Interchange

IOWA BANKERS ASSOCIATION

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THE ISSUE:

A retailer's proposed bill would prohibit financial institutions from charging an interchange fee on the tax portion of a sale (i.e., sales tax, gas tax, local option tax, etc.). Interchange is the fee retailers pay to transmit their payments electronically.

5 REASONS IT WON'T WORK

1 Systems don't support it

When a retailer makes a sale using a customer's electronic payment card, the systems that process the transaction recognize only the final purchase amount. Current U.S. infrastructure does not support a system where multiple segmented amounts can be blocked from the interchange fee.

2 New systems are costly

Because the structure to support this proposal does not exist, it would impose severe and costly burdens on all businesses in the processing chain — including merchants, processors, networks and financial institutions.

3 Credit risk remains

If an electronic payment cannot be collected, the financial institution bears the credit risk for the entire transaction, including the tax portion.

4 Hurts small retailers

Merchants will need specialized terminals and software to itemize and communicate segmented data to the card networks at the time of sale. Small retailers do not have sufficient volume to offset the costs the new systems would impose.

5 Consumers lose convenience

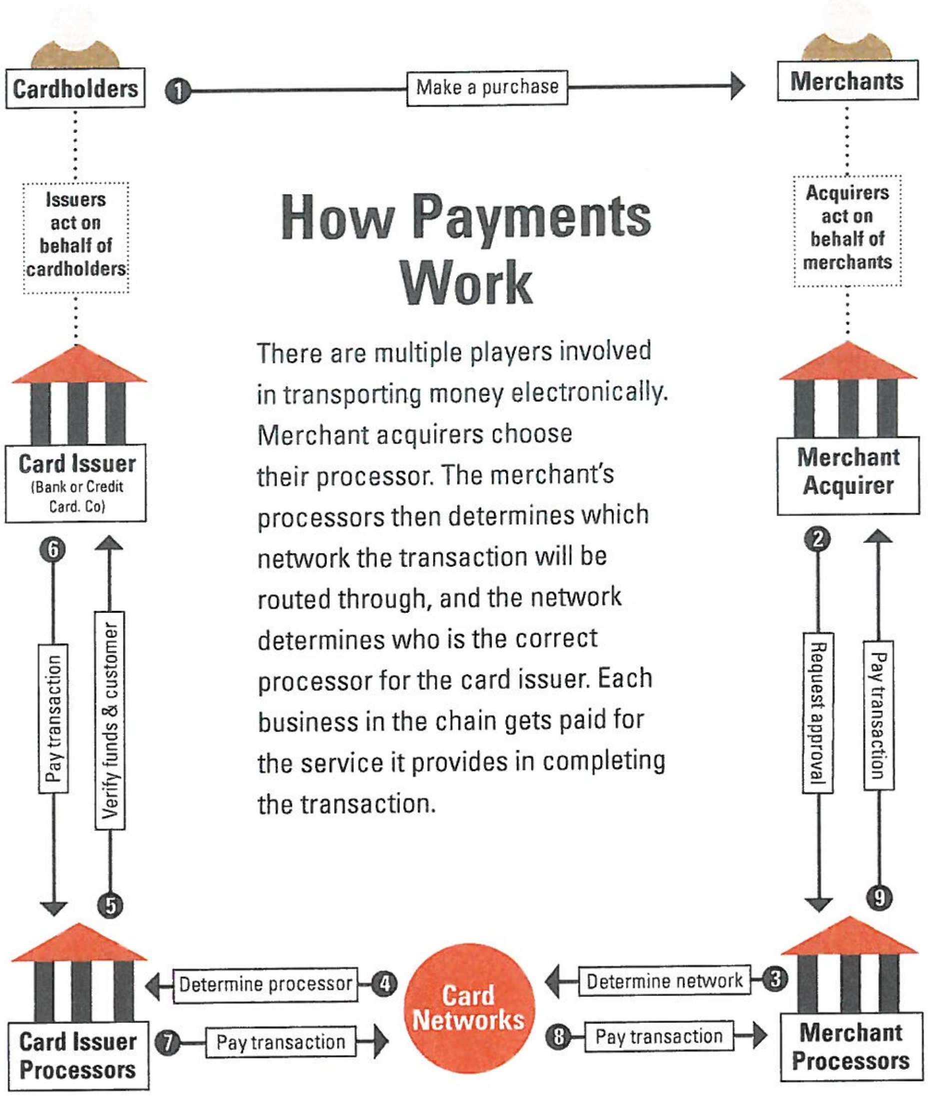
If the law passes, the best solution for the problems created would be to require consumers to pay for separate transactions — one for the sale of the product or service and another for the tax portion of the sale. Separate transactions would be a huge burden to consumers.

THE BOTTOM LINE:

If passed, this bill would make Iowa an island in the nationwide payment system. The infrastructure this bill requires does not exist, and it is uncertain if the many businesses involved in the electronic transfer of money, many of which are not located here, would even have to support the requirements of an Iowa law — and if so, at what cost? With all the different tax iterations that exist around the country, imagine the mess it would create if other states follow suit and adopt similar laws.

How Payments Work

There are multiple players involved in transporting money electronically. Merchant acquirers choose their processor. The merchant's processors then determines which network the transaction will be routed through, and the network determines who is the correct processor for the card issuer. Each business in the chain gets paid for the service it provides in completing the transaction.



WHY THE COST OF PLASTICS VARIES

The cost to merchants of accepting plastics is based on:

1. **Transaction Volume**
   A higher volume equates to cheaper cost
2. **Collection Risk**
   The risk varies by payment type:
   - **Credit card:** The financial institution accepts all credit risk.
   - **Signature debit:** The financial institution checks the account balance, but clears payment later.
   - **PIN debit:** Payment is verified by the financial institution and collected immediately.
3. **Fraud Exposure**
   Some merchants have higher risk of fraud exposure.

Retailers can and do have the ability to drive customers to the payment choice they prefer.

BENEFITS RETAILERS RECEIVE FROM PLASTICS

1. Plastics increase sales and profits for retailers.
2. Unlike checks, most plastics guarantee merchants payments for their sales.
3. Plastics enable faster and more efficient retail transactions.
4. **Merchants pay less for accepting plastic.**

Source: AEI-Brookings Joint Center for Regulatory Studies, Analysis of the Cost and Benefits of the Payment Instruments

Interchange Issue Overview

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