

Submission to the Reserve Bank of
Australia

Payment Systems reform –
ATM Interchange

July 2004



Contents

1.	Executive summary	3
2.	Introduction	4
3.	Australian consumers' use of ATM and foreign ATM transactions	4
4.	A direct charging model	5
4.1.	Public benefits	5
_____ 4.1.1.	Unbundling of fees & transparent fee disclosure	6
_____ 4.1.2.	Greater alignment of fees with costs	6
_____ 4.1.3.	Differential pricing	7
_____ 4.1.4.	Enhanced consumer choice and convenience	7
_____ 4.1.5.	Expanded ATM network	8
_____ 4.1.6.	Increased competition	8
4.2.	EFT Code of Conduct	9
5.	Networks	9
6.	Access	10
7.	Costs	11
8.	Technical implementation	11
9.	Designation and self-regulatory approach to reform	12
10.	Conclusion	12

1. Executive summary

ANZ is making this submission in response to an invitation from the Reserve Bank of Australia to participate in its consultation on whether it would be in the public interest for the RBA to designate Australia's ATM system as a payment system. This follows the Joint Study of October 2000 by the RBA and the Australian Competition and Consumer Commission that found that interchange fees for ATM services were above the costs of providing the service. The Joint Study indicated a preference for moving from the existing model of ATM interchange fees to a direct charging regime.

The industry, through the ATM Industry Steering Group, has developed a direct charging model that would have the following public benefits:

- unbundling of fees and transparent fee disclosure at the point of transaction ;
- enhanced consumer choice and convenience;
- transaction prices more closely aligned to costs;
- economic incentives for an expanded ATM network;
- enhanced access for new and existing market participants; and
- increased competition between ATM Acquirers and ATM Operators.

We have considered at length the impact of the proposed reforms on smaller institutions. A "pure" form of direct charging would prevent the operation of the existing aggregate networks of credit unions and building societies, which have been developed for the benefit of their customers. ANZ contends this outcome would be contrary to a public benefits test. As a result, ANZ would be comfortable supporting a "carve out" from the direct charging regime for ATM transactions conducted by Credit Unions and Building Societies within their respective shared networks. All transactions external to those networks should be part of the direct charging regime. Direct charging should apply to all other institutions.

ANZ recognises that the public benefits to be derived from direct charging will be enhanced through fair and equitable access to the ATM network. APCA is the appropriate body to undertake an access project and we recommend that APCA be permitted to develop a suitable access regime in parallel to any decisions the RBA may take to advance the reforms. APCA is also the appropriate body to project manage the significant implementation task required to introduce direct charging so as to maintain system stability.

Generally, ANZ believes self-regulatory solutions are preferable to regulations and to this end ANZ has been an active participant in the AISG work program. ANZ would expect the industry outcomes would be the basis for further RBA consideration of the approach to reform including the determination of standards or the development of an access regime should the RBA decide that the public interest would be served by designating the payment system.

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2. Introduction

This submission results from the Reserve Bank of Australia's announcement that it is consulting interested parties on their views on whether it would be in the public interest for the RBA to designate Australia's ATM system as a payment system. To date, the ATM industry has been progressing the reform agenda through the ATM Industry Steering Group (AISG)¹. We understand the AISG will provide the RBA with data describing the Australian ATM payment system and details of a consensus model developed under a self-regulated approach by the ATM industry participants.

The RBA consultation follows the Joint Study of October 2000 by the Reserve Bank of Australia (RBA) and the Australian Competition and Consumer Commission (ACCC) entitled *Debit and Credit Card Schemes in Australia - A Study of Interchange Fees and Access* (RBA/ACCC Joint Study). The RBA/ACCC Joint Study argued that interchange fees for ATM services were above the costs of providing the service and that they show little responsiveness to changes in major components of costs.

The RBA/ACCC Joint Study found that while interchange fees were the most common basis for recouping costs of providing ATM services around the world, ATM providers could seek to recover their costs directly from cardholders of financial institutions.

The RBA/ACCC Joint Study indicated a preference for moving from the existing model of ATM Interchange Fees to a direct charging model for ATMs. The Joint Study also outlined the benefits to competition of increasing price transparency and disclosure.

3. Australian consumers' use of ATM and foreign ATM transactions

The AISG commissioned consumer research to put the deliberations around interchange reform into context of existing consumer preferences and usage patterns.

The research, conducted by Roy Morgan Research², found that 83% of Australians use ATMs and that ATMs are widely accessible. Around 99% of consumers say they have access to an ATM and 85% state that they have access to their own bank's ATM where they do their shopping. The majority of people under the age of 50 use ATMs regularly, whereas over the age of 50 usage declines rapidly. Around 17% of consumers do not use ATMs at all.

In relation to Foreign ATM usage, the research found that most ATM users prefer to use their own bank's ATM, in the first instance.

The research also found that Foreign ATM usage is widespread, however less frequent than ATM usage overall. Foreign ATMs had been used by 64% of consumers in the preceding 12 months. People under the age of 50 are more

¹ The AISG comprises the following institutions: Adelaide Bank Limited, Australia and New Zealand Banking Group Limited, Bank of Queensland Limited, Bank of Western Australia Limited, Cashcard Australia Limited, Commonwealth Bank of Australia, Credit Union Services Corporation (Australia) Limited, HSBC, IMB Society Ltd (representing Building Societies), National Australia Bank Limited, Pulse International Pty Limited, St George Bank Limited, Suncorp-Metway Limited, Westpac Banking Corporation

² Roy Morgan Research, ATM Direct Charging Report for AISG, May 2003.

likely to use Foreign ATMs, as are those in higher socioeconomic groups. Rural users are less likely to use Foreign ATMs than their urban counterparts.

Of those that use Foreign ATMs, 23% are frequent users (i.e. more than 21 times in the past 12 months). The next group, moderate users (11-20 times in the past 12 months), represented 8%. Of consumers who do use ATMs, around 19% do not use Foreign ATMs. This is in addition to the 17% of the overall population that do not use ATMs at all. Accordingly, only about 16%³ of all ATM users will experience the most immediate and noticeable impact of the proposed changes to ATM charging arrangements.

4. A direct charging model

ANZ supports a model of direct charging in which interchange fees are set to zero and replaced by direct charging by the issuer and ATM owner for foreign ATM transactions with real time disclosure of the ATM owner fee. Specifically, we would support a model that required the following conduct of ATM industry participants:

- reduce the existing ATM Interchange Fees, charged or paid in connection with an ATM Transaction in Australia, to zero;
- require the ATM Operator to disclose the existence and amount of any direct charge to the Cardholder prior to the Cardholder committing to the transaction and permit the Cardholder to cancel the transaction without charge;
- allow for the amount of the ATM Operator Direct Fee to be debited to the Cardholder's account in conjunction with a cash withdrawal, balance inquiry or other Foreign ATM transaction for which an ATM Operator Direct Fee may be charged;
- require both amounts (cash withdrawal and direct charge) to be settled between the Card Issuer and the ATM Operator (or the ATM Acquirer);
- require the disclosure of the possible existence (however not necessarily the amount) of a Card Issuer Transaction Fee prior to the Cardholder committing to the transaction;
- require the amount of the Card Issuer Transaction Fee (if any) to be unbundled from any ATM Operator Direct Fee; and
- require the Card Issuer Fee to be disclosed in accordance with the EFT Code of Conduct.

4.1. Public benefits

The proposed conduct will be likely to result in significant public benefits including:

- unbundling of existing foreign ATM fees and transparent fee disclosure at the point of transaction;
- enhanced consumer choice and convenience;

³ This number is derived from frequent and moderate users of Foreign ATMs as a percentage of those who use Foreign ATMs.

- transaction prices more closely aligned to costs;
- economic incentives for an expanded ATM network;
- enhanced access for new and existing market participants; and
- increased competition between ATM Acquirers and ATM Operators.

The proposed reform will not result in any lessening of competition. A discussion of these public benefits follows.

4.1.1. Unbundling of fees & transparent fee disclosure

The proposed unbundling and disclosure that will result from the reform will cause a marked improvement in a Cardholder's level of fee knowledge at the time of making, or proposing to make, a Foreign ATM transaction. Research prepared for the Applicants indicates that:

“Generally, people were aware that, where they pay to use a foreign ATM, it costs more than using their own bank's ATM. However, for most people, their knowledge of the actual transaction fees was very limited, demonstrating that the proposed changes to the charging method for foreign ATMs would be introduced into a market where many people have little or no idea of existing ATM transaction fees. An increase in the immediacy of fee disclosure (for example onscreen at the time of the transaction) would have a major influence on future levels of fee knowledge and the possible use of ATMs.”⁴

Currently, Cardholders may not be aware of the components of the charge they will be levied for using a Foreign ATM. For the first time, Cardholders making a Foreign ATM transaction will be informed of the exact fee charged by the ATM Operator before committing to the transaction. Cardholders will also be informed at the time of the transaction that a Transaction Fee may be charged by their Card Issuer. Greater fee awareness will enable Cardholders to exercise more informed choices and thereby exert market influence over the prices charged by Card Issuers and ATM Operators.

When the Cardholder receives their statement they will see the Foreign ATM fee clearly identified, so that they are aware of the exact quantum and source of the fees they have been charged. Card issuers will write to all Cardholders before the changes to the ATM charging arrangements proceed to ensure that fees are fully explained.

4.1.2. Greater alignment of fees with costs

By enabling ATM operators to base the fees they charge Cardholders on the costs of providing the service, there are economic incentives created for placing ATMs in areas where the costs are currently prohibitive. This will benefit consumers in the following way:

- Consumers will be able to access ATM services in high cost areas more conveniently as ATM Operators have an incentive to deploy ATMs in these areas; and

⁴ Roy Morgan Research op. cit. at 5.

- Fees will be able to change in line with competitive and commercial circumstances including the development of a new access regime, and will not remain at a level unjustified by costs.

In the context of assessing the impact of alignment of fees with costs, the Reserve Bank's Payments System Board analysed developments in international jurisdictions where direct charging applies and concluded:

"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".⁵

4.1.3. Differential pricing

ANZ, along with several other banks, has indicated publicly that we do not intend to differentially price for foreign ATM transactions between city and rural locations. The Reserve Bank Governor said recently that "at the moment banks do not charge a different fee for any of the services they provide to rural customers compared to city customers ... I expect that that would continue if banks were free to charge whatever they wanted on their ATMs. I would expect that they would be mad not to – the reaction would be so overwhelming. I do not think they would want to anyhow."⁶

This will mean that some degree of cross subsidy will be maintained across the ANZ ATM network to ensure this commitment can be delivered and that the existing network can be maintained. A decision to price consistently across the network means that it is less likely that those institutions will expand into areas where it is currently not cost effective to do so. This decision may also impact on the level of pricing in high volume areas, with those fees not falling as far as a closer alignment of pricing and costs might suggest. However, this result still provides a net public benefit across all users of foreign ATMs.

4.1.4. Enhanced consumer choice and convenience

Consumers may benefit from an expanded ATM network that will provide them with more choices of ATM services with better, more convenient access to ATM services.

In some locations, services have been uneconomic, meaning that consumers have not had the choice of accessing more convenient banking facilities, and in some cases have had to travel significant distances to access an ATM. Under the reforms, additional investment by independent operators and the likely placement of ATMs in previously unserved areas will allow consumers more choices in their access to banking services.

Disclosure of fees will enable the public to make more informed banking decisions in relation to choosing their ATM provider, based on their individual circumstances including proximity to services.

⁵ Statement by RBA tabled at Chapman Parliamentary Inquiry, 5 Nov 2003

⁶ RBA Governor Ian MacFarlane before the Parliamentary Committee on Economics, Finance and Public Administration, 4 June 2004

The reform being proposed by ANZ also preserves network arrangements between credit unions and between building societies that will preserve the networks that have been developed and afford their customers greater convenience in terms of access to ATMs where they will not be direct charged.

4.1.5. Expanded ATM network

The ability for an ATM operator to earn economic returns, and the improvement of price signals to consumers, will encourage investment and innovation in the ATM market. The current system of interchange fees, which do not vary with location or any other attribute of the ATM service, is not flexible and restricts the ability of an ATM operator to expand their businesses. Under the proposed reforms, Independent ATM Operators may be able to profitably offer new services if there is sufficient demand for those services at the price they charge, and they will be able to vary the prices they charge in response to market conditions. Commercial disincentives to establishing services in areas where ATM services are currently unprofitable will be removed, which should encourage the growth of the ATM network.

The proposed conduct will therefore encourage a more efficient market whereby the supply of ATM services will be driven by the demand for these services in a particular location, resulting in expansion in the numbers of ATMs, particularly in areas currently not serviced. This will provide benefits for consumers who desire, and who are willing to pay for, the convenience of ATM services in particular locations.

4.1.6. Increased competition

The ATM market is competitive and barriers to entry are low. The low barriers to entry are evidenced by the enormous growth in the number of ATMs and new entrants, strongly indicating a largely open system. The number of ATMs in Australia has grown from approximately 4,600 in 1990 to over 21,000 in 2004. Much of this growth has occurred over the last five years with approximately 35% of ATMs owned and operated by Independent ATM Operators (IAOs).

There are a number of elements of the proposed arrangements that are likely to have positive competitive impacts resulting in a public benefit.

A fair and equitable access regime and enhanced transparency will allow prospective ATM operators full information providing certainty around access for the establishment of new ATM services. Freedom of entry into the ATM market will increase competitive pressure on the ATM market.

Increased incentives for market entry by ATM operators to earn an economic return on investments in the industry will encourage further market participation by independent operators and diversification in the industry. It is expected that this in turn will put competitive pressure on prices.

Transparency improvements in the provision of real time fee disclosure of foreign ATM fees will improve the pricing signals to cardholders, which is likely to lead to an improved competitive environment.

The reform will increase competition among ATM owners by unbundling the Foreign ATM Fee and providing consumers with better information to make decisions about selection of banking services based on their individual circumstances. Further, competitors in the market will have better access to

pricing information, which will improve market efficiency and have competitive benefits.

4.2. EFT Code of Conduct

The EFT Code of Conduct is a voluntary code of practice, overseen by the Australian Securities and Investments Commission (“ASIC”), that establishes rules around consumer electronic funds transfer transactions, including disclosure requirements. The Code sets out rules for business compliance, rights and responsibilities of consumers, complaints handling and dispute resolution mechanisms. The EFT Code of Conduct is designed to cover all types of electronic funds transfers including those involving an ATM. The Code will apply to all fee disclosure requirements under this reform.

5. Networks

We have considered at length the impact of the proposed reforms on smaller institutions. In particular, the impact this reform will have on credit unions through CUSCAL’s Rediteller network and Building Societies through the Cashcard network should be considered.

By virtue of their ATM business structure and acquiring arrangements it makes sense that these existing aggregate networks, developed for the benefit of their customers, should be preserved.

More specifically, credit unions are not-for-profit ADIs and tend to be significantly smaller than other ADIs in the Australian market. For example, the largest credit union is still about five times smaller than Bank of Queensland or Adelaide Bank and BankWest has approximately the same total assets as all credit unions combined.

Credit unions do not have bilateral interchange arrangements with other payment systems parties – these are held by CUSCAL, which holds and negotiates the bilaterals and operates the Rediteller and Redinet system. In a practical sense, CUSCAL acts as the Acquirer and the Card Issuer. All participants in the Rediteller network are credit unions, which share a range of common features, as opposed to other networks that comprise a variety of types of competing ADIs. A “pure” form of direct charging would prevent the operation of the Rediteller network, which ANZ contends would be contrary to a public benefits test.

As a result, ANZ would be comfortable supporting a “carve out” from the direct charging regime for ATM transactions conducted by credit unions and building societies within their shared networks. Of course, all transactions external to those networks should be part of the direct charging regime.

ANZ supports the principles, proposed by CUSCAL, that should underpin any “carve out” and be limited to networks as follows:

- A network where participants do not have other bilateral arrangements for the use or access of ATMs with other network providers;
- Participants on the network being limited to credit unions or a class of like institutions (eg building societies). Other participants on a network would direct charge all non-institutional cardholders, or in the case of an IAO, all cardholders;

- The arrangement would be limited to a proprietary aggregated network with brand, infrastructure and intellectual property held by a central owner;
- The arrangement would be limited to cardholders within a common card brand also settled through the central network (eg Redicard);
- ATMs within the exempt network (on which wholesale payments are allowed) would be commonly branded, share a common infrastructure, and operate within standards set by the network owner;
- Credit unions (or like institutions) could elect to 'opt out' which would require them to direct charge all cardholders (or all foreign cardholders).

To ensure that future developments continue to be monitored, we would suggest a review by the RBA every 2 years to ensure the exempt networks continue to comply with any exemption approval and that a level playing field is maintained. Direct charging should apply to all other institutions.

If other institutions competing in the ATM market wish to develop shared networks to aggregate volumes, and thus bypass the reforms, then they should seek ACCC authorisation on a case-by-case basis. ANZ would be concerned if exemptions from the reform were granted to other institutions so that competitive neutrality was not observed and that penalised those institutions that have invested heavily in their networks over many years for the benefit of their customers.

6. Access

ANZ recognises that the public benefits to be derived from direct charging will be enhanced through an access regime with well-understood protocols. Previously, the AISG has asked APCA to undertake a project to develop conditions of entry, which would facilitate access to the ATM network in the context of direct charging for Foreign ATM Transactions. It is important to note, however, that there will be a net public benefit from the interchange fee reform even with the current access arrangements. That is, nothing in the proposed conduct would introduce barriers to access.

The primary objective of APCA's work would be to develop a practicable and equitable regime to facilitate effective access to ATM networks for ATM Operators, Acquirers and Card Issuers. In agreeing to undertake the project APCA would include a review of the CECS Regulations and Manual and membership requirements and the development of an appropriate access regime in a direct charging environment. In undertaking such a review however, it will be crucial to maintain a set of principles relating to the security and integrity of the ATM system. Sensible commercial considerations should also be at the forefront of any consideration of access arrangements. For example, the bilateral agreements deal with many more issues than intellectual property and technical arrangements and links between players should not be jeopardised by oversimplifying these.

ANZ recognises APCA as the appropriate body to undertake this access project and we would recommend that this project should occur in parallel to any decision the RBA may take to advance reforms more broadly.

7. Costs

The provision of ATM services involves a substantial range of infrastructure and operating expenses incurred by the ATM Operator. These include device cost, installation, cash distribution, servicing, site rental, maintenance, signage, security, telecommunications and transaction processing. There is also a requirement for large regular investment in areas such as technology, maintenance, branding and security of the ATM network.

While ATM operating costs are influenced by a range of factors, location of the ATM is the primary driver with non-branch ATMs being significantly more expensive to operate. The ATM fleet has a high fixed cost base, meaning that high volume sites are generally economically positive whilst low volume sites are often run at a considerable loss for the benefit of customers. The traditional bank owned and operated ATM network offers high-end machines, which provide exceptional availability for customers and high levels of cash security. This requires expensive machines and dedicated communication and security infrastructure, which contribute to the high cost of running these fleets. In contrast some independent operators utilise low-end machines and unsophisticated communications technology and cash handling processes, which results in lower operating costs.

A Card Issuer also incurs significant costs including verifying, authorising, processing and settling transactions for Cardholders when they use a Foreign ATM. These costs are not directly influenced by the location of the ATM.

Since the Joint Study, the costs of running an ATM network continue to increase, driven by a number of factors:

- significant increases in the rental costs of ATM sites, particularly in shopping centres;
- substantial increases in the security costs of servicing ATMs, especially in NSW;
- emerging government requirements / regulations, such as the Victorian Government proposal to require cameras on some ATMs;
- substantial investments to upgrade ATM hardware and operating platforms; and
- compliance with scheme mandated security upgrades and disability access standards.

8. Technical implementation

The technical requirements to implement a direct charging regime, in such a way as to maintain financial system stability, are significant. Essentially, the reform requires every ATM industry participant to restructure their systems and to be able to test and then run those systems in a way compatible with all other systems. It requires all institutions to be ready to adopt the new system on the same date. Progress on testing and implementation will be determined by the pace of the slowest participant. This is a major industry undertaking.

For this reason, the AISG drafted a Project Scope document. The purpose of the document is to accumulate detailed business requirements for the

implementation of a direct charging model across the Australian domestic ATM network. If a decision is taken to introduce direct charging in Australia, the document will be the primary business requirement reference source for use by project participants in developing detailed Design Specifications and Technical Specifications for their internal ATM Systems. A version of this document was made available to APCA some time ago. APCA agreed to facilitate the project management of the technical implementation. It is estimated that this project, including the testing phase, could take between 18 to 21 months to complete. The Project Scope business requirements document details the functional requirements necessary to implement the Direct Charge model across the domestic ATM Network.

ANZ has already commenced an internal system design including the technical and operational issues that will enable the implementation of the industry's requirements. The testing phase included in the AISG Project Scope will cover both internal testing and industry-wide testing based on an industry-wide test strategy. This latter step is one that must be coordinated by a body such as APCA (or overseen by APCA) to ensure the process works properly and to maintain system integrity and stability. APCA has the industry credibility and authority to undertake this work. The testing phase will be followed by the required contractual amendments and settlement implementation.

ANZ asks that the RBA take into consideration the technical implementation required for direct charging when it decides how it wishes to advance the reform and in what time frame.

9. Designation and self-regulatory approach to reform

Generally, ANZ believes self-regulatory solutions are preferable to regulations and to this end ANZ has been an active participant in the AISG work program. ANZ would expect the industry outcomes would be the basis for further RBA consideration of the approach to reform including the determination of standards or the development of an access regime should the RBA decide that the public interest would be served by designating the payment system.

10. Conclusion

The ATM industry has completed a major piece of work, over a considerable period of time, in assessing how to give effect to the RBA/ACCC Joint Study findings on ATM payment system reform. ATM industry participants, through the AISG, have developed a compromise direct charging model that would achieve the outcomes sought by the regulators.

ANZ supports this model, but would prefer that a network "carve out" be limited to credit unions and building societies, with an appropriate monitoring and review process to ensure the integrity of the reform is not undermined.

Direct charging will have a net public benefit for ATM users. As such, giving effect to the industry's work would be in the public interest. ANZ would support regulatory activity where it was giving legal effect, and business certainty, to the ATM interchange reform program.

ANZ appreciates that in the event the ATM payment system is designated, that further detailed consultation would ensue about the standard and access regime that would then be developed. The industry's work to date is a good basis for those discussions.