Scheme fee management: how acquirers can optimise their margin

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Introduction

The card payments industry show high growth rates as the consumer preference to non-cash transactions is driven by the growth in online and mobile commerce. Furthermore there is an increasing usage of cards for low-value transactions. This trend has even been accelerated by the impact of Covid19 on the shopping behaviour of consumers.

The rapid changes in the card payments industry have an immense impact on the merchant acquiring industry and how acquirers cope with these market forces to achieve their growth strategies. There are several factors driving these changes:

- Changing payment needs of consumers towards more online and mobile
- Regulatory compliance matters
- Fraud and Security concerns
- Emergence of non-banking players

The payment networks, like Mastercard and Visa, are constantly revising their network standards and pricing and fee structure to the rapid changes in the card payment industry. Merchant Acquirers who act as link between merchants, issuers, and payment networks in the whole process of card payment transaction processing need to cope with these changes. This will make the difference to which extent acquirers are able to be and remain successful as these pricing and fee structure changes have an immense impact on margin, compliance and (payment) processes. Besides merchant acquirers also merchants, issuing banks and other stakeholders like investors are impacted.

In this paper we will discuss the key drivers of recent pricing and fee structure changes and successful methods for stakeholders to maintain or increase their margin.

Basics of scheme fees

The Interchange[1] Fee Regulation (IFR) which was accepted by the European Parliament and took effect on June 8, 2015 ensured that card schemes must manage their processing activities from the rest of their operations independently. The reason for this ruling is to prevent card schemes from favoring their own processing entities over processing entities of competitors. Furthermore this also prevents card schemes to hook customers with bundling processing services with other services. As a result the card schemes split their services in broadly 3 ways: Scheme, Switching and Services.

Under Scheme, the card schemes are charging fees that are related to their brand and market development funds. Some examples of fees are 1) Volume / Assessment fees, 2) Market development funds 3) Innovation funds and 4) Marketing funds. Fees that are related to the usage of the scheme processing network are called Switching services. Main fees are 1) Clearing fees, 2) Authorization fees and 3) Cross border fees. Finally card schemes offer a wider range of services for which the charge fees. Most common fees 1) License fees, 2) Reporting fees, 3) Consultancy & Project related fees.

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[1] Interchange fee is the term used for fees between banks for the acceptance of card-based transactions. Usually it is a fee for facilitating transactions that a merchant's bank (the "acquiring bank") pays to the customer's bank (the "issuing bank”).

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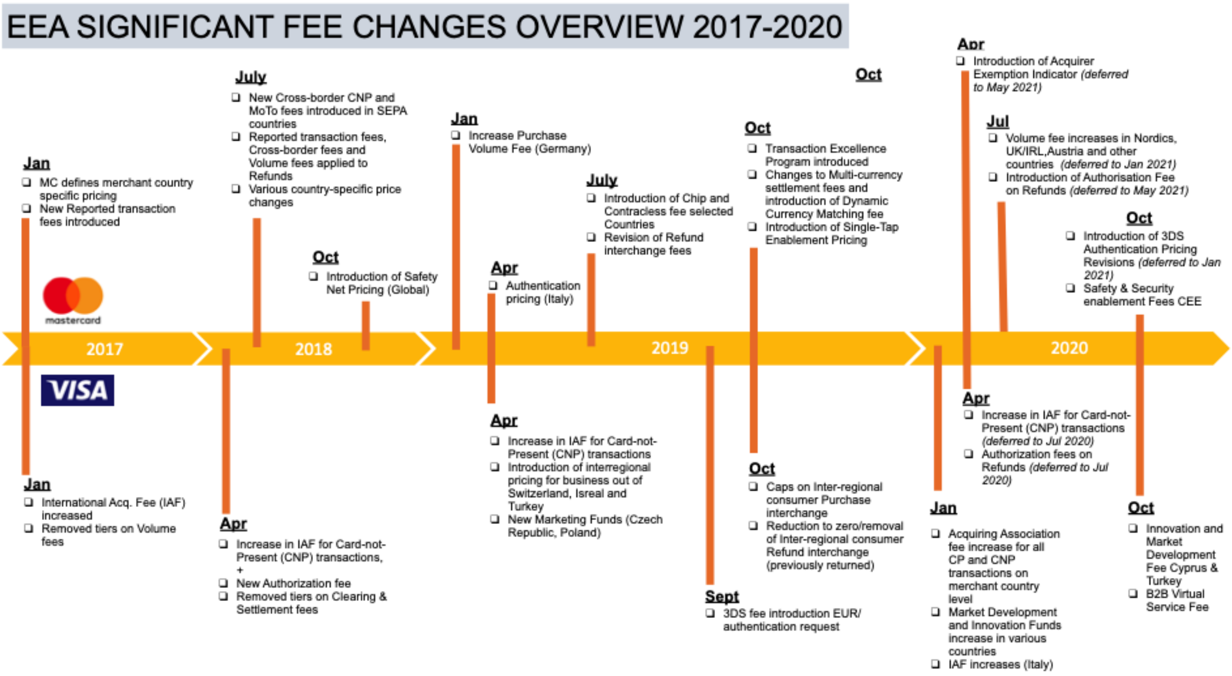
The card schemes are free to set their fees and fee structure. Therefore we see multiple fees, which have a different setup and vary independently from one another. There are over 50 different cost elements linked to various scheme fees, triggered by very distinct transaction nature. For example volume fees which are triggered based on regional definitions of the transactions (i.e. domestic, intra regional or extra regional transactions). Or country specific fees or country specific exceptions.
Card schemes are constantly revising their network standards and pricing & fee structure. Therefore acquirers, merchants and other stakeholders are faced with new developments which impact their margin.

Recent high impact pricing & fee structure changes

See overview below of EEA changes in card scheme fees of Mastercard and Visa in the period 2017-2022 which are currently known (July 2021).



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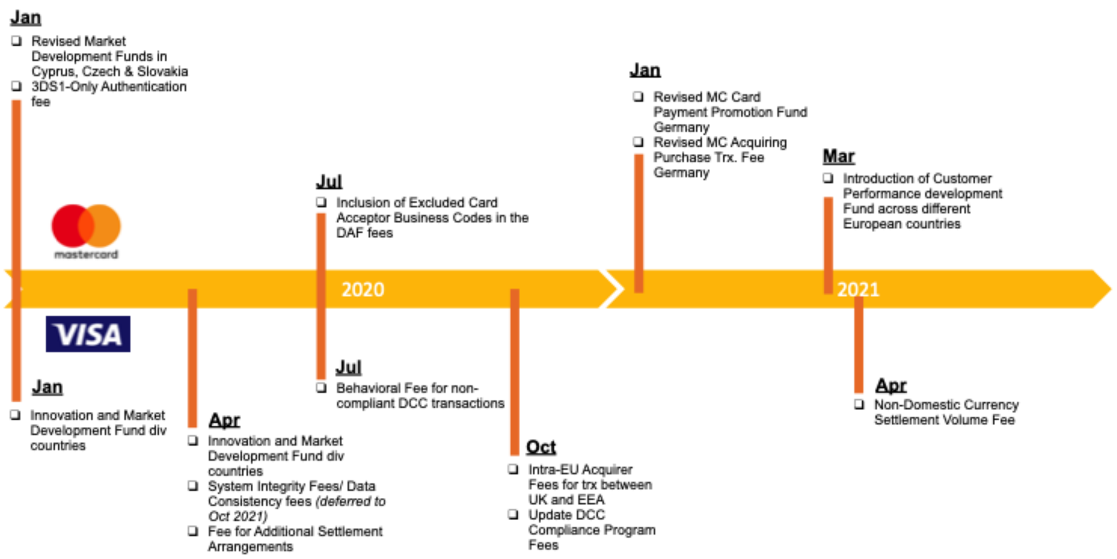
EEA SIGNIFICANT FEE CHANGES OVERVIEW 2021-2022



Successful methods for stakeholders to maintain or increase margin

As card scheme fees are the second biggest acquiring cost (after interchange) any change of the card schemes in pricing and fee structure impacts margin. Furthermore the focus of card schemes in generating revenue is more and more through fines and non compliance fees, for example like the introduction of the Mastercard Single Tap and Visa System Integrity fees.
This emphasises the importance for acquirers and merchants to know and manage the changes in fees and fee structure as well as insight in their card scheme cost and future card scheme cost exposure. Basically, there are then 2 ways of margin management on the scheme cost side.

The first method is scheme fee management through pass through of card scheme fee changes.

- Reconciliation and control of card scheme fees. The process of continuously monitoring the pass through and calculated scheme fees versus the actual invoiced scheme fees provides insight in card scheme fee configuration issues which causes margin loss.

- Timely and correct adjustment of fee changes to merchants. For merchants that are on a blended[2] rate this means that the merchant service charge need to be adjusted. This can be done in different ways, like using markups specifically for the card scheme change. For merchants on an Interchange ++ pricing[3], the card scheme fee component needs to be adjusted. According to the way the IC ++ pass through has been set up, the configuration of the card scheme fee component needs to be adjusted.

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[2] Blended pricing is a type of pricing where the merchants pays an average cost plus a fixed markup for every transaction

[3] IC++ pricing is a type of pricing where the cost are based on three components:
- Interchange fee paid to the issuer bank
- Card scheme fees
- Acquirer fee

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- Pass through or fix of merchant related scheme fees. These type of card scheme fees occur when a merchant is non-compliance with the standard processes. An example is the Mastercard final authorization fee which is charged when the final authorization is not meeting requirements (i.e. clearing transactions is not sent within 7 days of the authorization or the clearing transactions has a different amount).

The second method is scheme fee management through optimisation.
There are several areas for optimising scheme fees, which will have the effect of lowering card scheme fees. To which extent optimisation is possible in each area depends on the characteristics & current setup of the acquirer.

- FX currency conversion optimisation. By optimising the currency conversion flows acquirers are able to cut FX cost from the schemes which are in general higher than spot rates.
- Avoidance of scheme fees by bilateral processing. In case bilateral agreements with issuers are possible, the acquirer and issuer are able to avoid specific scheme fees.
- Incentives from card schemes. The card schemes incentivise specific areas and markets for which cash back and benefits in kind could be received.
- Waivers for and fixes of non-compliance fees and fines. In some cases the card schemes are willing to discuss waivers for areas of non-compliance and specific fines.
- Various fixes and actions to lower scheme fees. By analyzing the total scheme fees some invoiced items could be fixed or mitigated by using a different setup.

Final thoughts
If you are interested to get more insight on the scheme fee changes 2021 and 2022 or if you want to learn more about innovative ways of margin management on the scheme cost side, please contact us for the full article.

Besides card scheme fee management the other major cost components for acquirers: Interchange fees and Processing/Switching fees also have diverse possibilities of optimising and streamlining. Please subscribe for our newsletter and don’t miss out on any future articles.

About the author of the article
Dinesh Badal cooperates with Connective Payments since 2017. Having worked for multiple acquirers, processors and major Banks across Europe Dinesh is specialised in optimising Card Scheme Fees management and margin management processes. He focuses on margin improvement and (financial) control in payments.