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The Hidden Win For Merchants–And Their Loyal Customers–In The Visa-Mastercard Settlement

Loosened card network rules could pave the way for a new age of discounts and rewards— one where merchants, not banks, hand out more of the incentives.

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Visa and Mastercard cards (Photo Illustration by Karol Serewis). SOPA IMAGES/LIGHTROCKET VIA GETTY IMAGES

Last week, when Visa V -0.4% and Mastercard MA 0.0% announced a settlement of their 19-year federal court battle with merchants, it sure didn't look like much of a win for the retailers. For example, among several changes the merchants wanted—and didn't get– was the right to pick which bank cards they would accept or reject instead of having to accept all cards issued on a network.

Ultimately, the retailers were aiming to bring down the average fees they pay the banks for processing purchases made with credit cards. (These are known as interchange fees.) On that front, they made what seems like comparatively modest progress: the card networks agreed to bring interchange fees–now an average 2% of transactions' face value–down by at least 0.07 percentage points for the next five years. That will save merchants a projected $30 billion over the five years, compared to the more than $800 billion in estimated interchange fees they'll likely be paying over that period.

But assuming the deal is approved by the federal judge overseeing the case in the Eastern District Court of New York, it could eventually give bigger merchants more leverage in their dealings with the banks while ushering in a new era of shopping discounts and rewards for merchants' more loyal customers.

Here's why: One reason that interchange fees are so high and vary so much in the U.S., is because of all those rich credit card rewards consumers get from the banks, like 2% cash back or free travel. Currently, interchange fees range from 1.18% to 3.15% of a sale, depending on which card a consumer uses, with higher fees linked to richer rewards. That's why retailers wanted the ability to say, for example, we'll take that plain vanilla low-rewards Mastercard, but not that fancy maximum reward platinum version that costs us high interchange fees. They didn't get that. They still must honor all cards.

But here's something merchants did get: they will finally be able to offer you, the customer, *extra* discounts or store rewards if you're using a specific bank card that costs them less or a payment method —say "pay-by-bank"—that cuts out the card networks and costs sellers a lot less. Say a big box retailer like Walmart WMT -0.3% or Kroger wanted to steer consumers towards a card from a particular bank in exchange for a break on processing fees, they could now offer discounts to those customers that aren't available to people with cards from other banks. That freedom to offer extra discounts or rewards could give retailers the leverage to negotiate lower card interchange rates with some banks; in return for lower fees, they'd use store discounts to steer customers to those favored banks' cards.

The deal also allows merchants to enact more granular surcharging by attaching fees to premium credit cards, though that's a technically difficult task for small-to-medium sized businesses and risks alienating the well-heeled customers who wield those cards, says Stephanie Martz, chief administrative officer and general counsel for the National Retail Federation trade association.

Martz is no fan of the settlement, since it doesn't deliver on several of merchants' key priorities, such as being able to reject some cards;

forcing Visa and Mastercard to compete with other networks to process every transaction; and ending default interchange (the system where Visa and Mastercard set default card processing fees for merchants on behalf of all card issuing banks on their networks). “At the end of the day, those are the only things that we think are really going to help this market,” Matz says. “None of them are in the settlement.”

But others, particularly those from the ecommerce world, see a lot more potential for change.

“This settlement could give merchants an opportunity to build out and fund their own loyalty programs to push some of the cheaper payment rails [methods] that they’ve been moving towards anyway,” says Julie Fergerson, CEO of the Merchant Risk Council, which represents ecommerce merchants.

The settlement could become part of a shift towards merchants assuming more control over their loyalty programs by moving away from interchange-funded rewards systems offered by banks to rewards schemes they design and fund themselves, says Jordan Glazier, CEO of Wildfire Systems, an ecommerce rewards startup helping businesses offer perks like cashback or digital coupons.

Prior to the settlement, merchants didn’t have the leverage to do special discount deals based on which bank card a customer used. They were also hamstrung by rules that prevented merchants from steering consumers to preferred payment methods at checkout.

While cutting deals with preferred banks still means running through the card networks, in the future, if merchants want to encourage consumers to ditch their cards altogether, they could design rewards programs to incentivize consumers to use a cheaper, alternative method of payment instead. Pay-by-bank, for example, allows consumers to pay merchants directly from their bank accounts (without using a debit card) and helps sellers develop more direct relationships with their customers.

“That building of a direct relationship with the consumer is something merchants’ value versus giving empty calories to the (card) networks for facilitating that transaction,” says Tikue Anazodo, CEO of rewards startup Kudos Technologies, which works with 15,000 merchants to help consumers maximize rewards.

Kudos is exploring ways to offer rewards for consumers who opt for pay-by-bank at checkout. As an example, shoppers could earn 3% back on a credit card transaction but 5% back if they use pay-by-bank.

"If giving a consumer a higher percentage back can get them to make a purchase directly on a specific merchant site and ultimately to build a longer term relationship with the brand, merchants value that," says Anazodo, whose startup was named to the *Forbes* 2024 Fintech 50. "Many merchants would actually be open to the idea of even giving higher than the interchange percentage directly to the consumer without having to pass that money directly to Visa or Mastercard."

Some service providers have already adopted strategies for converting customers to pay-by-bank for their recurring payments. At AT&T, clients who opt for automatic payments receive discounts on their monthly bill. Clients using pay-by-bank receive $10 off their monthly bill versus only $5 for people using their credit card. Similarly, Verizon offers autopay customers $10 off their monthly bill if they pay directly with their bank account or with the Verizon Visa Card.

Pay-by-bank hasn't gained much traction in the United States largely due to the ubiquity, convenience–and rich rewards–offered by credit cards, but there have been a few notable launches. Airbnb, for example, introduced a pay-bank-bank option last year through a partnership with Stripe. In 2023, JP Morgan announced a pay-by-bank product designed for recurring payments like rent or utilities offered through Mastercard's open banking platform, which helps with the secure exchange of financial data. Also last year, Plaid announced plans to launch a pay-by-bank product for general use in partnership with Dutch payment processor Adyen.

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