



# Interchange Guide

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# How community bankers can answer small-business customer questions about interchange.

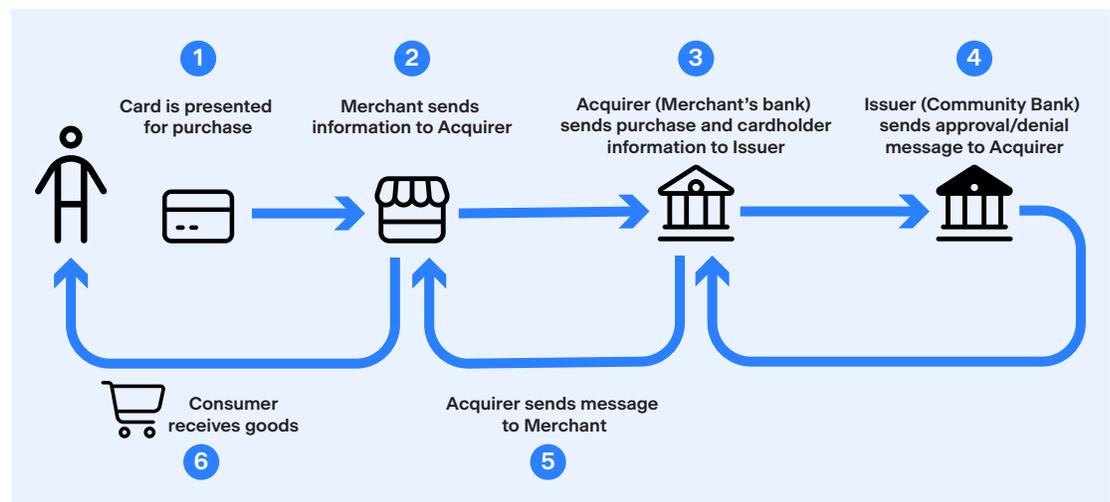
With community bank small-business customers occasionally posing questions about payment card interchange and other swipe fees, understanding and being able to communicate about this issue is important for many community bankers.

Let's discuss how to make sense of swipe fees, for community bankers and the small businesses they serve.

## Six steps and four parties: the life cycle of a card transaction

Each credit card transaction has four parties and six steps that occur in the blink of an eye: three steps outbound and three returning. They are as follows:

1. The **cardholder** presents their card for the purchase.
2. The **merchant** sends the card information to the merchant's acquirer—the bank or fintech that enables businesses to accept credit and debit card payments via a merchant account.
3. The acquirer sends the purchase and cardholder information to the card **issuing bank**.
4. The card issuer sends an approval or denial message back to the merchant's acquiring bank.
5. The acquiring bank sends an approval or denial message to the merchant.
6. The transaction is completed: either approved or denied.





## Swipe Fees

Swipe fees are what the merchant pays the acquirer to accept the card. Swipe fees have three distinct parts: interchange, network fee, and acquirer fee. For example, if an acquirer transacted a \$50 sale for a merchant, the acquirer returns \$48.25 to the merchant. The acquirer keeps the \$1.75 to cover interchange, network, and acquirer fees.

### Interchange

Interchange is what the issuing bank collects. The issuing bank is the cardholder's bank—the bank listed on the card plastic.

#### Accounting for Risk

Interchange, which is set by the networks and through government price controls, is designed to align with the risk of the transaction.

Safer transaction methods, such as chip, tokenized, and contactless payments, have lower interchange rates. Riskier transactions, such as mag stripes and online key-entered transactions, have higher interchange.

The risk of high consumer disputes is also priced into interchange. Credit card interchange is higher than debit interchange to help offset credit risk.

For consumer transactions, there are seven tiers of interchange: two debit and five credit.

#### Debit Interchange

Debit interchange has government price controls required by the Durbin amendment which directly and indirectly regulates debit interchange amounts. In the \$50 example where the acquirer retained \$1.75 in swipe fees, a covered issuing bank would collect just \$0.25. Debit card transactions are the most common consumer card transaction, and nearly 70% of debit transactions are covered directly by government price controls with all transactions also being subject to routing requirements.

#### Credit Card Interchange

Consumer credit card interchange has five tiers: traditional, rewards, premium rewards, elite rewards, and uber rewards. Community banks generally issue traditional and reward cards.

## Network fees

The second part of the swipe fees is the network fee, which is the portion that card networks such as Visa and Mastercard collect. This is usually the smallest part of the swipe fees. It is the toll for using the payment card rail and is used to fund the security of the rail.

## Acquirer fees

The final part of the swipe fees is the acquirer fee, which is the portion the acquirer keeps. The acquirer historically was the merchant’s community bank, which as part of relationship banking provided various services such as business accounts and lines of credit in addition to card services. Now small businesses generally use fintech card processors, not their community banks, as their acquirer.

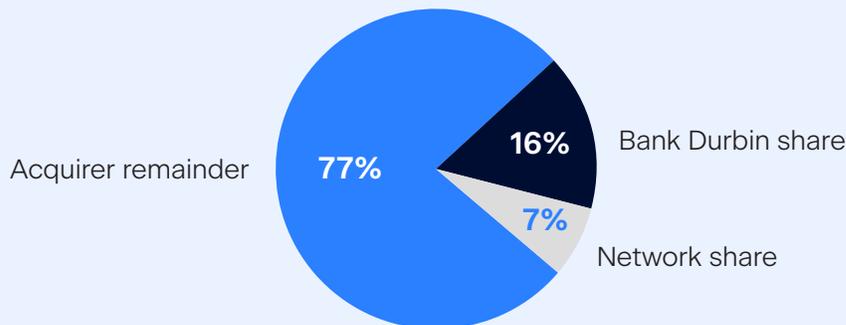
There are two main pricing models for card processing: interchange plus and blended:

- **Interchange plus** is when the acquirer passes on the direct and variable interchange and network fee to the merchant and adds on a fee per transaction.
- **Blended** is when the acquirer offers the merchant a flat rate per transaction. Some merchants find the flat rate easier to budget. Card processor acquirers—such as Square, Clover, Toast, Stripe, and PayPal—publish their blended swipe fees on their websites.

### Average swipe fee on \$50 purchase: \$1.51

Acquirer (ie Square, Stripe, PayPal, Toast, Clover)	<b>\$1.17</b>
Bank share	<b>\$0.25</b>
Network share	<b>\$0.10</b>

### Swipe fee distribution on a \$50 Durbin Debit Transaction



## Bottom Line

It is important for community bankers, merchants, and policymakers to understand that swipe fees and interchange are distinct, with acquirer fees from nonbank fintech card processors often accounting for the bulk of merchant costs for accepting card payments.

With so much confusion—and misinformation—over what swipe fees are, these distinctions are critical in ensuring both banker and merchant are working with the same information, particularly as “interchange” debates in Washington continue.

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