: Welcomed at millions of locations worldwide.
- Reliability: 24/7 network capability.
- Budgeting: Monthly record of transactions.
- Rewards: Airline miles, hotel points, cash back.

### Benefits to Merchants

- Increased sales: Potential for higher spend.
- Faster checkout: Decreased payment transaction time.
- Guaranteed payment: Low-risk payment.

- Greater risk management: Cardholder identity authentication.
- Potential cost savings: Streamlined back-office processes.
- Internet and phone sales: Easier online commerce and telesales.
- Customer loyalty: Cardholder rewards and promotions that can increase loyalty.

### Benefits to Global Economy

- Efficiency: Greater efficiency in commerce.
- Access: Greater access to modern financial services and global payments infrastructure.
- Global trade: Reduced risks in cross-border transactions.
- Travel and Tourism: Promotes easier, safer global travel.

### Visa facilitates global electronic payments between all participants



\* Includes merchant acceptance locations and ATMs in the Visa Europe territory  
Source: Visa Inc. for 12 months ending 12/31/2007



## Interchange — A Cornerstone of One of the Most Reliable Electronic Payment Systems in the World

Interchange is the transfer rate exchanged between the merchant's and cardholder's financial institutions each time a Visa payment product is used. Its primary role is to create the right balance of incentives between cardholders' financial institutions — which promote and issue Visa cards to consumers — and merchants' financial institutions — which enroll and process Visa transactions for merchants.

Interchange powers the payments system, which enables financial institutions to connect to merchants and cardholders all around the globe. It assures that financial institutions invest in the Visa system and the benefits that all cardholders enjoy — from protection against fraud to car rental insurance to airline miles to 24/7 customer service. And by balancing the economics among all participants, interchange encourages more merchants to accept Visa.

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### A Typical Transaction

Visa payment transactions take place every minute of every day in every corner of the world through VisaNet, the Visa network that connects merchants, merchants' financial institutions (acquirers), cardholders, and cardholders' financial institutions (issuers).

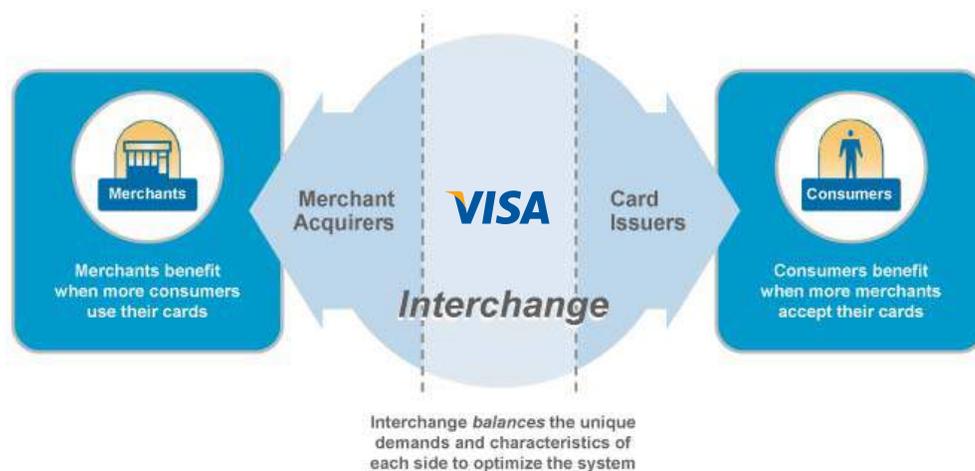


- A cardholder selects his or her goods, agrees to pay the retail price to the merchant and presents his or her card for payment.
- The merchant submits the purchase details, including the Visa card information, to its financial institution for approval.
- The merchant's financial institution sends the purchase details to the cardholder's financial institution.
- Assuming it has correctly followed the procedures required by its financial institution, the merchant receives a "payment guarantee," and the cardholder receives the goods.
- The cardholder's financial institution remits to the merchant's financial institution the retail price less the interchange rate. This interchange rate may be a unique rate that has been negotiated directly between the cardholder's and merchant's financial institutions, or it may be the default rate that is set by Visa.
- The merchant's financial institution remits to the merchant the retail price less the Merchant Discount or Merchant Service fee, which may include interchange; the cost of transaction processing, terminal rental and customer service; and the merchant financial institution's or processor's margin, among other costs. This charge is negotiated directly between the merchant's financial institution and the merchant.

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## The Market Forces of Interchange

The Visa payment system is a classic “two-sided” economic market that brings together and benefits two interdependent groups.



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### Doing Business in a Two-Sided Market

The Visa payments system is what economists call a “two-sided” market because it consists of two distinct groups — cardholders and merchants — that provide each other with benefits. Cardholders want a payment card they can use at as many merchants as possible. Merchants want to accept a payment card that is carried by as many customers as possible.

The newspaper industry is another example of an industry that must

balance the needs of two groups: readers and advertisers. Charging advertisers too much to run an ad in a newspaper would result in fewer ads, less revenue and a lower quality product that consumers might be unwilling to buy. Charging consumers too much or not having the content consumers want would diminish the readership base, making the newspaper less attractive for advertisers.

Like other two-sided economic models, the Visa payments system must balance the needs and desires

of all of those involved. If the cost to merchants were too high, many businesses would stop accepting Visa cards, thereby hurting the effectiveness of the system. Similarly, if the cost to consumers were too high, it would limit consumer use of Visa cards and, as a result, inhibit consumer spending.

## Frequently Asked Questions

### How does Visa set interchange?

Interchange is set in response to dynamic and highly competitive market forces and strikes the right economic balance between participants in the payment network. Among other things, it varies by the type of merchant, cost of the sale, payment product type, processing technology the merchant uses and region or country. For example, transactions at fuel merchants, quick service restaurants and car rental agencies each possess unique attributes that may require different interchange categories and processing strategies. Similarly, the type of payment product used (e.g., credit or debit) and how that product is used (e.g., face-to-face or over the Internet) affect the interchange rate and processing requirements.

### Who pays interchange?

The merchant's financial institution generally pays interchange. Merchants make a payment to their financial institution for Visa transactions, frequently referred to as a Merchant Discount or Merchant Service fee. This is a market-based fee set by each merchant's financial institution operating in a competitive marketplace — merchants can choose their financial institution in the same way cardholders can choose the financial institution that issues their Visa card. Interchange is only one component of this cost of doing business.

### How much is interchange?

Among other things, interchange may vary by the type of merchant, cost of the sale, payment product type, processing technology the merchant uses and region or country. For example, transactions at fuel merchants, quick service restaurants and car rental agencies each possess unique attributes that may require different interchange categories and processing strategies. Similarly, the type of payment product used (e.g., credit or debit) and how that product is used (e.g., face-to-face or over the Internet) affect the interchange rate and processing requirements.

### Can merchants negotiate interchange rates?

Merchants do not pay interchange directly. They pay a Merchant Discount or Merchant Service fee that they can actively negotiate directly with their financial institution. Interchange is a mechanism that helps manage a worldwide system made up of thousands of financial institutions, millions of merchants and millions of consumers.

### Are merchants suing you over interchange?

In some countries, such as the United States, merchants have chosen to attempt to negotiate their cost of accepting cards through litigation.

### Are interchange rates regulated?

In some countries, price controls have been imposed on interchange. Such regulation has only proved to harm consumers. In Australia, where interchange levels are regulated, merchants have increased their profits, while consumers have lost card benefits and choice. Consumers are also paying higher prices due to the check-out fees merchants can now charge.

### How much revenue does Visa gain from interchange?

Interchange is the transfer rate paid by the retailer's financial institution to the cardholder's financial institution for the vast majority of transactions. For ATM transactions, interchange flows in the opposite direction, from the cardholder's bank to the acquiring bank. It is part of financial institutions' cost structure.



## What You Should Know About Interchange

- Interchange is set in a highly competitive and dynamic environment.
- There is a cost to accept Visa cards, just as there is a cost to accept cash, checks and other forms of payment. For example, it takes time to count and deposit cash, and cash may disappear as a result of errors or theft. Checks can be delinquent or cause losses to merchants because of a lack of funds in the check writer's account. The cost to accept electronic payments may be more apparent to merchants, however, because they are directly billed for the service.
- Interchange is consistently monitored and adjusted — sometimes increased and sometimes decreased — in order to assure the economics and value of the transaction are balanced for all parties. Such adjustments enable Visa to expand the types of payments consumers can make with their cards, including payments for small-ticket items, rent, utilities and even mass transit.
- Merchants and consumers do not pay interchange. Merchants pay what is known as a Merchant Discount or Merchant Service fee, which is negotiated with their financial institution and may include interchange; the cost of transaction processing, terminal rental and customer service; and the acquirer's or processor's margin, among other costs. So imposing price caps on interchange would not necessarily lower a merchant's costs for card processing.
- Visa sets interchange in a manner that balances the value and economics among all parties that participate in the Visa network — merchants, financial institutions and cardholders. If interchange is too low, then cardholders' financial institutions won't issue cards; if interchange is too high, merchants won't accept them.
- Merchants have options for lowering their costs if they genuinely believe that their card acceptance costs are too high. They can provide discounts to those who pay with cash, or choose to accept only cash or checks. Or, merchants can shop around among competing financial institutions for the best prices.

