CHAPTER 6

ATM INTERCHANGE FEES

6.1 While the PJSC inquiry was in progress, the Reserve Bank of Australia and the Australian Competition and Consumer Commission published *Debit and Credit Card Schemes in Australia – a Study of Interchange Fees and Access, October 2000*. On 1 November 2000, Dr John Laker, Assistant Governor (Financial Systems) of the RBA, together with his colleagues, Dr John Veale and Ms Michelle Bullock, privately briefed the Committee on the study.

6.2 The study concentrated on interchange fees, or "wholesale" fees which are paid between financial institutions when customers of one institution are provided with card services by another. In Australia, interchange fees are unique to ATMs, credit cards and debit cards; in other cases financial institutions recover their costs directly from their own customers.

6.3 The study advised that the justification for interchange fees is that they maximise the benefits of the payments network. The result has been growth of world-class ATM and credit and debit card payment networks. Pricing for these networks is, however, still based on interchange fees, which are set by financial institutions at one remove from the cardholders and businesses who ultimately pay the fees. This is in contrast to most other markets, where users influence price setting.

6.4 The PJSC was most interested in the parts of the study dealing with ATMs. In this context, the study advised that ATM interchange fees are a substantial mark-up on costs. For instance, interchange fees average about $1.00 for cash withdrawals, which is double the average cost. Card issuers pass on these fees in full to customers using foreign ATMs. On the other hand, fees for ATM excess withdrawals from their own ATMs are much more in line with costs. Interchange fees for balance inquiries are also substantially higher than costs; in many cases they are the same as for cash withdrawals. The study suggested that interchange fees do not change over time to reflect changes in costs, even though it appears that the costs of operating ATMs have fallen.

6.5 The study advised that the substantial difference between interchange fees and costs could be expected to attract new entrants to the provision of ATM services. Neither these new entrants, however, nor competition between providers, has resulted in a reduction of interchange fees. Most bilateral interchange fees have not been adjusted for 10 years, despite significant changes in cost structures.

6.6 One reason why interchange fees have not fallen is that there is no incentive for financial institutions to lower them. In addition, the bargaining power of parties negotiating ATM interchange agreements favours large financial institutions over smaller new entrants. Owners of large ATM networks and large card issuers are both at an advantage over new and smaller operators. Finally, bilateral interchange agreements are not easy to re-negotiate, with smaller parties prepared to accept the status quo rather than deal with the unequal bargaining strength of large players.

6.7 The study advised that direct charging for the use of foreign ATMs would be a preferred alternative to interchange fee arrangements. The benefits of direct charging are that it could result in transaction fees more in line with costs, and be more transparent. For instance, it puts the ATM owner in a direct economic relationship with the cardholder, which would allow the consumer to directly influence pricing. It would also avoid the present position where the same interchange fee is paid for all ATM withdrawals by a given issuer, which is an effective subsidy of high cost locations by low cost ATMs.

6.8 The study concluded that interchange fees, because they are an integral part of retail payment services in Australia, contribute to distorting the payment choices facing consumers. As a whole, therefore, Australia has a higher cost retail payments system than is necessary. The study found that Australia has well-established ATM, credit card and debit card networks, which are technically efficient and which have a high level of customer acceptance. Interchange fees in the past may have played a significant part in the development of these networks, but they have done so by reducing the effectiveness of the normal market mechanisms which determine consumer choice and resource allocation. The study then emphasised that for ATM networks there are alternative pricing arrangements under which providers of card services could recover their costs directly from users, as they do with other payment instruments.

6.9 The PJSC notes that the ACCC has commenced Federal Court action against the National Australia Bank, alleging price-fixing in the fees charged to retailers for the supply of credit card systems. The other three big banks have all agreed to an authorisation process by the ACCC which should improve public scrutiny of the fees.