

# ACCESS REGIME FOR THE ATM SYSTEM: A CONSULTATION DOCUMENT

DECEMBER 2008

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# Access Regime for the ATM System: A Consultation Document

## 1. Introduction

This Consultation Document seeks views from interested parties on a proposed Access Regime for the ATM system.

The decision by the Payments System Board to consider an access regime for the ATM system comes after many years of industry-based efforts, supported by the Reserve Bank, to improve competition and efficiency in the ATM system. While the industry has made considerable progress in implementing the technical aspects of a reform package, it recently wrote to the Reserve Bank requesting the designation of the ATM system, and regulation by the Bank, in order to give greater legal certainty to aspects of the reforms.

The Board has long encouraged industry-based solutions to issues of competition and efficiency in the payments system. Indeed, in its recent review of Australia's payments system reforms, the Board indicated that it was prepared to step back from regulation of interchange fees in the credit and debit card systems if industry took further steps to improve competition and efficiency.<sup>1</sup> Consistent with this philosophy, the Board would have preferred an outcome for reform of the ATM system that did not involve regulation. But, in the current circumstances, it is prepared to consider regulation in the public interest so as to ensure that the industry meets its agreed implementation date of 3 March 2009.

The proposed Access Regime has two features. First, it eliminates the payment of interchange fees among the direct participants in the ATM system. This addresses the concern that negotiations over interchange fees, which are a price of access for new entrants, could be used in a way that limits competition from new entrants. Second, it sets a cap on the price that a new entrant can be charged to set up a direct connection with another direct participant. Other aspects of access – including the rights of access seekers, obligations on access providers, the process of access and implementation time lines – will be addressed through the industry-developed ATM Access Code, a draft of which has been released by the Australian Payments Clearing Association (APCA) for public comment.<sup>2</sup>

While the Board is prepared to introduce an Access Regime to support the industry Access Code, it remains concerned about the difficulties that the current bilateral architecture in the ATM system poses for new entrants. In the Final Conclusions of the review of the payments system reforms, the Board encouraged the industry, as a matter of priority, to examine alternative access arrangements that would allow entry without the need to establish a multitude of bilateral connections. Although the proposed industry Access Code represents an improvement on current

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1 *Reserve Bank of Australia (2008), Reform of Australia's Payments System: Conclusions of the 2007/08 Review, September.*

2 See <http://www.apca.com.au/atmexposedraft>.

arrangements, it does not address this issue. Accordingly, the Board views the Access Code and the Access Regime as only a temporary solution to the current access issues. If more fundamental access reform has not occurred by March 2010, the Board will consider alternative approaches to improving access arrangements, including the possibility of setting technical standards to require the industry to implement a more access-friendly network.

This Consultation Document sets out the proposed Access Regime. Section 2 provides background on the ATM system in Australia. Section 3 discusses the reform process to date, including the issues that have been identified with the current system and the evolution of the reform proposal. Section 4 then outlines why a regulatory approach is being considered for some elements of the reforms. Section 5 sets out the proposed Access Regime. Section 6 discusses the need for more fundamental reform of the ATM system architecture.

The Bank invites submissions from interested parties on the proposed regime by 16 January 2009. All submissions will be posted on the Bank's website ([www.rba.gov.au](http://www.rba.gov.au)) and parties making submissions will have the opportunity to discuss them with the Bank. Submissions should be sent to:

Head of Payments Policy Department      or      [pysubmissions@rba.gov.au](mailto:pysubmissions@rba.gov.au)  
Reserve Bank of Australia  
GPO Box 3947  
Sydney NSW 2001

## **2. The ATM System**

The Australian ATM system is comprised of a number of ATM 'networks', linked together through a series of bilateral agreements. Most of these individual networks are owned by large banks and were initially established to provide their customers with access to cash withdrawals and some account management functionality. There are also two 'sub-networks', operated by Cashcard and CUSCAL, which were initially set up to serve building societies and credit unions (respectively), although these days their membership is wider. These sub-networks effectively link together ATMs of a large number of smaller institutions so that they can provide their customers with access to a larger network of ATMs. In addition, in recent years, a large number of ATMs have been deployed by owners that are not financial institutions, but rather whose sole business is to provide ATM services. The networks owned by these 'independent deployers' are also linked into the system, typically through one of the financial institutions. Figure 1 provides a stylised representation of the Australian ATM system.

When ATMs were first introduced in Australia in the early 1980s, cardholders could only use the ATMs of their own financial institution. Gradually, however, these individual networks were connected so that bank customers could use their ATM card at a wider range of ATMs. By the 1990s, these interconnections had progressed to the point where most cardholders had universal access to ATMs – most ATM cards can now be used in any ATM in Australia, regardless of who owns the ATM.

The interconnection of ATM networks was facilitated through bilateral agreements between network owners that allow each institution's cardholders to use the other institution's ATMs. Among other things, these bilateral agreements provide for the payment of 'interchange fees'

from the card issuer to the ATM owner in compensation for the service that the ATM owner is providing to the cardholder.<sup>3</sup>

Since interchange fees are set through bilateral negotiation they have typically been confidential to the parties in the agreement. In 2000, however, the Reserve Bank and the Australian Competition and Consumer Commission (ACCC) undertook a study of interchange

fees (the Joint Study), including those for ATMs, which found that interchange fees for a cash withdrawal varied between \$0.80 and \$1.30, averaging around \$1.00.<sup>4</sup> The Bank's understanding is that there has been very little change in these fees since that time.

As interchange fees are a cost to the card issuer, many financial institutions charge their customers a 'foreign fee' when they use an ATM belonging to another financial institution. These fees are, however, typically significantly higher than interchange fees. Currently the four largest banks charge \$2.00, up significantly from the average of \$1.35 at the time of the Joint Study. Since interchange fees have not changed since this study, the increase represents a substantial rise in the margin over interchange fees. In contrast, many smaller financial institutions choose to absorb the cost of the interchange fee for their customers, effectively providing them with fee-free access to a large number of ATMs.

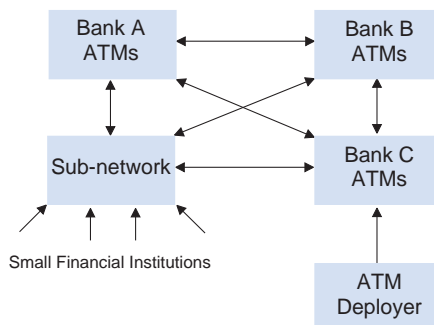
The ability to use ATMs of other networks is an important public benefit, providing cardholders with choice and convenience, as well as helping promote competition between financial institutions. Indeed, of the 850 million cash withdrawals from ATMs undertaken in the year to June 2008, almost half were conducted at ATMs not owned by the cardholder's financial institution. This is despite the fact that, as noted above, many banks charge their customers for using such ATMs.

### 3. The Reform Process to Date

#### 3.1 The issues

For a number of years, both the Reserve Bank and many industry participants have seen a need to improve arrangements in the ATM system. In particular, two main issues with the current system have been identified: a lack of competitive pressure on interchange fees; and the access difficulties facing potential new participants.

**Figure 1**



<sup>3</sup> In this respect, they are quite different from interchange fees in most other payment systems. ATM interchange fees can be understood as a fee for service rather than the more complicated balancing device used in card payment systems.

<sup>4</sup> Reserve Bank of Australia and Australian Competition and Consumer Commission (2000), Debit and Credit Card Schemes in Australia: A Study of Interchange Fees and Access, October.

### 3.1.1 Lack of competitive pressure on interchange fees

As noted above, an important feature of the current arrangements is the existence of bilateral interchange fees between the major participants. When the Bank studied these fees in 2000, it made two main observations.

The first was that these fees had remained fixed for many years at the levels agreed when the links were first established and that it was very difficult for existing ATM owners and card issuers to negotiate different rates. At the time of the Joint Study, the Bank was aware of only 15 changes to bilateral interchange fees since the mid 1980s, with many of these being a result of mergers between financial institutions.

The second observation was that although interchange fees were paid to ATM owners as recompense for providing the service, the fees bore little relationship to the cost of providing an ATM withdrawal. The Bank found that while interchange fees averaged around \$1.00, the average cost of a cash withdrawal at an ATM was around \$0.50 and there appeared to be no competitive pressures to reduce interchange fees or, by extension, foreign fees. The foreign fee being paid by cardholders for a cash withdrawal was, therefore, substantially more than the cost of providing the service and there seemed to be only limited competitive pressures to reduce that margin.

One reason why ATM interchange fees are not subject to the normal forces of competition is that bilateral interchange agreements are not easy to renegotiate. The potential loser out of any renegotiation naturally prefers the status quo so unless the potential winner is prepared to walk away from the agreement – which may be difficult if its cardholders have become used to the convenience of access to a wider ATM network – the interchange fee is likely to remain unchanged. Experience suggests that such ‘sticky’ interchange fees are a common feature of bilateral payment systems.

A second reason why normal competitive forces do not bear on ATM interchange fees is that cardholders have no influence over these fees. Although interchange fees have some bearing on foreign fees, customers face the same foreign fee from their financial institution regardless of the interchange fee paid. They therefore have no incentive to favour ATMs with lower interchange fees. This in turn means that there is no incentive for ATM owners to lower their interchange fees to promote use by cardholders. More generally, it implies that the relationship between interchange fees and the costs of providing ATM withdrawals is weak.

This weak relationship between interchange fees and costs raises a potentially important issue going forward. Because of the difficulties with renegotiating bilateral interchange fees noted above, these fees may remain at their current levels even if costs rise. As a result, there is a risk that many ATMs will become uneconomical over time. Indeed, the Bank estimated in 2007 that the average cost to an ATM owner of providing the service of a cash withdrawal was around \$0.75, up from \$0.50 in 2000.<sup>5</sup> As costs continue to rise, it is possible that the number

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<sup>5</sup> Schwartz C, J Fabo, O Bailey and L Carter (2008), ‘Payment Costs in Australia’, in Payments System Review Conference, *Proceedings of a Conference, Reserve Bank of Australia and Melbourne Business School, Sydney*, pp 88–138. The figures are not directly comparable as the 2007 measure of average cost is more comprehensive. Nevertheless, a number of comparable component costs of a cash withdrawal do appear to have increased over the period; for example, cash handling, off-site rental and float costs.

of ATMs – particularly those operated by the independent deployers – will decline if interchange fees are not renegotiated. This would result in less convenience for consumers and reduced public benefit from the ATM system.

### **3.1.2 Access difficulties**

The second issue with current arrangements is the difficulties faced by new entrants in gaining access to the system. These difficulties are similar to those identified by the Bank with respect to the EFTPOS system and which were addressed in a co-regulatory framework by the Bank and APCA in 2006.<sup>6</sup>

The bilateral arrangements in the ATM system make access complicated in three main ways. First, any potential new provider of ATM services that wants to be a direct player in the system must separately approach existing participants to negotiate agreements to establish connections. Each individual agreement is likely to be slightly different with respect to technical and business requirements, further complicating the negotiation process and increasing costs.

Second, existing direct connectors have little incentive to facilitate entry since the prospective entrant is likely to be a competitor in at least some aspects of the participant's business and, in the case of smaller new entrants, might offer existing participants only limited benefit in terms of network expansion. This means that participants may either refuse to negotiate or delay the process. Even if an in-principle agreement to connect is reached, there are no standardised procedures around testing or guidelines around timing. As a consequence, the incumbent may effectively hold up entry by delaying the technical work required. In addition, there is no standard cost of connection nor is the cost of connection known in advance, so new entrants may find it difficult to build a robust business case.

Third, in a bilateral system, negotiation of the interchange fee to be paid can also act as a barrier to entry. At its most prohibitive, the inability of a new entrant to negotiate an interchange fee would prevent it from participating in the system. But even if the other participants are prepared to negotiate such an agreement, the new entrant may find that the only interchange fee the incumbents are prepared to consider is at a level that would render the new entrant uncompetitive. If, for example, the owner of a new ATM network found that other participants were only prepared to pay it \$0.50 for use of its ATMs by cardholders when other ATM owners were receiving \$1.00, it would immediately be at a competitive disadvantage to other participants. Bilateral interchange fees therefore effectively act as a price of access.

## **3.2 Evolution of the reform proposal**

In response to these issues, the industry, with the support of the Reserve Bank, has been working for a number of years on a reform package for the ATM system. Following the release of the Joint Study, the industry, with the assistance of the Reserve Bank, established a working group (the ATM Industry Steering Group) in 2001 to develop a reform proposal. The working group made slow progress but by early 2004 it had developed a proposal to submit to the ACCC for authorisation.

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<sup>6</sup> Reserve Bank of Australia (2006), Update on Payments System Issues, Media Release 2006-06, 13 September.

The centrepiece of the proposal was for ATM owners to recover their costs by charging a fee directly to the user of the ATM, rather than through an interchange fee. This is known as direct charging. There were, however, some carve-outs to assuage the concerns of the smaller institutions. In particular, smaller institutions were permitted to continue paying interchange fees within the existing sub-networks (Cashcard and CUSCAL).

This model was seen as a way to address the lack of competition over interchange fees. ATM owners would be able to compete on the basis of the charge to cardholders, and cardholders could, by their choices, exert competitive pressure on these charges. Furthermore, direct charging was seen as addressing the lack of incentive to provide ATMs in locations for which the cost is higher than the prevailing interchange fee, and as promoting widespread availability of ATMs.

Before the working group submitted its proposal to the ACCC for authorisation, however, the Australian Competition Tribunal overturned the ACCC's authorisation of a proposal to set EFTPOS interchange fees to zero. This led to concern among some members of the working group that seeking authorisation from the ACCC for zero interchange fees in the ATM network would not necessarily offer a timely or successful outcome and no proposal was submitted.

In June 2004, in response to these developments, the Reserve Bank called for submissions on whether it would be in the public interest to designate the ATM payment system with a view to achieving reform through the use of its regulatory powers. In response, industry participants expressed a strong view that industry could develop and implement the reforms without the need for regulation. At the same time, the majority of submissions supported the working group's proposal for the abolition of bilateral interchange fees and the ability of ATM owners to direct charge – although there were disagreements over the extent of the carve-out for smaller institutions. In September 2004, the Bank announced that it would not, at that time, designate the ATM system, allowing the industry more time to develop its proposal.

While industry participants indicated that an industry-based solution could be developed, progress effectively came to a halt in mid 2005, prompting the Chairman of the Australian Bankers' Association (ABA) Council to write to the Reserve Bank in July 2005 asking for guidance on the way forward. The Bank subsequently met with a wide range of participants in the ATM system to discuss their views on the reform process. Following these consultations, the Bank highlighted two aspects of the current arrangements in the ATM system that, in its view, should be addressed in further industry work: access to the ATM system and direct charging.<sup>7</sup>

On access, the Bank stated that it saw merit in the development of an access code to liberalise access arrangements in the ATM system. It also indicated that it saw merit in arrangements that ensured that negotiations over interchange fees could not be used in a way that adversely affected access or competition; it suggested that one way of achieving this would be to establish a common interchange fee for ATM transactions, as exists in many other countries. The Bank also indicated that ATM owners should be able to levy a direct charge at the ATM if they saw a case for doing so, and that accordingly, there was 'a strong case for the removal of any technical or business restrictions that limited the ability of ATM owners to impose a direct charge'.

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<sup>7</sup> Reserve Bank of Australia (2005), Payments System Board – November 2005, *Media Release 2005-13*, 25 November.

In response to the Bank's views, the Chairman of the ABA Council wrote to the Reserve Bank on 15 December 2006 setting out a proposal for reform. This proposal was then refined during a number of industry-wide meetings facilitated by the Bank and a final reform package was considered by the Payments System Board at its August 2007 meeting. This package involved:

- (a) an industry-developed access code implemented through APCA;
- (b) ATM owners having the freedom to charge cardholders directly for the use of an ATM;
- (c) zero interchange fees between direct connectors, implemented through an access code;
- (d) sub-networks being able to retain their multilateral interchange fees;
- (e) an ability for institutions to enter into arrangements to rebate the direct charge for their customers at the time of the transaction; and
- (f) a dispute resolution and disclosure regime.

Since May 2007, the industry has been working on both the technical and legal changes necessary to implement the proposal, which it has committed to introducing by 3 March 2009. This work has been proceeding broadly to timetable and is set out in progress reports compiled by APCA and posted on the Reserve Bank's website.<sup>8</sup>

#### **4. Why is Regulation Needed?**

Notwithstanding the substantial progress on implementing the reforms, the industry has recently come to the view that the most effective way of providing legal certainty to the process is for the Reserve Bank to designate the ATM system and set interchange fees to zero. This is despite earlier arguments that the industry itself could address the relevant issues.

The main alternative to regulation by the Bank is for industry participants to apply to the ACCC for authorisation of the arrangements. This was the route taken by the industry when it created the clearing systems for APCA. While some industry participants have supported this approach, this support has not been sufficiently widespread for an application to proceed.

The Board has strongly encouraged industry participants to find an industry-based solution to reform of the ATM industry. While it welcomes the significant progress that has been made over the past year or so, it is disappointed that after such a long process the industry has not been able to find a solution that does not involve designation of the ATM system and formal regulation by the Bank. Notwithstanding this, the Board is of the view that the package of reforms developed by the industry will improve competition and efficiency in the ATM system and is therefore proposing to provide legal certainty to some aspects of that package by introducing regulations requiring that no interchange fees be paid between direct participants in the system and improving access arrangements.

Although the Bank has in the past set standards to regulate interchange fees, in the case of ATM interchange fees the Board is of the view that the most appropriate regulation to give effect to zero interchange fees is an access regime. As discussed in Section 3.1.2, because interchange fees are set bilaterally in the ATM system, agreement on a fee is a condition of access for new entrants. Inability to agree on a bilateral interchange fee, or one at least as favourable as other

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<sup>8</sup> See [http://www.rba.gov.au/PaymentsSystem/Reforms/ATM/ind\\_sub\\_reports.html](http://www.rba.gov.au/PaymentsSystem/Reforms/ATM/ind_sub_reports.html).

participants, can effectively act as a barrier to entry. Setting bilateral interchange fees to zero is, therefore, standardising a price of access.

As discussed in Section 3.1.2, another of the complications for a new entrant to the ATM system is that if it wants to participate directly, it has to establish a number of direct connections with other participants. This includes negotiation with each participant on the cost of any such connection – there is no once-off, standardised entry fee. Participants could use such negotiations to limit competition by charging a very high price to establish a connection. By capping such a cost, an access regime can provide some certainty to current participants and new entrants, while ensuring that the cost to new entrants does not act as a barrier to entry.

The *Payment Systems (Regulation) Act 1998* sets out the criteria that the Bank must take into account when imposing an access regime on a payment system. Specifically, the Act states that:

*The access regime imposed must be one that the Reserve Bank considers appropriate, having regard to:*

- (a) whether imposing the access regime would be in the public interest; and*
- (b) the interests of current participants in the system; and*
- (c) the interests of people who, in the future, may want access to the system; and*
- (d) any other matters the Reserve Bank considers relevant.*

The Act also sets out the matters that the Bank is required to take into account in determining if a particular action is in the public interest. Specifically, the Bank is required:

*to have regard to the desirability of payment systems:*

- (a) being (in its opinion):*
  - (i) financially safe for use by participants; and*
  - (ii) efficient; and*
  - (iii) competitive; and*
- (b) not (in its opinion) materially causing or contributing to increased risk to the financial system.*

The Board is of the view that the combination of an Access Code implemented by the industry and the proposed Access Regime is in the public interest. It will provide a number of benefits and address the shortcomings in competition identified in Section 3.

First, by replacing interchange fees with direct charges by the ATM owner, stronger competitive forces will be able to be brought to bear on fees paid by consumers. Unlike interchange fees, on which normal competitive forces could not act, consumers will be able to directly observe direct charges and, if they are too high, choose to withdraw cash elsewhere. ATM owners will therefore face competitive pressures when setting their fees.

Second, by setting interchange fees to zero and capping the cost of connection, the proposed Access Regime will make access less complicated for new entrants, particularly when combined with the industry Access Code, which allows for a clear and enforceable timetable for access.

Access has long been an issue for the ATM system and, although the reforms will impose costs on current participants, this is a necessary feature of opening up access in a system with a bilateral architecture.

Third, the ability to direct charge will help ensure that ATMs continue to be widely available, including in high-cost locations, and that as costs rise over time, ATM numbers will not decline simply due to an inability to renegotiate interchange fees. Over recent years, there has been a substantial rise in the number of ATMs, primarily driven by independent ATM owners. This has increased the convenience and reach of the ATM network, offering substantial benefits to Australian consumers. These reforms, of which the proposed Access Regime is an integral part, will help ensure that these benefits are maintained.

Fourth, the reforms will result in fees for cash withdrawals being more transparent to customers. The direct charge will be disclosed at the time of the transaction and the cardholder will be given an opportunity to cancel the transaction at no cost. Furthermore, with interchange fees at zero, card issuers will no longer have to pay a fee to the ATM owner and the Board is therefore of the view that foreign fees should be eliminated, particularly given that per-transaction charges do not currently apply to most transaction accounts in Australia.

While the proposed Access Regime and Access Code will liberalise entry to the ATM system, there will be no diminution in the safety of the system for participants, nor will risk in the financial system rise. The requirements imposed on access seekers by the proposed Access Code, and in particular the requirement that access seekers join the Consumer Electronic Clearing System and meet the associated technical and security requirements, will ensure that the safety and security of the ATM system in Australia is maintained.

Although the proposed Access Regime will set bilateral interchange fees between direct participants to zero, it will still permit fees to be paid in two circumstances. The first is within sub-networks that have multilateral interchange fees, and the second is bespoke agreements between small financial institutions and large networks. Both of these arrangements allow small financial institutions to compete more effectively with large financial institutions in offering a widespread network of ATMs and are therefore pro-competitive. This issue, along with detail on how the proposed Access Regime will allow for these arrangements, is discussed in Section 5.

While the Board is of the view that the proposed Access Regime will help improve competition, it nevertheless has ongoing concerns about access arrangements in Australian bilateral payment systems, including the ATM system.<sup>9</sup> In particular, while the proposed Access Code and Access Regime address some concerns such as timeframes and cost of access, they do not address the more general concern that, as a result of the bilateral architecture, new entrants need to establish multiple connections and business relationships. The Board is therefore of the view that further reform is needed. In particular, the Board would like to see, as a matter of priority, the industry introduce alternative access arrangements which would allow entry without the need to establish a multitude of bilateral connections. This issue is discussed in Section 6.

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<sup>9</sup> *These concerns were also raised in the conclusions of the review of the card payment system reforms.*

## 5. Draft Access Regime

The draft Access Regime is set out in the Attachment. It should be considered in conjunction with the draft Access Code developed by APCA.

The draft Access Regime addresses two issues. It imposes a cap on the charge for providing a 'Direct Connection Service' and it specifies that no interchange fees will be paid except where particular conditions are met.

### 5.1 Cap on connection charges

In determining an access regime that meets the requirements of the *Payment Systems (Regulation) Act*, the Board has considered the two types of connection services defined in the draft Access Code:

- a *direct connection* – a direct communication link between two parties that enables them to directly exchange ATM transaction messages, and clear and settle ATM transactions that arise between them; and
- a *direct clearing/settlement arrangement* – an arrangement between two parties that are indirectly connected via a switch that enables them to directly clear and settle ATM transactions that arise between them.

A direct connection service is essential for new entrants that wish to participate directly in the ATM system. As discussed in Section 3, a fundamental feature of the bilateral technical architecture is that new entrants have to establish connections with a number of participants in order to participate fully in the payment system. Currently, new entrants have no rights to such connections and participants are not obliged to provide them. The Access Code would provide such rights and obligations and envisages that those obliged to provide the direct connection will be able to recover some of their costs from new entrants as a connection charge. The Board sees a strong case to cap this charge both to provide some certainty to new entrants around the cost of direct participation and to ensure that potential new entrants do not face unnecessary barriers to entry.

A direct clearing and settlement service is somewhat different. An integral part of any financial institution's business is the provision of payment services to its customers. This necessarily involves having arrangements with other financial institutions to send and accept payment messages, and for clearing and settling the resulting obligations. Clearing and settling is fundamental banking business and, provided financial institutions meet appropriate objective prudential standards, they should have the right to clear and settle directly with other financial institutions. It is therefore the Board's view that, if a new entrant meets the eligibility criteria under the Access Code to seek access to direct clearing and settlement services, it should not be charged to establish this service. The access seeker will still, however, have to meet its own costs and any fees for membership of the Access Code and the clearing system for ATM transactions.

The draft Access Regime therefore proposes setting a cap on direct connection only. From the date the ATM Access Regime comes into force, the cap for the cost of a direct connection service is to be set at the lowest estimated cost of providing that service as reported in a survey of ATM connection costs undertaken by APCA in August 2008. On the basis of this, the draft

Access Regime sets a cap on the cost of a direct connection service of \$76 700. This cap will apply to any applications from an access seeker for a direct connection service under the Access Code from the date the Access Regime comes into force.

The choice of this cap reflects a balancing of the interests of both current and prospective participants as well as being the methodology adopted for setting a cap on the cost of EFTPOS connections in the EFTPOS Access Regime. The basis of the methodology is that the cost should be capped at the cost of the most efficient provider of the connection service. This represents, in the Board's view, an appropriate balance between the interests of existing participants and prospective participants, given existing technology, while also providing incentives for efficiency within the system. It is the Board's view that setting any higher cap would overweight the interests of existing participants at the expense of both prospective participants and the overall efficiency of the system.

Consistent with the view that access seekers should not be charged for the establishment of direct clearing and settlement services, the draft Access Regime does not provide for access providers to charge access seekers for establishing this service. The Board expects that the industry Access Code will not impose such a charge either.

Although the proposed Access Regime sets a cap on the cost of a bilateral connection, the Board's view is that the existing bilateral web of connections is no longer promoting the efficiency of the system. These connections unnecessarily complicate access and are based on obsolete technology that is due for replacement. The Board is therefore proposing that any Access Regime (and complementary Access Code) should only be a temporary measure while the industry moves to a more access-friendly architecture. One consequence of this is that the proposed Access Regime does not allow for the recalculation of the cap as was done in the EFTPOS Access Regime. The Board's views on the future of the ATM network architecture are discussed in more detail in Section 6.

## 5.2 Interchange fees

As discussed in Section 3, the Board is of the view that bilateral interchange fees in the ATM system are not subject to competitive pressures and can act as a barrier to entry. It therefore sees merit in the industry's reforms that would set a common interchange fee of zero with ATM owners recovering their costs through direct charges that are transparent and subject to competition. To implement these reforms, the draft Access Regime requires that no interchange fees be paid between participants in the ATM system except in some special circumstances. These are:

- the fee is being paid by a participant to a provider as a one-way arrangement for access to the provider's ATMs (a bespoke agreement); or
- the fee is being paid between participants of an ATM sub-network and is set as a multilateral fee by that sub-network.

The draft Access Regime also prevents a participant that receives an interchange fee in a one-way arrangement from paying an interchange fee to any other participant, other than within a sub-network.

The purpose of allowing fees to be paid between participants in these circumstances is to permit arrangements that enhance competition. The Bank has received representations from many small financial institutions highlighting the difficulties they face in competing with financial institutions that have large networks of ATMs. Small institutions argue that in order to compete effectively, they need to be able to offer to their customers a reasonable network of ATMs from which they can withdraw cash at no charge – just as large institutions do. They have historically achieved this in a couple of different ways.

First, many small institutions have joined sub-networks in which there is a multilateral interchange fee between the participants. Customers can use ATMs within that network, but can also use ATMs outside that network through the switching capability of the network operator. These sub-network arrangements were explicitly allowed for in the reform package proposed by the industry.

Second, some small institutions have negotiated ‘bespoke’ agreements with a large network (typically a large bank) in which their customers can use the large institution’s ATMs. This involves the payment of what might be best regarded as an access fee to the large institution. These arrangements have only recently come to the Bank’s attention and it has clarified its views on such bespoke arrangements to the industry in a letter to APCA of 1 September 2008.<sup>10</sup>

The draft Access Regime explicitly allows for both such arrangements while making it clear that bilateral interchange arrangements between direct connectors in the ATM system must have no interchange fees.

## 6. The Future Evolution of the ATM System

As discussed above, the Board has, for some time, expressed concern about the effect of Australia’s reliance on bilateral payments system architecture. In the Board’s view, while this architecture may have been useful in the original development of some payment systems – including the ATM and EFTPOS systems – it is no longer conducive to the efficient evolution of these systems or to the promotion of competition within these systems.

The difficulties are highlighted by the industry’s draft ATM Access Code. While this Code is an improvement on current arrangements, it includes some provisions that are undesirable from the perspective of competition. In particular:

- it includes provisions that allow current participants to place limits on the number of concurrent implementations they have to carry out; and
- it allows up to 150 business days, or around 8 months, for the participants to implement new connections. This time frame, combined with the time required for processing applications and agreeing the project plan, means that it could take the best part of a year to establish a single connection.

These provisions are designed to ease the burden on current participants by limiting the links they have to establish and by stretching out the time over which the links need to be implemented. While such restrictions work to the advantage of the existing institutions, they also work to the disadvantage of potential new entrants. In the Board’s view, a better balance

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<sup>10</sup> See [http://www.rba.gov.au/PaymentsSystem/Reforms/ATM/rba\\_010908\\_1.pdf](http://www.rba.gov.au/PaymentsSystem/Reforms/ATM/rba_010908_1.pdf).

needs to be achieved, with fundamentally different network architecture arrangements creating the possibility that new entrants could come into the system without the existing institutions having to incur significant costs. Such arrangements, coupled with appropriate governance arrangements, have the potential to promote both competition and innovation in the overall payments system.

A significant part of the current communications technology underpinning the ATM system (and indeed other Australian bilateral payment systems) is soon to become obsolete and will have to be replaced in the next year or so. This provides the opportunity for significant improvements to the systems' network architecture, which would in turn allow improved access arrangements. Given the timing, the Board views it as reasonable to expect that the changes necessary to support more open access to the ATM system could be in place by 2010. It expects that, as a consequence, by March 2010 much of the industry Access Code and associated Access Regime should be obsolete and will be able to be replaced with a model that provides for a single point of access.

The potential change to the access arrangements for ATMs also has implications for access to the EFTPOS system. Like the current proposals for the ATM system, the EFTPOS Access Code and Access Regime implemented in 2006 were established on the basis of a bilateral access model. The Board therefore anticipates that if any changes are made to the ATM system architecture to support a more efficient access model for ATMs, similar changes will also be made to the EFTPOS system. As a result, the current Access Code and Access Regime for the EFTPOS system should also be able to be simplified substantially in 2010.

The Board does not wish to specify a particular technology for the ATM and EFTPOS systems – ideally this is best done by the industry. There are, however, a number of characteristics that the Board views as important if the new arrangements are to effectively promote competition and efficiency. These include:

- a single point of access, enabling new entrants to establish one connection only. Furthermore, the arrangements should minimise the extent to which new entrants are required to individually negotiate with multiple participants;
- the use of message formats that are, to the fullest extent possible, standardised; and
- the use of international standards where appropriate.

If, by March 2010, the industry has not addressed the Board's concerns about the access model for the ATM and EFTPOS systems, the Board will consider a more active role. This may involve setting technical standards that the systems and the participants would be required to meet. The Board may also consider how the Bank could play a role in promoting access to retail payment systems through its own operations.

# Attachment

## Draft Access Regime for the ATM System

### Objective

*The objective of this Access Regime is to promote competition and efficiency in the Australian payments system, having regard to:*

- (i) the interests of current participants in the ATM system;*
- (ii) the interests of people who, in the future, may want access to the ATM system;*
- (iii) the public interest; and*
- (iv) the financial stability of the ATM system.*

### Application

1. This Access Regime is imposed under Section 12 of the *Payment Systems (Regulation) Act 1998*.
2. This Access Regime applies to the payment system operated within Australia known as the ATM system, which was designated as a payment system on 10 December 2008 and referred to below as the ATM system.
3. In this Access Regime:
  - ‘Access Provider’ has the same meaning as in the ATM Access Code;
  - ‘Access Seeker’ has the same meaning as in the ATM Access Code;
  - ‘APCA’ means the Australian Payments Clearing Association Limited (ABN 12 055 136 519);
  - ‘APCA’s 2008 costs survey’ is the survey, conducted by APCA, of the estimated incremental direct costs to Access Providers of providing to an Access Seeker a Direct Connection Service or a Direct Clearing/Settlement Service, the results of which were supplied to the Reserve Bank of Australia on 22 October 2008;
  - an ‘ATM’ means an automatic teller machine in Australia;
  - an ‘ATM Acquirer’ has the same meaning as in the ATM Access Code;
  - ‘ATM Access Code’ means the ATM Access Code adopted by ATM Access Australia Limited [ABN] on [ ] and as varied from time to time;
  - an ‘ATM Issuer’ has the same meaning as in the ATM Access Code;
  - an ‘ATM sub-network’ is a component of the ATM system for which access is provided on a multilateral basis, rather than by bilateral negotiation, and for which there is a common, multilateral interchange fee;

‘ATM transaction’ means a cash withdrawal, balance enquiry, or any other service obtained from an ATM in the ATM system in Australia;

‘Connection Agreement’ has the same meaning as in the ATM Access Code;

‘Connection Charge’ means the charge payable by an Access Seeker to an Access Provider under a Connection Agreement as described in Clause 3 of Schedule 3 of the ATM Access Code;

‘Direct Connection Service’ has the same meaning as in the ATM Access Code;

‘Direct Connector’ means a participant that exchanges ATM transaction messages, and clears and settles ATM transactions using two or more direct connections;

an ‘interchange fee’ is a wholesale fee which is payable by an ATM Issuer to an ATM Acquirer when a cardholder of the ATM Issuer undertakes an ATM transaction that is acquired by the ATM Acquirer;

a ‘one-way arrangement’ is an access arrangement whereby an ATM Issuer pays an interchange fee to an ATM Acquirer for use of an ATM by a cardholder, but that same ATM Acquirer does not pay an interchange fee to access any ATMs of the ATM Issuer in the arrangement;

terms defined in the *Payment Systems (Regulation) Act 1998* have the same meaning in this Access Regime.

4. Each participant in the ATM system must do all things necessary on its part to ensure compliance with this Access Regime.
5. If any part of this Access Regime is invalid, it is ineffective only to the extent of such part without invalidating the remaining parts of this Access Regime.
6. This Access Regime is to be interpreted:
  - in accordance with its objective; and
  - by looking beyond form to substance.
7. This Access Regime comes into force on [3 March 2009].

## **Price of access**

### *Connection Charge for providing the Direct Connection Service*

8. The Connection Charge levied by an Access Provider for providing the Direct Connection Service to an Access Seeker must not exceed the Direct Connection Cap, calculated in accordance with paragraph 9 below, applying on the date the Connection Agreement is entered into.
9. From [3 March 2009], the Direct Connection Cap for the Connection Charge in the ATM system is the lowest estimated cost for providing a Direct Connection Service as measured in APCA’s 2008 costs survey. This cost is \$76 700 (excluding GST).

### *Interchange fees*

10. From [3 March 2009], no interchange fee shall be paid between participants in the ATM system in relation to any ATM transaction, unless the interchange fee is being paid by:
  - (i) a participant with a one-way arrangement to access one, and only one, other participant's ATMs and the fee is paid in respect of this arrangement; or
  - (ii) a participant that is a member of an ATM sub-network and the fee is the common interchange fee payable between the members of the sub-network, and the fee is paid to another member of that sub-network.
11. A participant that pays an interchange fee in a one-way arrangement cannot receive an interchange fee from any other participant in the ATM system unless both those participants are members of an ATM sub-network and the interchange fee is the common interchange fee payable between members of the sub-network.

### **Transparency**

12. Each ATM Acquirer in the ATM system that receives an interchange fee within the terms of sub-paragraph 10(i) must report that arrangement to the Reserve Bank of Australia no later than [3 April 2009] for existing arrangements or within thirty days of the date the arrangement is entered into for new arrangements.
13. The administrator of an ATM sub-network or a representative of the participants in an ATM sub-network must publish the multilateral interchange fee of the sub-network on the administrator's website or on a representative of the participants' website, or make the multilateral interchange fee generally available through other means.
14. The administrator of an ATM sub-network must publish the rules that govern access to the sub-network.