

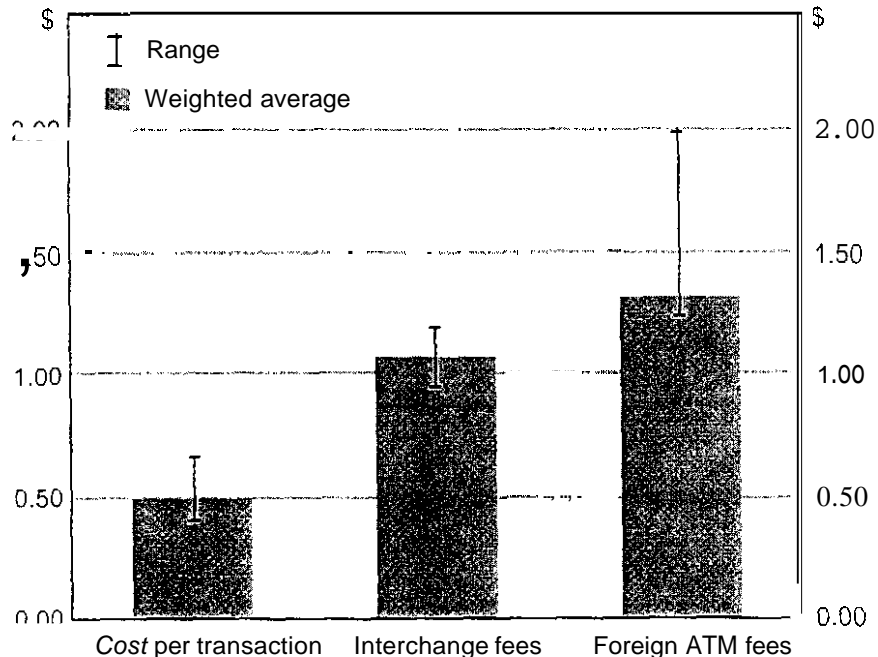
## PAYING FOR USING A "FOREIGN" ATM

### I Reserve Bank and ACCC Joint Study: Debit and Credit Card Schemes in Australia

In its joint study with the ACCC published in 2000, the RBA addressed the arrangements that underpin the charges incurred by Australian cardholders who use a debit card to withdraw cash from an Australian ATM that is not operated by the institution that issued the debit card. These are known as "foreign" ATM transactions, though they have nothing to do with using a card in an ATM overseas. The study did not investigate the charges levied by institutions when cardholders withdraw funds from an ATM operated by the institution that issued their card. Institutions recover the costs of providing these services in a variety of ways, including interest rate margins, monthly account keeping fees and explicit transaction charges, usually after a number of fee free transactions.

The study concluded that, under current arrangements between financial institutions, customers who use a "foreign" ATM pay considerably more than the cost of supplying the service. Data provided for the study showed that in 1999 the average cost of providing ATM cash withdrawals was around \$0.49 per transaction, but financial institutions which owned ATMs charged institutions whose customers withdraw cash (known as card issuers) an interchange fee averaging about \$1.03. This fee was passed on to cardholders with a mark-up, to give an average "foreign ATM fee" paid by cardholders of around \$1.35. Many cardholders appear to be unaware of the size of "foreign ATM fees", partly because they see them only much later when they receive their statements.

#### Costs, interchange fees and foreign ATM fees – cash withdrawals



Source: CANNEX Australia & Reserve Bank of Australia

The series of bilateral arrangements (about 65) which support the interchange arrangements under which ATM owners receive payments for ATM transactions undertaken by other institutions' customers have changed little over many years. The study noted that competitive

forces were unlikely to bring ATM interchange fees into line with costs, in part because cardholders could not influence foreign ATM owners directly. Issuers had no incentive to press ATM owners for lower interchange fees, since they recovered them (plus a margin) from cardholders through foreign ATM charges.

Given that current arrangements did not hold out any prospects of providing a competitive impetus to lower the charges faced by cardholders using foreign ATMs, the study canvassed the alternative of a direct charging regime, under which ATM owners would seek to recover their costs directly from cardholders of other institutions using their ATMs.

A direct charging regime would put the ATM owner in a direct economic relationship with the cardholder, rather than an indirect one via the issuer. Such a regime would allow the cardholder to exert a direct influence on pricing – for example, by using less expensive ATMs. Additionally, under a direct charging regime, ATM owners could vary the transaction fee according to the cost of individual machines. This could provide an incentive to place ATMs in higher cost locations, where none were previously available, offering greater convenience for those cardholders willing to pay.

## **II Developments Since the Joint Study**

In February 2001 the Parliamentary Joint Statutory Committee on Corporations and Securities released its *Report on Fees on Electronic and Telephone Banking* which recommended that interchange fees be abolished and replaced by direct charging. A dissenting view was put by some members of the Committee who did not support the introduction of direct charging without wider agreement on the level of bank fees.

Following preliminary discussions, in July 2001, the Reserve Bank convened a meeting of ATM operators to discuss options for reform. After considerable discussion, in March 2003 ATM owners released a paper seeking public comment on proposed reform of charges for foreign ATM transactions. Under the proposals, the ATM interchange fee would be set to zero and ATM owners would recoup their expenses through direct charges for foreign transactions. Card issuers would recover their costs of maintaining accounts and authorising withdrawals directly from their customers. Freedom to set direct charges was expected to stimulate provision of ATM services and make them flexible and responsive to changes in costs and cardholder demand.

In May 2003 the Australian Consumers Association (ACA) said it was unconvinced about the merits of the proposal, arguing that evidence from overseas (particularly the United States and the United Kingdom) did not show any benefits to consumers from the introduction of direct charging.

## **III Evidence from Abroad**

It is not possible to say with certainty how a direct charging regime will work. However, the Reserve Bank's Payments System Board has analysed relevant developments in the UK, Canada and USA, where forms of direct charging apply.

It summarised its conclusions in its 2003 Annual Report released in October:

“a direct charging regime is likely to result in much greater availability of ATMs, particularly in locations where there were previously none. Some of these ATMs are likely to charge a higher fee than banks currently charge on their machines.

Nevertheless, many ATMs are likely to continue to charge less than the “convenience” ATMs, providing consumers with choice.”

The following paragraphs provide some of the background to these conclusions. The source material is listed in the references.

Most ATMs in the United Kingdom are connected through LINK, which is owned by 22 financial organisations. LINK sets business rules for ATM operations and provides centralised switching and processing. It also sets the interchange fees that are paid by card issuers to ATM owners. Under LINK’s rules, which have been in force since 2000:

- ATM owners can impose a direct charge; but
- ATM owners that levy direct charges will not receive interchange fees from issuers; and
- all customer charges must be shown on ATM screens before the withdrawal takes place.

Most banks and building societies in the UK do not levy direct charges. The imposition of a “foreign” fee is also not common; most banks and building societies absorb any interchange fees they pay to ATM owners. The result is that withdrawals are free at most bank and building society ATMs. In contrast, independent providers of ATMs in “convenience locations” such as petrol stations or local stores usually levy a direct charge for each transaction.

Around a quarter of all ATMs now levy a direct charge but only around 2% per cent of transactions actually attract a charge, typically in the range of £1.25-£1.50. Where an ATM charge applies, this is clearly identified at the time of the transaction, giving customers the option to cancel the transaction without charge.

The ATM market in the United States is made up of a large number of networks, most of which require that issuers pay an interchange fee to ATM owners: most issuers pass these costs on to their customers as “foreign” fees. In addition, direct charges have been introduced progressively since 1996. For banks they average around US \$1.35 and are now imposed by about 90 per cent of banks with ATMs. Surcharges for independent operators are a little higher. There is some evidence that while surcharges are widespread, frequent users only pay these on about 20 percent of their transactions.

Since the introduction of direct charging in 1996, the number of ATMs has grown by 130 per cent compared with 50 per cent over the previous five years. Most of the recent growth has been in ATMs away from bank premises and operated by independent operators. These machines have transaction volumes around half of those of bank-owned ATMs.

One concern that has been raised in the USA is that a bank whose ATM network dominates in a particular area may raise direct charges to encourage cardholders to move accounts to it in order to avoid the charge. This seems unlikely in Australia where the main ATM networks all have substantial coverage and customers tend to hold their deposit account and housing loan at the same institution, making it difficult for banks to convince customers to move accounts simply to avoid an ATM charge.

Most of the ATM network in Canada is controlled by Interac, which is a cooperative organisation owned by its members. All corporations in Canada are eligible to join. Interac

sets the rules and standards for access to the system and an interchange fee of about CAD 0.75 for ATM transactions.

Until 1996, Interac prohibited members from imposing direct charges. However, Canada's Competition Bureau regarded this prohibition, in conjunction with the collectively set interchange fee, to be a restriction on competition. In 1996, the Competition Bureau ruled that direct charges on ATM transactions be allowed but the customer must be given prior notification at the terminal. As well as a fee to recover the interchange fee, the user of a "foreign" ATM could face a direct charge of CAD \$1.00 to \$3.00.

Following the introduction of direct charges, there was rapid growth in independent ATMs from less than a quarter of all ATMs in 1997, to over half of the ATMs in Canada in 2001.

The United Kingdom, United States and Canada present quite different experiences of direct charges. Nevertheless, the overseas experience suggests a number of conclusions of relevance to Australia:

- Direct charging results in an increase in ATMs, particularly machines in locations with small numbers of transactions.
- Most customers continue to use lower cost alternatives which remain widely available. UK evidence shows that only a small proportion of customers actually pay direct charges.
- If ATM owners are permitted to receive interchange fees and charge the consumer directly as well, many will do so. This can result in some very high fees being paid in total at some ATMs.

These conclusions suggest all ATM owners would be under competitive pressure in a direct charging regime, so long as there are no unreasonable barriers to entry to the ATM business. Direct charging would bring greater availability of ATMs but with higher fees on some machines. These machines may genuinely have higher costs per transaction (for example remote machines or low transaction volumes) in which case a higher direct fee is an efficient outcome. In most cases those machines would not exist prior to the introduction of direct charges because it was not economic to put ATMs in these higher cost locations when the interchange fee was the only revenue source.

Reserve Bank of Australia  
5 November 2003

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**Reserve Bank of Australia, Payment System Board Annual Report 2003**, Sydney, October 2003

### List of Relevant Websites

Association for Payment Clearing Services	<a href="http://www.apacs.org.uk">www.apacs.org.uk</a>
Australian Payments Clearing Association	<a href="http://www.apca.com.au/">www.apca.com.au/</a>
Australian Prudential Regulation Authority	<a href="http://www.apra.gov.au/">www.apra.gov.au/</a>
Bank for International Settlements	<a href="http://www.bis.org/">www.bis.org/</a>
Federal Reserve Bank of Chicago	<a href="http://www.chicagofed.org/paymentsystems">www.chicagofed.org/paymentsystems</a>
Financial Consumer Agency of Canada	<a href="http://www.fcac-acfc.gc.ca">www.fcac-acfc.gc.ca</a>
Board of Governors of the Federal Reserve System	<a href="http://www.federalreserve.gov">www.federalreserve.gov</a>
Interac Association, Canada	<a href="http://www.interac.org">www.interac.org</a>
Federal Reserve Bank of Kansas City, Payments System Research Department	<a href="http://www.kc.frb.org/FRFS/PSRRegs.htm">www.kc.frb.org/FRFS/PSRRegs.htm</a>
LINK Interchange Network, UK	<a href="http://www.link.co.uk">www.link.co.uk</a>
New York Public Interest Research Group (NYPIRG)	<a href="http://www.nypirg.org/consumer/atm/2003/">www.nypirg.org/consumer/atm/2003/</a>
UK Office of Fair Trading	<a href="http://www.oft.gov.uk">www.oft.gov.uk</a>
Reserve Bank of Australia	<a href="http://www.rba.gov.au/">www.rba.gov.au/</a>
The Exchange	<a href="http://www.the-exchange.ca/">www.the-exchange.ca/</a>