

ATFS Bulletin June 2021 – Visa Interchange Increase

Those that pay attention to these bulletins will recall that the January issue covered interchange increases announced by Mastercard. These applied to UK customers purchasing goods and services from the EEA. Eagled eyed amongst you will have spotted the announcement last month from Visa. For some reason this did not gain as much press coverage as Mastercard's, but Visa's increases are being applied bilaterally: transactions using UK-issued cards at EEA merchants and EEA-issued cards used with UK merchants will receive the updated interchange rates. So, for a University, this will especially impact on all cardholder not present transactions for fee and accommodation payments from EEA students.

Like Mastercard, from October 2021, Visa will also be treating the UK as outside the EEA, meaning that the EU capped interchange levels for consumer cards that have been in place since 2015 will no longer apply. Note that this will only impact on cardholder not present transactions or in other words any transaction that is not face to face. Unfortunately, that doesn't really help the sector much as most foreign card payments are online rather than F2F. This is because the student will open a UK bank account once they are here and will then typically use their debit card.

Card Acquiring Basics

So, let's just run through the basics of card pricing once again. Interchange is one of the three elements of the cost of a card transaction:

- **Interchange:** This is the fee that your acquirer will pay to the issuing bank; it is the same, regardless of who your acquirer is. Its level depends on the card type, how it is processed (including how securely) and where it was issued.
- **Scheme/Assessment Fees:** This fee is paid to the scheme to which the card belongs - primarily Visa and MasterCard. It is charged both on the value of the transaction and as a pence per transaction fee (PPT). Both elements vary considerably, depending on the broad card group e.g., Visa Debit, where the card was issued and how it is processed. Scheme fees across the acquirers are broadly similar, but the differences should not be ignored.
- **Processing Fee:** This third element is kept by the acquirer; it is the only element they have complete control over. It can also be charged on an ad valorem basis or by PPT and of course covers all acquirer costs.

Interchange and scheme fees are set depending on which part of the world the card is used. There are three regions: **Domestic**, which are cards issued in the UK, **Intra-Regional** - cards issued in the EEA and **Inter-Regional**, which are cards issued anywhere in the rest of the world.

The three pricing elements can be combined into three different pricing models:

- **Blended:** This combines the three elements into a price for each card or group of cards. The processing fee is hidden in the blend and will vary across different cards. It is the least transparent pricing model.
- **Interchange Plus (IC+):** This combines the processing and scheme fees into a single fee, with interchange applied separately. Whilst more transparent, some blending can still occur across different card types/groups.
- **Interchange Plus Plus (IC++):** This is the most transparent form of pricing; the three elements are shown separately in the merchant statement. The lack of blending ensures the acquirer charges the same processing fee for every card transaction.

What are the Changes?

The following interchange rates will only apply to cardholder not present transactions taken on cards issued within the EEA. We understand this to be from the middle of October:

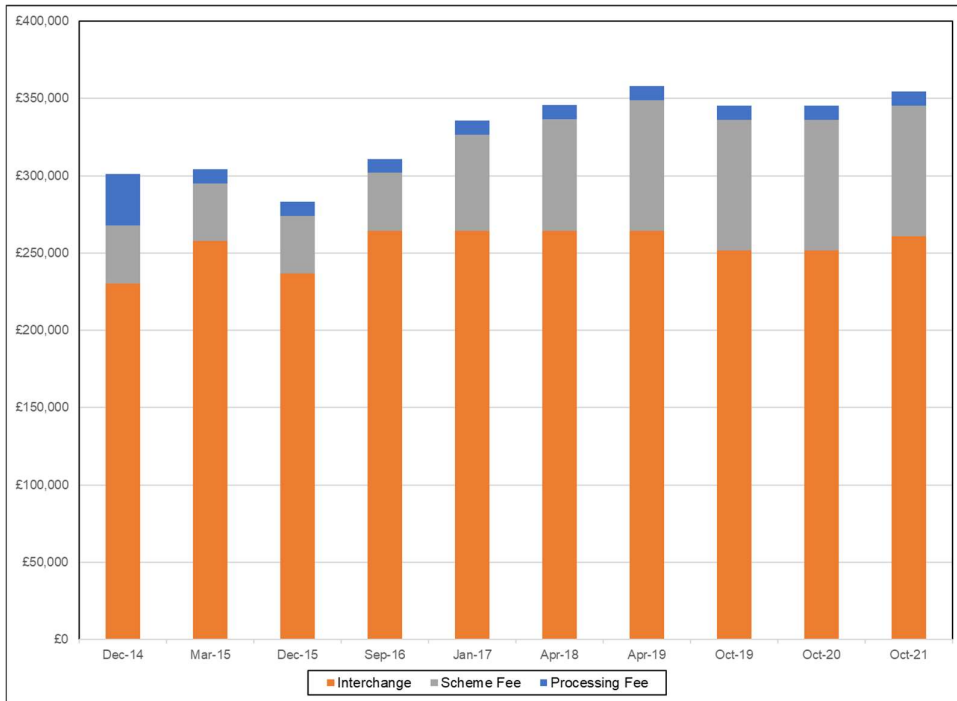
- Consumer debit cards are increasing from 0.20% up to 1.15%
- Consumer credit cards are increasing from 0.30% up to 1.50%

These are the key impacting changes, but there are also changes to commercial rates; these are not all increases. For example, Corporate/Purchasing cards (currently between 1.55% and 1.90%), will be set at 1.80%.

What's the Impact?

For the WPM Webinar held earlier this year in February, ATFS made a presentation on what should be taken into account when considering whether to review/negotiate or tender card acquiring arrangements. Included were graphs showing the impact of changes to interchange and scheme fees since before the EU interchange caps were applied in 2015. Several have been updated for the bulletin. For the graphs, we used the data for a north-east England University client, based on December 2014 values and volumes.

Graph 1 – Cost impact of Interchange and Scheme Fee changes since early 2015 – Stable Activity

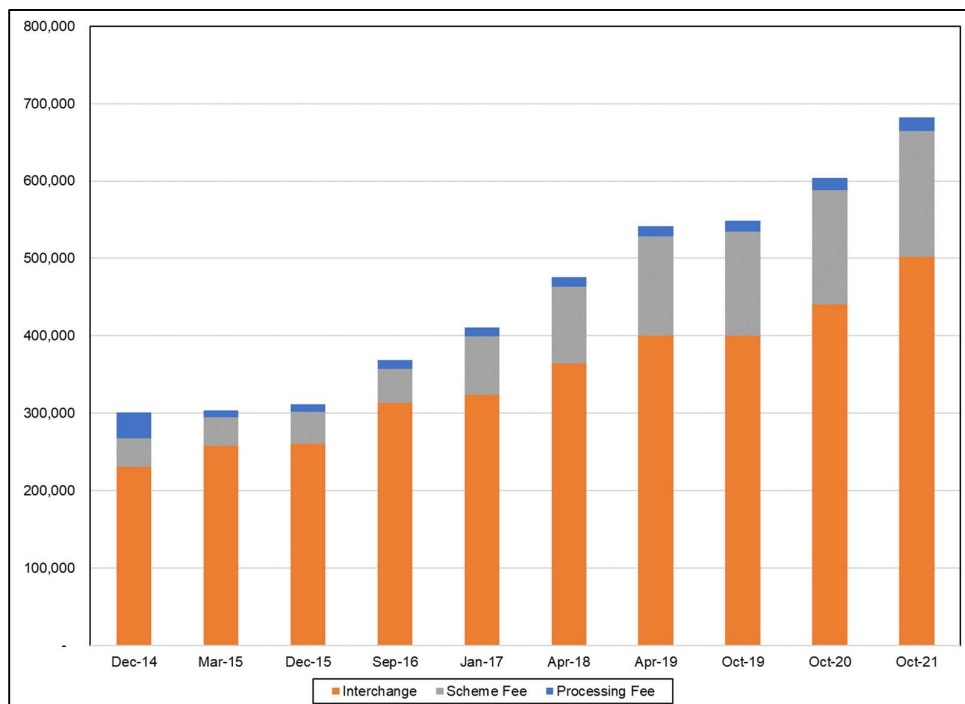


This graph shows the impact of all significant interchange and scheme fees from December 2014.

It starts with blended pricing, into I/C++, the Dec. 15 EU levels, removal of cost caps, the series of scheme fee increases seen, through to the October changes to come.

Assuming no increase in value/volume over the years, costs increased by £30,600 or 18%, with the upcoming increase accounting for c£9k.

Graph 2 – Cost impact of Interchange and Scheme Fee changes since early 2015 – 10% Annual Increase



This second graph shows a more realistic outcome based on an annual growth in value & volume of 10%.

Over the whole series, costs have increased from around £301k up to around £682k – equivalent to an increase of some 125%.

Based on this pattern, the October increases would see the interchange cost for this University rise by over £61k.

Can this be mitigated in any way?

Pricing Model: Move away from blended pricing. The last six years has seen a significant shift across the sector. Most acquirers have been promoting interchange plus plus as the preferred pricing model for the sector and to a lesser extent, IC+. ATFS has also played a part; we have now competed over 100 reviews and tenders across the sector, working closely with Finance and Procurement Teams. The recent WPM acquirer surveys have shown that the proportion of respondents on blended pricing has significantly reduced, to circa 25%. This is much improved, but there is still work to be done.

Introduce Dynamic Currency Conversion (DCC): For the uninitiated, in simple terms, DCC is the process that allows the cardholder to pay in their own currency, as opposed to Sterling. From the University's perspective, this is a process that allows it to reduce its acquiring costs through benefiting from the foreign exchange transaction that takes place when it receives Sterling, but the cardholder has paid in their own currency. The transaction involves a foreign exchange transaction and the DCC process allows the university to receive a proportion of the value of the foreign exchange spread built into the transaction. All Universities can benefit from DCC; this enables acquiring costs to be reduced as well as allowing the student to pay in their own currency. The largest Universities we've worked with receive a rebate of over £100k – a significant reduction to their costs.

There are several points worth noting. Firstly, for the cardholder the DCC process is voluntary; forcing it is against card scheme rules and there are several points within the payment process where the cardholder can decline. Secondly, the reader should note the foreign exchange deal occurs regardless of the choice made by the student at the time of the transaction. With DCC, the cardholder has some control over the process and will know at the time of the transaction what exchange rate is applied. If Sterling is chosen, the rate will only be known when the card statement is received, or the account viewed online.

There is a range of factors affecting the financial benefit of DCC, including the student nationality mix and the different approach of each acquirer. Further detail on this may be the subject of another bulletin later in the year. Many Universities already benefit from the provision of DCC, but we have found multiple instances where the conversion level has been below the sector average. Reasons can include turnover of staff, poor staff training or lack of online visibility to the cardholder. Accordingly, it is just as important to ensure that the DCC uptake keeps at the expected level as it is to introduce it in the first place.

Review or tender your Card Acquiring for the best deal: Last year's WPM acquirer survey results showed that nearly half of the sector hadn't changed their acquirer in the last 5+ years, but also found that one-third of institutions said they plan to review their acquirer in the next twelve months. If you are one of those, any colleagues likely to be involved will find this bulletin useful as the survey also found that transaction costs and achieving "Value for Money" was the most important factor when choosing an acquirer.

Timing: With these increases scheduled for the middle of October, it's doubtful at this relatively late stage whether a university would be able to accelerate fee and accommodation deposits or full payments if they are impacted. The same can probably be said for any instalment plans scheduled.

Reduce the value/volume of card payments: Many Universities already work with one of the specialist providers that supply a payment platform for alternative payment methods. Some have enabled all payment methods including by card, whilst others have restricted this to their existing acquirer arrangements. This does of course save money by passing costs on to the payer. However, payments by Mastercard/Visa are already the most expensive option even before these increases are applied.

Should any University require any help in understanding the impact of these interchange increases, we would of course be happy to discuss this with you.

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