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ISOs Will Feel the Interchange Amendment on the Bottom Line

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By [Kate Fitzgerald](#)

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New debit card interchange rules that are likely to take effect next year could take a bite out of independent service organizations' profit margins, according to industry watchers.

"The debit-interchange amendment will most likely have far-reaching implications for ISOs and acquirers," said Steve Mott, a principal at BetterBuyDesign, a Stamford, Conn., payments consulting company.

The regulatory reform bill wending its way through Congress authorizes the Federal Reserve banks to set "reasonable and proportional" rates for debit transactions, and this change means ISOs should expect a cut in the portion of the discount rate that they receive from acquirers, Mott said.

Some analysts speculate regulators could cut interchange by 25% to 75% of current levels. The National Retail Federation, a Washington, D.C. retail trade group, said debit interchange costs merchants some \$20 billion annually.

The Federal Reserve would have nine months after the financial-reform bill passes to set new debit-interchange rates, and the rules would become effective 12 months after the bill is signed into law.

The Electronic Transactions Association lobbied against the debit-interchange amendment, sending a letter last month to members of the congressional conference negotiating provisions of the bill. The letter said ISOs' business models typically depend on a portion of fees merchants pay acquirers. "If interchange fees are capped, they are in the undesirable position of experiencing the greatest reduction in income. Quite simply, this can translate into ISOs and other small businesses in the payments chain having to downsize, lay people off or possibly go out of business," the Washington trade group said.

Several players are excluded from the new debit-interchange rules, and observers say this could pose considerable challenges for merchants and processors.

Banks and credit unions with assets of less than \$10 billion would not have to abide by the new debit-interchange rules. Also excluded are governments delivering benefits through debit cards and issuers of reloadable prepaid cards.

The legislation does not specify how merchants would differentiate among these players at the point of sale, and there is debate about the potential complexity the excluded groups pose for merchants and processors.

"We don't know of any system that automatically sorts transactions at the point of sale by the size of the institution," said Mary Bennett, the ETA's director of government and industry relations. "This law is going to cause a lot of headaches, and it may result in greater costs to ISOs and processors to sort out different types of debit transactions."

Though merchants generally applaud the arrival of debit-interchange regulations, at least one merchant-processor consultant is skeptical about the long-term benefits for merchants and processors.

"The term 'interchange' is used pretty loosely in the industry, and not only does it vary a lot, but there are a lot of other fees built into interchange that are not affected by legislation," said Robert Livingstone, president of IdealCost.com, a West Palm Beach, Fla., merchant-processor consulting firm. "Banks set interchange fees, but those are passed on to merchants through a complicated chain, which includes a general processing fee that's built into merchants' payment-acceptance costs. We assume the actual debit-interchange piece

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will be lower, but it doesn't mean overall costs will be substantially lower."

Merchants may be faced with diverse additional costs in accommodating the exempted debit cards. "Merchants may have to invest in new tools not yet on the horizon that would let them know which cards offer higher or lower transactions. And they may end up spending considerable time, especially smaller merchants, trying to find out which card is cheapest to accept, taking time away from sales and service," Livingstone said.

Although merchants have not yet assessed all the potential implications of debit-interchange regulation, few foresee complications. "This is the start of a new way of thinking for the financial community," said Jeff Lenard, a spokesperson for the National Association of Convenience Stores. "For the first time there is going to be some consideration for the actual cost of interchange, and fair competition between debit networks. This may force banks to have to fight for customers with better deals," he said.

Sonja Hubbard, the chief executive of E-Z Mart Food Stores Inc., a Texarkana, Texas, convenience store chain with 300 stores, said she does not anticipate difficulties at the point of sale in handling debit cards from different-size issuers.

"The exemptions won't cause hassles," Hubbard said. "All cards will be treated the same way. While some will cost the retailer, and ultimately consumers, more, that won't make any difference as to how things happen at the point of sale."

Merchants likely "won't know which cards cost more," and the incentives they offer to steer customers to lower-cost payment forms "will be applied in an even-handed way," she said.

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