

REDUCE COSTS AND MAXIMIZE SAVINGS

# The Merchant's Guide to Lower Interchange Fees: **4 Strategies to Save Now**

Optimized Payments



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Your payments data  
isn't just a **record of  
transactions**; it's a  
roadmap to greater  
profitability.

# Understanding Interchange Fees

Interchange fees are one of the most significant costs for merchants accepting card payments. For businesses processing at least \$100 million in annual card sales, these fees typically account for around **80% of total payment processing costs**—including card network assessments, acquirers, and gateway fees.

At its core, interchange is the wholesale fee paid by merchants to the bank that issued the customer's card when a credit or signature debit transaction occurs. While these rates are set by Visa, Mastercard, and Discover, the revenue ultimately goes to the card-issuing bank.

For example, if a shopper uses a Citibank-issued Visa credit card to make a \$100 purchase at Macy's, and the transaction qualifies for an interchange rate of 0.80% + \$0.15, the total interchange fee would be \$0.95—paid by the merchant and received by Citibank.

While interchange fees are often viewed as an unavoidable cost, they play a critical role in funding the electronic payment ecosystem. Understanding how these fees are structured is the first step to optimizing costs and improving profitability.

## What Do **Interchange Fees** Pay For?

Interchange fees serve several critical functions within the payments ecosystem.

A significant portion of these fees funds the rewards programs that many cardholders enjoy, such as points, miles, and cashback incentives. These perks, while appealing to consumers, come at a cost—one that is largely subsidized by interchange revenue.

Interchange fees also cover the "cost of money." When cardholders use their credit cards for purchases and pay off their balances in full each month, they essentially receive an interest-free loan from their card issuer. This short-term lending is made possible, in part, by the interchange fees merchants pay on every transaction.

Beyond rewards and lending, interchange fees help banks manage operational costs, including fraud prevention, chargeback handling, and maintaining the infrastructure that enables secure card transactions. These behind-the-scenes expenses ensure the reliability and security of electronic payments.

Finally, interchange fees are a profit driver for issuing banks. A study we reviewed a few years ago found that **40–45%** of the interchange revenue collected by banks contributes directly to their bottom line.

## Navigating the **Macro and Micro Factors of Interchange Fees**

If you were to download Visa, Discover, and Mastercard's interchange tables and add up all the unique rates, you'd find that there are over 700 different interchange rates. This complexity leaves many merchants asking:

**“Why are there so many interchange rates, and what makes them so complicated?”**

The answer lies in a mix of macro-level industry trends and micro-level transaction details that influence how interchange fees are structured. Economic factors, competitive pressures, merchant classification, and transaction details all contribute to the evolving landscape of interchange pricing.

While many of these variables are beyond your control, others can be actively managed to optimize costs. Understanding these distinctions is key to reducing unnecessary fees and improving overall payment efficiency.



# Macro Considerations

## Competition Amongst Card Networks

Visa and Mastercard dominate the U.S. payments industry, but their real competition is for bank partnerships—not consumers. Because banks rarely switch networks, card brands offer incentives—like higher interchange rates—to attract issuers, ultimately driving costs up for merchants rather than lowering them.

This competition among card networks drives interchange rates higher rather than lower. A higher interchange rate means greater revenue for the issuing bank, making a network's offering more appealing. As a result, networks may increase interchange fees to entice banks, ultimately impacting merchants who bear the cost.

## Card Network and Issuer Strategies

Card networks and issuers share a common goal: to increase transaction volume. One of the key ways they achieve this is by expanding into emerging markets and new payment environments.

Fifteen years ago, most vending machines and parking meters only accepted cash. Today, many of them take credit and debit cards—thanks to targeted efforts by card networks and issuers. By creating new interchange categories tailored to small-ticket transactions, they made card acceptance more appealing for businesses in this space.

The same strategy has been applied to industries like utilities and grocery stores.



To encourage card acceptance in these high-volume, lower-margin sectors, networks introduced specialized interchange categories with capped fees, making electronic payments more viable for merchants in these verticals.

These strategic shifts help networks and issuers expand their footprint, while also shaping the broader payment ecosystem—affecting how and where consumers use their cards.

### 3. Legislation

If you recall, the Durbin amendment went into effect in October 2011, creating a new set of interchange rates for regulated financial institutions and capped debit interchange fees at 5 basis points and 22 cents.

## Micro Considerations

### Merchant Category Codes (MCC)

Your merchant category code (MCC) plays a critical role in determining your interchange rates.

An MCC is a four-digit number that classifies your business type, and different industries are assigned different interchange rates. Of the 700+ interchange rate categories, many are industry-specific—meaning businesses in sectors like airlines, hotels, restaurants, and e-commerce have designated rate structures based on their MCC.

## Type of Card

Not all Visa or Mastercard transactions are charged the same interchange rate. Card type matters—whether it's a traditional rewards card, a corporate card, or a signature debit card.

Additionally, the method of entry affects fees. Transactions where the card is physically swiped, dipped, or tapped often have lower interchange rates than those entered manually. In general, card-not-present (CNP) transactions, such as online purchases, carry higher interchange fees due to increased fraud risk.

## Risk of Transaction

The risk level of a transaction also impacts interchange rates. Transactions deemed higher risk—such as CNP purchases or those lacking proper authorization—typically incur higher fees. However, merchants can control some of this risk by adhering to card network compliance standards, implementing fraud prevention measures, and ensuring proper transaction security protocols.

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While many of these variables are outside of your control, others can be actively managed to reduce costs. Understanding the difference between controllable and non-controllable factors is an important step toward minimizing unnecessary expenses.

# Controllable Vs. **Non-Controllable Variables**

One factor that cannot be changed is your Merchant Category Code (MCC), which is assigned by your acquirer during the underwriting process. While you cannot alter your MCC, you should verify its accuracy because misclassification can result in higher interchange fees than necessary. While some businesses may benefit from a more favorable classification, correcting it may not always be in their best interest. Ensuring your MCC is correctly assigned helps maintain transparency and compliance.

Another factor outside your control is the method of entry—whether a card is swiped, dipped, tapped, or keyed in manually. Additionally, transaction size (the total purchase amount) also impacts interchange fees, but as a merchant, you have limited influence over how much customers spend per transaction.

While these factors cannot be changed, there are key variables merchants can control to optimize interchange fees. By focusing on these areas, you can take proactive steps to minimize costs—leading us to our four strategies for interchange optimization:

## Strategy #1

# Utilizing Address Verification System (AVS)

Address Verification Service (AVS) is a fraud prevention tool used for card-not-present (CNP) and manually keyed Visa and Discover transactions. AVS compares the billing information provided by the customer at checkout with the billing details registered with the card issuer.

At a minimum, AVS requires a zip code match, but you can also submit the numeric portion of the street address for additional validation. For example, if a customer's billing address is 123 Elm Street, Atlanta, GA 30346, the numeric values—123 and 30346—can both be sent for verification.

When a CNP or keyed-in transaction occurs, you have the ability to transmit both numeric values to their acquirer, which then forwards the information to the card network and issuer for validation. However, many merchants only submit the zip code, missing an opportunity to enhance security and optimize interchange fees.

While Visa and Discover are the only networks that require AVS, it is a best practice to use AVS for all card types. Proper AVS usage can lower interchange rates, while failing to use it can result in higher fees.

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**Zip code is minimum, but address is recommended.**

Submitting both values is highly recommended and should be utilized for all transactions.

**For Card Not Present Keyed/Ecommerce, AVS must only be an attempt**

With card-not-present transactions you must make an AVS attempt. However, if there is a mismatch it will not result in a downgrade, meaning you'll pay the same interchange fee regardless if the AVS is successful or not.

**For Card Present Keyed Transactions, AVS must match at least on the zip code**

With card-present transactions, AVS requires a match on the zip code - meaning whatever the consumer types in, must match what's on file with the card issuer.

## Strategy #2

# Adhering to Authorization and Settlement Timelines

The phrase "time is money" doesn't just apply to personal finance—it's just as relevant to interchange optimization. Every transaction has a preset time limit for processing, and if these limits are exceeded, the transaction will downgrade, leading to higher interchange fees. To avoid unnecessary costs, it's crucial to process transactions within the optimal timeframe.

Here are a few general guidelines to help you stay within these limits:

### Settle transactions within 24 hours of the purchase date

If you are in a retail environment, settling transactions within 24 hours from purchase date is optimal. Most card networks allow two days for optimal timing, but setting your limits at 24 hours assures enough time for your POS system, gateways, and processors to clear to the associations.

Most retailers have automated systems that auto close at the end of the day, depending on where you're located it might be midnight or 1:00 a.m. However, in an e-commerce environment there has to be additional business rules to maintain those authorizations and keep them as "fresh as possible."

## Authorization Holds for Card-Not-Present Transactions

For Card-Not-Present (CNP) transactions, merchants can hold an authorization for up to seven days before settlement. Ensuring timely settlement within this window prevents downgrades and additional interchange fees.

E-commerce merchants typically authorize a transaction at the time of purchase but settle upon shipment. If shipping occurs within seven days, the authorization remains valid. However, if delays occur—such as an out-of-stock item—it's crucial to reverse the original authorization and obtain a new one to reset the authorization period and avoid costly downgrades.

### Strategy #3

# Leveraging Level II and III Data

In the United States, there are two primary types of payment cards: consumer cards and commercial cards. Commercial cards are used by businesses of all sizes and can be further categorized into:

- ✓ Business cards - Typically used by small businesses.
- ✓ Corporate cards - Used by larger businesses and enterprises.
- ✓ Purchasing cards - Designed for procurement and expense management.

Whether you realize it or not, your business likely processes commercial card transactions. If a significant portion of your transactions involve commercial cards-something that can be identified through interchange analysis-you can reduce interchange costs by sending Level-2 and Level-3 data in your settlement files.

### Why Does Enhanced Data Lower Interchange Fees?

Card networks incentivize merchants to send enhanced transaction data because it provides corporations with greater insights into their employees' spending. Enhanced data helps businesses:

- ✓ Track the amount of sales tax paid, which supports financial reporting and tax compliance.
- ✓ Identify SKU-level purchase details, offering better insight into spending patterns and procurement strategies.

By providing this enhanced data, you benefit from significantly lower interchange rates, making it a valuable strategy for interchange optimization.

## Level 2 vs. Level 3 Data Requirements

There are two levels of enhanced data that merchants can send: Level-2 and Level-3.

### Level-2 Data Requirements

- ✓ Merchant demographic information (e.g., tax ID, state, ZIP code, etc.)
- ✓ Customer code (a custom identifier for the cardholder or merchant-defined field)
- ✓ Sales Tax Indicator
- ✓ Sales Tax Amount

**Note:** If you process tax-exempt transactions (e.g. selling to schools or nonprofits), those transactions will not qualify for Level-2 interchange rates unless a non-zero tax amount is reported. *Some exceptions apply to Mastercard transactions.*

### Level 3 Requirements

Level-3 data is more detailed and requires additional transaction information. However, merchants are only required to submit a minimum of one line-item SKU per transaction.

Even if a customer purchases 100 different SKUs in a single order, submitting a single line item is sufficient to qualify for Level-3 interchange rates.

Unlike Level-2, Level-3 transactions can qualify even if sales tax is zero.

## Cost Savings from Level 2 and Level 3 Data

Interchange rates decrease as merchants move from Level-1 (standard data) to Level-2 and Level-3. Here's a breakdown:

- ✓ Level 1 - Basic transaction data (same as consumer card processing)
- ✓ Level 2 - Includes sales tax and customer-specific data
- ✓ Level 3 - Includes SKU-level details, offering the highest savings

Depending on the category, the interchange rate difference between Level 1 and Level 3 transactions can range from 5 to 165 basis points. This means for every \$10 million in commercial card volume, merchants can save approximately \$100,000 by submitting Level-3 data.

For example, one of our clients processed \$400 million in commercial card transactions annually. By implementing Level-3 data submission, they saved \$5-6 million per year in interchange fees. The potential savings are substantial and should not be overlooked.

By strategically optimizing how you process commercial card transactions, you can take full advantage of interchange savings while providing valuable reporting benefits to your customers.



## Strategy #4

# Least Cost Debit Routing (LCR)

Another key strategy for optimizing interchange fees is Least Cost Debit Routing (LCR). This strategy applies specifically to debit card transactions. If you examine a debit card, you'll typically see a Visa or Mastercard logo on the front and one or more EFT (Electronic Funds Transfer) network logos on the back.

EFT networks include Pulse, NYCE, STAR, Interlink, and Accel. With the Durbin Amendment, implemented in October 2011, issuing banks are required to enable multiple payment networks on each debit card. This gives merchants flexibility in how they route debit transactions, allowing them to choose the most cost-effective option.



## How Least cost Debit Routing Works

When processing a debit transaction, merchants (or their payment processors) can determine the cheapest routing path for each transaction. The routing decision typically involves:

**Choosing between Signature or PIN Debit Rails** – Transactions can be processed through Visa/Mastercard (Signature) or an EFT network (PIN Debit).

**Selecting the Lowest-Cost PIN Network** – If multiple PIN networks are available, merchants can dynamically route transactions to the network with the lowest interchange fees.

Some merchants handle LCR internally using BIN tables, while others rely on their acquirer or processor to perform routing on their behalf.

While LCR is more relevant for brick-and-mortar retailers, eCommerce merchants are increasingly able to leverage it.

## Implementing a Least Cost Debit Routing Strategy

There are multiple ways to implement LCDR, each with different levels of control and complexity:

- ✓ **Acquirer/Processor Directed Debit Network Routing** – The acquirer automatically routes transactions to the most cost-effective network.
- ✓ **Merchant-Directed Least Cost Debit Routing** – The merchant directly controls which networks are used.

- ✓ **Cost-Based LCDR** – The system calculates all eligible interchange levels and dynamically routes transactions to the lowest-cost option.
- ✓ **Card-Present PINless Debit Routing** – Some debit cards allow routing through a PIN-based network without requiring the cardholder to enter a PIN.
- ✓ **Card-Not-Present PINless Debit Routing** – A growing option for online merchants, enabling debit transactions to route through PIN-based networks without requiring a PIN.

LCR can significantly reduce interchange fees, as routing through PIN debit networks often incurs lower fees than Signature debit transactions. The potential savings can be substantial, especially for high-volume merchants.

By implementing a well-structured LCR strategy, you can further optimize interchange costs while maintaining payment flexibility and security for their customers.

While interchange optimization may seem complex, the potential savings make it a worthwhile investment. Businesses that actively manage their interchange fees can unlock substantial cost reductions, improve operational efficiency, and maintain competitive pricing. By taking control of the factors within your reach and implementing these strategies into your business, you can significantly reduce your overall payment processing expenses and maximize profitability.

## Key Takeaways

By proactively optimizing the following areas, you can take greater control over your payment costs and drive meaningful savings.

**Utilizing Address Verification System (AVS)** – Implementing AVS on card-not-present and manually keyed transactions can reduce fraud risk and qualify transactions for lower interchange rates.

**Adhering to Authorization and Settlement Timelines** – Ensuring transactions are processed and settled within optimal timeframes helps prevent downgrades to higher-cost interchange categories.

**Leveraging Level II and III Data** – Providing enhanced transaction data for commercial card payments can lower interchange rates and improve reporting for business customers.

**Implementing Least Cost Debit Routing (LCR)** – Routing debit transactions through lower-cost PIN networks instead of defaulting to Visa/Mastercard's signature rails can significantly reduce interchange fees.

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**Want to uncover hidden savings in your payments?** Our team of experts can help you identify cost-saving opportunities and implement strategies tailored to your business.