

Technical Annex to the *Economic Note*

“Are Loyalty Programs Bad for Consumers?”

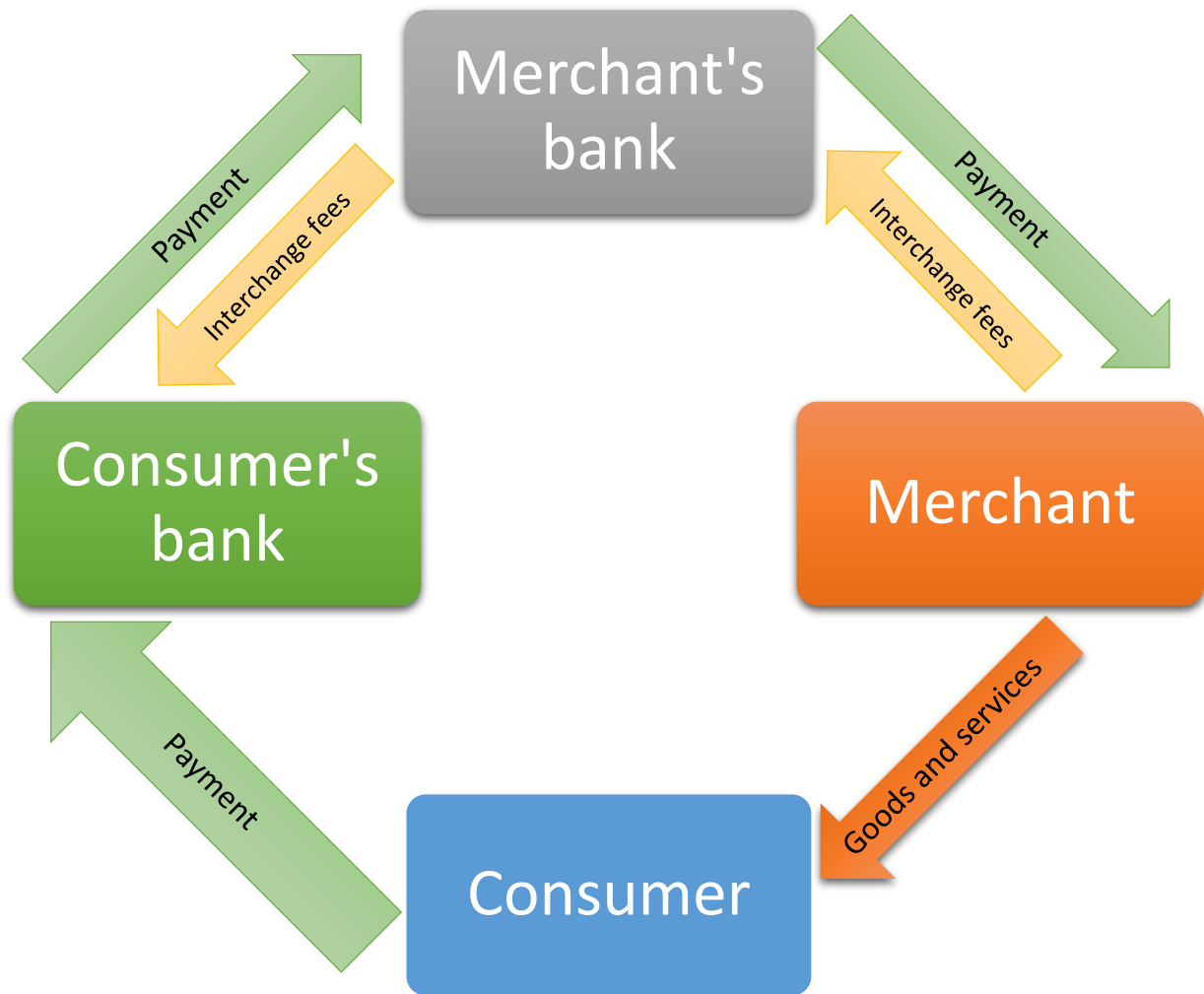
published on January 28, 2016

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Interchange fees

Interchange fees are those charges that finance the credit card payment system. Figure A-1 represents the exchanges in this system. This is the four-party credit card payment model, in which the four parties are the consumer, the consumer’s bank, the merchant, and the merchant’s bank. There also exists a three-party model, much less widespread, but this model has generally not been subject to the regulations discussed in the *Economic Note*. Table A-1 details what each party pays and obtains in the four-party system.

Figure A-1
Credit card payment transactions



Source: Ann Börestam and Heiko Schmiedel, *Interchange Fees in Card Payments*, European Central Bank, Occasional Paper Series No. 131, September 2011, pp. 10-11.

Table 1

Who does what and who pays what in transactions using credit cards with loyalty programs

	Consumer's bank	Merchant's bank	Merchant	Consumer	Platform (Visa, MasterCard, etc.)	Loyalty program operators
Pays and provides:	<ul style="list-style-type: none"> - Insurance and various reimbursements in cases of fraud or nonpayment - Issuing of the card - Immediate payment of the merchant, no-charge advance for the consumer - Guarantee of payment for the merchant 	<ul style="list-style-type: none"> - Provides and maintains the payment terminal - Pays interchange fees to consumers' banks 	<ul style="list-style-type: none"> - Commission to merchant's bank - Rents a payment terminal 	<ul style="list-style-type: none"> - Annual fees for use of the card - Interest if the balance is not entirely paid 	<ul style="list-style-type: none"> - Provides the payment platform to the banks that are party to the transaction - Ensures the reliability and speed of the platform - Works to enlarge their network 	<ul style="list-style-type: none"> - Rewards - The know-how to make use of consumer data
Receives and determines:	<ul style="list-style-type: none"> - Annual fees - Interest - Sets interchange fees 	<ul style="list-style-type: none"> - Sets fees that are paid by the merchant 	<ul style="list-style-type: none"> - Greater ease of accounting - Guarantee of payment by consumer's bank - Greater safety due to less use of cash - Possibly a larger clientele - Fraud protection 	<ul style="list-style-type: none"> - Differed payment - Credit - Insurance - Loyalty program rewards - Safety (less cash) 	<ul style="list-style-type: none"> - A charge (which is not the interchange fee, which is paid to the consumer's bank) 	<ul style="list-style-type: none"> - A charge (which is not the interchange fee, which is paid to the consumer's bank) - Payments when merchants want to advertise

Source: Pierre Garelo, *Understanding Multilateral Interchange Fees (MIF), and Why It Would Be a Mistake to Regulate Them*, Aix-Marseille Université, CERGAM, CAE Working Papers No. 102, 2013, pp. 5-6.