ATM Industry Steering Group
Direct Charging

The Australian ATM System
Prepared for the Reserve Bank of Australia

Direct Charging for
Foreign Automatic Teller Machine (ATM)
Transactions in Australia

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1. Background

1.1 RBA/ACCC Joint Study and Industry Reform

In light of the findings of the RBA/ACCC Joint Study, the RBA convened a meeting of the ATM industry on 23 July 2001. Subsequently, the RBA encouraged the formation of the ATM Industry steering Group (AISG) to progress ATM interchange reform options and proposals.

On 4 March 2003, the AISG published a consultation paper on the RBA website entitled "*Discussion Paper - Direct Charging for "Foreign" Automated Teller Machine Transactions in Australia*" ("Discussion Paper"). It outlined how a Direct Charging model could achieve the objectives of the RBA/ACCC Joint Study and invited submissions from interested parties.

The Direct Charging model, has received endorsement from the RBA, which stated in its 2003 Annual Report that:

"An industry proposal for a 'direct charging' regime that would replace ATM Interchange Fees has been put out for public consultation. The RBA believes that the proposed regime will lead to more transparent pricing and greater incentives for competition in the provision of ATM services in Australia, to the benefit of ATM users, and has encouraged industry participants to finalise the proposed reform during 2003." [1]

In addition, the Payment Systems Board of the RBA reiterated its support for reform in its 2003 Annual Report:

"The Board supports this proposal to eliminate hidden fees and believes that it would lead to greater competition in the ATM market... The Board's own work in this area suggests that 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." [2]

The proposed reforms also were discussed in a public hearing conducted by the Parliamentary Joint Committee on Corporations and Financial Services in November 2003. The RBA reiterated its support subject to the issue of access to the ATM market being addressed in the future Direct Charging environment.

The AISG assembled a considerable body of information as it progressed a self-regulatory approach to developing a response to direct charging. The purpose of this document is to provide the RBA with a description of how the Australian ATM network currently operates. The AISG considered this might be useful information to make available to the RBA as discussion continues around the public benefits of designating the ATM network as a payment system.

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[1] Reserve Bank of Australia, Annual Report 2003 at 19.

[2] Payment Systems Board, Annual Report 2003 Reserve Bank of Australia at 20.

2. The Existing Australian ATM Market

2.1 Background

The first ATM was installed by a credit union in 1977. They were more widely introduced into Australia in the early 1980s. Since then, there has been enormous growth in the number of ATMs, as well as in the volume and value of transactions conducted through ATMs by cardholders.

Cardholders primarily use ATMs for withdrawing cash or making account balance inquiries. Generally they would use an ATM deployed by their Card Issuer. A significant portion of ATM activity however, is transactions initiated at ATMs deployed by another financial institution or an independent company. These transactions are generically termed “Foreign ATM transactions”.

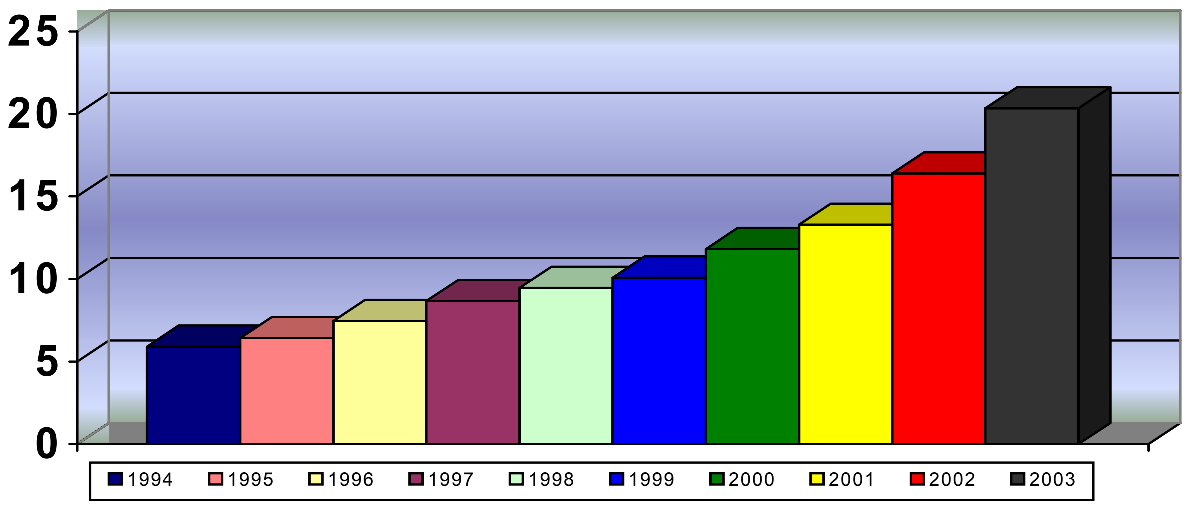
2.1.1 Growth in Number of ATMs

As Figure 2.1 demonstrates, 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.

There are a variety of financial institutions and Independent ATM Operators (“IAOs”) owning and operating small, medium and large networks of ATMs. Approximately 35% of ATMs are owned and operated by IAOs.

Expansion of linkages between the networks of financial institutions has been the primary catalyst for growth in the ATM network. The network has consequently become increasingly attractive to Cardholders and Card Issuers alike. Complete reciprocity among all ATM networks in Australia has ensued thereby achieving universal access for Cardholders.

Figure 2.1 – Annual Australian ATM Population (k)

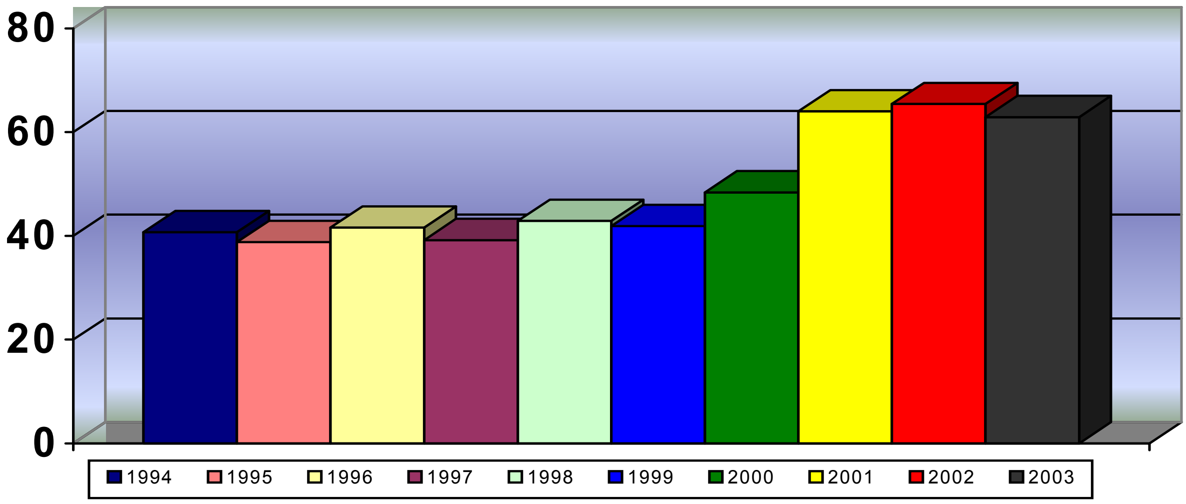


Source: Australian Payments Clearing Association (APCA)

2.1.2 Growth in Number of ATM Transactions

Both the number and value of ATM transactions have also increased dramatically in line with expansion of the Australian network and underpinned by consumer demand for convenient access to cash. In 2003, it was estimated that there were approximately 63 million ATM withdrawals per month in Australia with an annual value in excess of $11 billion. This represents an increase of approximately 50% and 200% respectively for volume and value over the last 10 years. Figure 2.2 illustrates this growth.

Figure 2.2 – Annual Australian ATM Withdrawals (m)

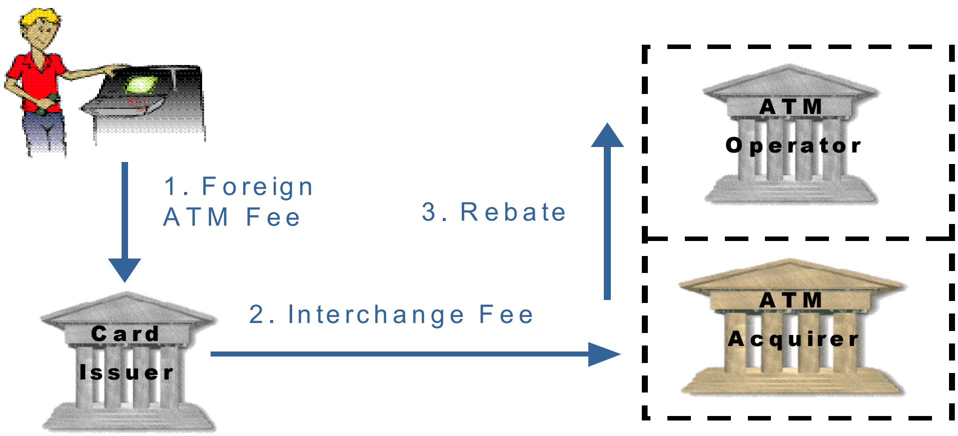


Source: Australian Payments Clearing Association (APCA)

2.2 Present Interchange Model for ATM Transactions

The figure below depicts the flow of an existing Foreign ATM Transaction.

Figure 2.3 – Existing Foreign ATM Transaction



1. Card Issuer's fee levied on cardholder for foreign ATM use eg $1.50.
2. Card Issuer pays Interchange Fee to ATM Acquirer eg $1.25.
3. ATM Acquirer receives interchange and may pay rebate to ATM Operator for service provided.

Note: ATM Acquirer and ATM Operator may be same institution or business entity.

2.2.1 Foreign ATM Fees

For Foreign ATM transactions, an Interchange Fee is usually charged by the ATM Acquirer to the Card Issuer to recover the Foreign ATM Operator's costs, as well as a margin for economic return. The Card Issuer will usually recover the Interchange Fee (and its own additional costs) from its Cardholder through a Foreign ATM fee (although in some cases these costs may be absorbed as part of the financial service relationship).

Cardholders are generally only aware of the amount of the Foreign ATM Fee. They would not normally be informed about the level of the Interchange Fee or the other components of the Foreign ATM Fee.

In some cases, Card Issuers such as credit unions and building societies refrain from levying a Foreign ATM Fee and absorb the ATM Acquirer's Interchange Fee as part of the cost of the Cardholder's relationship. This provides Cardholders with access to a more expansive ATM network than the Card Issuer can viably deploy in its own right.

2.2.2 Own ATM Fees

Where a Cardholder uses an ATM owned and operated by its own Card Issuer, Foreign ATM Fees do not apply as the ATM transaction involves just two parties, the Cardholder and the Card Issuer.

Card Issuers regard access to their own ATMs by their Cardholders as a key element of the service associated with the banking relationship. Accordingly, the costs of ATM transactions are usually recovered through fees associated with providing a transaction account (eg, account maintenance and transaction fees, possibly with a number of fee-free transactions). These fees are disclosed in the contractual terms and conditions between Cardholder and Card Issuer.

2.2.3 Costs

The viability of an ATM is underpinned by three key elements:

- deployment cost;
- operational expense (fixed and variable) and;
- revenue generated from the transaction volume.

The provision of ATM services involves a range of infrastructure and operating expenses incurred by the ATM Operator. These include, purchase, installation, cash distribution, servicing, site rental, maintenance, signage, security, telecommunications and transaction processing. There is also a requirement for continued investment in areas such as technology, maintenance, branding and security of the ATM network. Costs will differ substantially between sites and the level of service offered.

While ATM operating costs are influenced by a range of factors, location of the ATM is the primary driver. ATMs in high volume sites are usually expensive to operate and profitable. The converse would normally apply for low volume ATMs. Factors such as low cost ATMs, emerging telecommunications technology or efficiencies in cash distribution however, can produce outcomes where lower volume ATMs are equally viable compared to higher volume ATMs.

A Card Issuer also incurs 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.

2.2.4 Bilateral Agreements

Approximately 32% of all domestic ATM transactions are conducted at Foreign ATMs and will usually involve three parties. They are the Cardholder, Card Issuer and ATM Acquirer.

Where the ATM is owned and/or operated by a building society, credit union or IAO, additional parties may be involved to switch transactions to a corresponding Card Issuer or ATM Acquirer.

Foreign ATM transactions are secured by PIN-based access and real time authorisation by the Card Issuer over a secure electronic network. This network relies upon:

- bilateral agreements between Card Issuers and ATM Acquirers (some 65 bilateral agreements currently underpin ATM transactions in Australia); and
- Consumer Electronic Clearing System (CECS).
- In addition, the ATM network relies upon:
- terms and conditions of the contracts between individual Cardholders and their Card Issuer;
- any agreements between an ATM Acquirer and IAOs or with intermediaries who have agreements with IAOs; and
- any agreements with parties who act as switches for transactions.

The series of bilateral (and subsequent) agreements has resulted in Cardholders having universal access, ie the convenience of being able to use their card at any of the expanding number of ATMs in Australia. Universal access to ATMs in Australia is presently a unique feature globally that has only been achieved relatively recently.

2.3 Australian Consumer Use of ATM and Foreign ATM Transactions

Consumer research conducted by Roy Morgan[3] 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. Of those that use Foreign ATMs, 23% are frequent users (ie 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%[4] of all ATM users will experience the most immediate and noticeable impact of the proposed changes to ATM charging arrangements.

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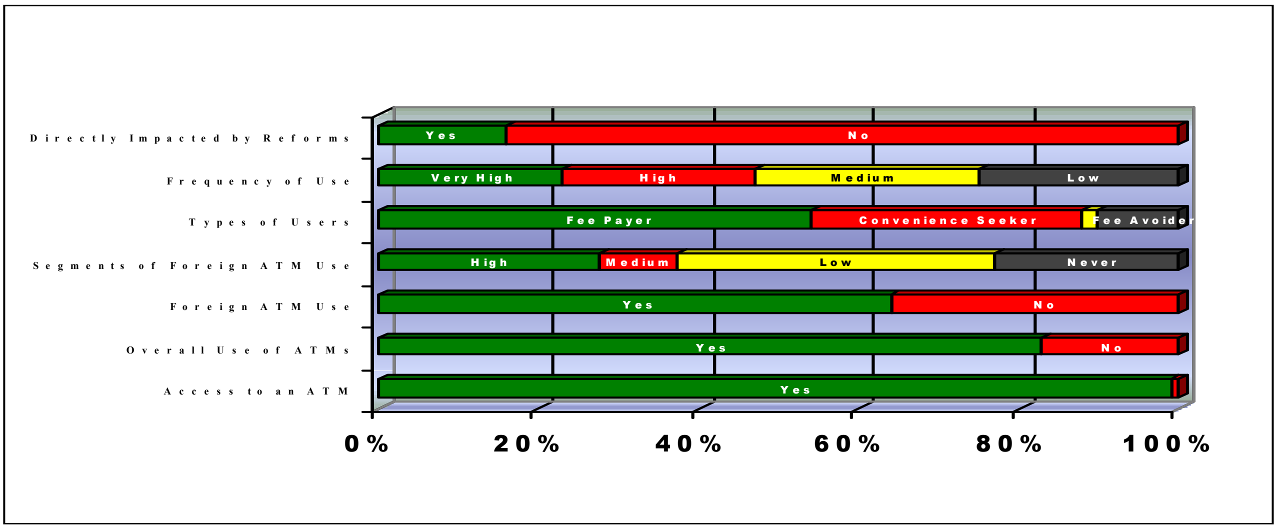
[3] Roy Morgan Research, ATM Direct Charging Report for AISG.

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

People under the age of 50 are more 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.

Figure 2.4 – ATM Usage Research



2.4 Access

2.4.1 Present Access Arrangements for ATM Operators

The market for ATMs, as a result of the growth in the number of ATMs, has become very competitive. The RBA/ACCC Joint Study noted however, that competition could be further enhanced by reforming Interchange Fee arrangements.

To become a participant in the market for ATM services, either as a Card Issuer, ATM Acquirer or ATM Operator (or any combination of these), it is essential for an institution or business entity to obtain either direct, shared or sponsored access to the industry's ATM interchange system.

Access means participating in the system of interchange of ATM transactions to facilitate authorisation, processing and settlement between Card Issuers, ATM Acquirers and ATM Operators in accordance with the authorised technical, operational and security standards that underpin and maintain the integrity of the system. Access is achieved by a variety of methods depending upon the strategic and business objectives of an institution or business entity as well as the costs and commercial imperatives.

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 volume and value of transactions conducted through ATMs has consequently also grown substantially creating further stimulus for new entrants. In practice, there are a number of access options for parties wishing to become an ATM Operator.

Much of the recent growth of ATMs is attributable to ATMs operated by IAOs, which are neither financial institutions nor Card Issuers. This growth would not have occurred without network reciprocity that was established by the financial institutions through bilateral interchange arrangements and underpinned by consumer demand for convenient access to cash.

Switch providers have also facilitated the entry of IAOs as the switches facilitate linkages between IAOs, ATM Acquirers and the Card Issuers. This type of arrangement has been a catalyst for an increasing number of participants in the market, further demonstrating that barriers to entry are low.

Access to the ATM network is facilitated by a range of options depending on the commercial and structural requirements of the ATM provider. An explanation of each option follows.

2.4.2 Direct Bilateral Agreements

As noted in this submission, there are some 65 bilateral interchange agreements that underpin the ATM network in Australia. Bilateral agreements set the technical, operational and security standards as well as settlement arrangements and the legal framework required to support the linkages between ATMs.

These direct bilateral arrangements between financial institutions (and shared ATM networks) developed out of the need for Card Issuers to provide their Cardholders with access to ATMs outside of their own proprietary ATM network. In conjunction, ATM Acquirers were compelled to achieve returns on the investment in existing ATM networks through greater utilisation.

Bilateral agreements have significantly improved the efficiency of the ATM networks by limiting the need for institutions to develop extensive duplicate networks to service the needs of their Cardholders. Cardholders have also benefited significantly from the resulting access to ATM services at any ATM throughout Australia.

Fundamental to these arrangements was the establishment of bilaterally agreed Interchange Fees to reimburse the ATM Operator for the cost of undertaking a transaction on behalf of other institutions' Cardholders.

2.4.3 Shared ATM Network Arrangements

For smaller institutions with relatively small Cardholder bases and ATM fleets it became a commercial imperative to aggregate volumes with other similar institutions in order to create the scale to enter into bilateral arrangements with other ATM network participants. Both the Cashcard shared ATM network and CUSCAL's Rediteller network are examples of this access model, providing benefits to a large number of smaller Card Issuers and ATM Operators. More recently, emerging networks, such as the CreditLink Qcard network, have also been developed using this model.

These arrangements have enabled smaller financial institutions to participate in bilateral arrangements with other Card Issuers or ATM Acquirers that may not have been commercially viable on a bilateral basis. A recent development in relation to the Cashcard shared ATM network has been their participation as an ATM Acquirer for transactions acquired through its own fleet of ATMs. This development is significant in that Cashcard is not a financial institution, however it participates directly in the ATM network as a specialist ATM deployer. Shared networks have even been developed to become sponsors of IAOs in their own right.

2.4.4 Sponsorship Arrangements

The sponsoring of participants into the ATM network arrangements is a relatively new development that has facilitated growth in the deployment of ATMs in recent years by IAOs. Sponsorship arrangements are based on an ATM Acquirer processing transactions from an IAO fleet through existing bilateral ATM interchange arrangements.

Under these arrangements, the sponsoring institution retains the critical obligations to Card Issuers of maintaining transaction security, network integrity and financial settlement of transactions. The commercial arrangements that underpin this model enable the IAO to receive a transaction rebate from the ATM Interchange Fee revenue received by the sponsoring institution. The early deployment of this model involved IAOs working with the larger financial institutions, however the recent substantial growth in the number of ATMs deployed by IAOs has been possible through the involvement of smaller ATM Acquirers working with a number of IAOs. This is a cost effective and relatively efficient process for providing IAOs with a commercially sustainable outcome.

Through these sponsorship arrangements, the number of ATMs deployed in Australia has increased substantially without lessening the integrity and security of the ATM network.

2.4.5 Card Issuers

In the same way that access has expanded for ATM operators, so has access for Card Issuers. In recent years, domestic and internationally based Card Issuers such as AMP, American Express, Diners, JCB, Citibank and HSBC have all established access to ATM services for their Cardholders. This has also been achieved through the existing bilateral agreements, while again maintaining network integrity and security. In addition, undertakings imposed by the ACCC in relation to mergers of domestic financial institutions in recent years have included requirements to provide access to new entrants on commercial terms.

2.4.6 Independent ATM Operator Arrangements

The means by which IAOs have been able to introduce a significant number of new ATMs into the ATM network has been a result of many factors enabling provision of these services in a lower transaction volume environment. Generally, technological advances have enabled the use of new lower cost ATMs utilising dial-up communications, thereby reducing the overall cost of installing and operating ATMs. The most significant factor however, has been the involvement of retail merchants through revenue and expense sharing arrangements with IAOs.

Site owners and merchants have supported the deployment of ATMs in their premises as a means of attracting new customers and providing additional services. The participation by merchants in transaction income from the ATM Interchange Fee is a matter for commercial negotiation, however is dependent on a number of factors, including the level of service and support they provide for the ATM (e.g., provision of cash and maintenance). These arrangements will continue into the future, however they are likely to be financed from Direct Charging revenue by the ATM Operator rather than from the share of interchange fees received by the ATM Acquirer.

2.4.7 Competition in ATM Deployment

ATM networks were initially developed by financial institutions in their branch networks as an avenue for their own customers to undertake convenient self-service transactions and to extend the availability of these services beyond traditional banking hours. The extension of this service by financial institutions was deployment of free-standing ATMs in locations such as shopping centres and service stations. The focus of the deployment of these ATMs was two-fold. Firstly, to service their own customer base and secondly, to attract Cardholders of other financial institutions to use the service, thereby providing a revenue stream to offset some of the cost of deploying the ATM in such locations as they generally incur high site rental charges.

The model of off premise ATMs has been taken to the next level by IAOs who generally deploy their ATMs under direct arrangements with retailers, particularly into environments where cash is a significant payment method e.g., convenience stores, hotels, clubs and service stations. Critical to the success of this model is that the IAO receives a direct income stream from each transaction processed through the ATM. Accordingly, the motivation for an IAO to deploy an ATM in a particular location differs significantly from that of a Card Issuer or ATM Acquirer.

In this way, ATMs deployed by IAOs compete directly for Cardholder transactions with ATMs deployed by financial institutions and IAO access has flourished under the existing bilateral interchange environment. Primarily this has occurred given the range of objectives of financial institutions and their differing requirements from bilateral ATM interchange arrangements depending upon their institution's role and size (either as a Card Issuer or ATM Acquirer), geographical network coverage and commercial imperatives.

There is evidence to suggest that access will be extended by ATM Acquirers to new IAOs as long as they can demonstrate their capability around adhering to the technical and security standards imposed by a sponsoring institution consistent with APCA's CECS requirements.

2.4.8 Role of APCA's Consumer Electronic Clearing System

APCA's CECS Rules and Regulations establish minimum technical, operational and security standards by which APCA members agree to participate in ATM interchange processing. Membership of CECS does not bestow any rights of access on participants, as interchange arrangements are determined through the establishment of bilateral interchange agreements. Through CECS, each member undertakes to meet the minimum standards, which are central to ensuring the integrity of the ATM network arrangements.

While it is not a requirement that ATM network participants join CECS, the majority of Card Issuers and ATM Acquirers have become CECS members. According to the CECS Regulations, an ATM Acquirer discharges the obligations owed by the Card Issuer to the relevant Cardholder. In order to ensure that an institution can discharge such obligations and maintain the integrity of the ATM system, a CECS member must comply with minimum standards.

2.4.9 EFT Code of Conduct

The EFT Code of Conduct is a voluntary code of practice, overseen by the Australian Securities and Investments Commission ("ASIC"), which establishes rules around consumer electronic funds transfer transactions. 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.

More generally, disclosure is governed by a series of legal and self-regulatory measures such as ASIC oversight under the EFT Code of Conduct, disclosure obligations under the Financial Services (Reform) Act 2000 and industry codes of practice.

3. Glossary of Industry Terms

ABA – Australian Bankers' Association.

ACCC – Australian Competition and Consumer Commission.

ADI – Authorised Deposit-taking Institution, as defined by APRA, being corporations that are authorised under the Banking Act 1959 (Cth).

AISG – ATM Industry Steering Group.

APCA – Australian Payments Clearing Association Limited (ABN 12 055 136 519).

APRA – Australian Prudential Regulation Authority.

ASIC – Australian Securities and Investments Commission.

ATM – an automatic teller machine, being an APCA certified, self-contained, electronic device located in Australia and capable of automatically dispensing cash in response to a cash withdrawal transaction initiated by a Cardholder. Other transactions (initiated by either a debit or credit card) such as funds transfers, deposits and balance inquiries may also be supported. The device must accept either magnetic stripe cards or smart (chip) cards where transactions are initiated by the Cardholder together with a Personal Identification Number (PIN). Limited service devices (known as cash dispensers) that only allow for automated cash withdrawal are included.

ATM Acquirer - a body corporate that in connection with an ATM Transaction by a Cardholder, engages (either directly or indirectly) in ATM Interchange Activities with the Cardholder's Card Issuer.

ATM Card - a card issued by a Card Issuer to its customer, containing a sensitised signature strip and magnetic strip for validation and embossed with the Card Issuer's branding, card number and expiry date, which enables that customer, to effect ATM Transactions.

ATM Cash Withdrawal - a completed cash withdrawal from an account linked to an ATM Card that originates from the Cardholder instructing an ATM, through the use of the ATM Card and PIN, to perform a cash withdrawal, resulting in a debit to the account and the dispensing by the ATM of an equivalent amount of cash.

ATM Infrastructure - infrastructure, including one or more ATMs, operated by or on behalf of a party to this Agreement, or for which the party is otherwise able to provide access, for the purposes of permitting an ATM Transaction to be conducted.

ATM Interchange Activities - the exchange of items for value between ATM Acquirers and Card Issuers, arising from ATM Transactions.

ATM Interchange Agreement - an agreement providing for access by one party, as or on behalf of a Card Issuer, to ATM Infrastructure of the other party (with or without reciprocal access to ATM Infrastructure of the first party) permitting Cardholders of a Card Issuer to conduct ATM Transactions using the ATM Infrastructure and providing for the authorising, processing and settlement of such transactions and for the payment of an ATM Interchange Fee in respect of such transactions.

ATM Interchange Fee - an interchange fee charged or paid under an ATM Interchange Agreement between two parties to this Agreement for an ATM Transaction.

ATM Operator - a body corporate or other person that has primary control over the management and operation of one or more ATMs and is either:

- an ATM Acquirer; or
- has a contractual relationship with an ATM Acquirer [or its agent].

ATM Operator Direct Fee - a fee, set at the ATM Operator's discretion, to a Cardholder for successfully completing an ATM Transaction requested by the Cardholder through an ATM operated by the ATM Operator.

ATM Retained Card - an ATM Card that has been retained by an ATM in accordance with CECS standards.

ATM Transaction - means:

- an ATM Cash Withdrawal;
- an ATM Declined Transaction;
- an ATM Retained Card;
- an ATM Balance Inquiry; or
- any other financial or non-financial ATM transaction,

effected by a Cardholder at an ATM in Australia.

ATM Transaction Fee - the fee charged by the Card Issuer when their Cardholder uses a Foreign ATM.

Cardholder - a customer of a Card Issuer who is issued with an ATM Card and a PIN.

Card Issuer - a body corporate that issues a debit or credit card and in connection with any ATM Transaction effected using that card:

- assumes obligations to the relevant Cardholder, which obligations are in the first instance discharged on its behalf by the ATM Acquirer; and
- engages as a result in ATM Interchange Activities with that ATM Acquirer.

Card Issuer Transaction Fee - a fee charged by a Card Issuer to one of its own Cardholders for authorising, settling and processing an ATM Transaction conducted by one of its own Cardholders with an ATM Operator.

CECS – Consumer Electronic Clearing System, a payments clearing system administered by APCA for clearing and settling proprietary card-based EFTPOS and ATM transactions, which is administered and managed by APCA.

Direct Charging – a form of charging for ATM transactions where an ATM Operator charges the Cardholder directly for using the ATM for a Foreign ATM transaction, as opposed to charging indirectly by means of an Interchange Fee charged to the Card Issuer.

EFT Code of Conduct - is a voluntary code of practice overseen by ASIC that sets out rules about how electronic funds transfers should work. The Code sets out the rights and responsibilities of businesses and consumers and problem/incident resolution. The EFT Code is designed to cover all types of electronic funds transfers including those involving an ATM.

EFTPOS – Electronic funds transfer at point of sale.

Foreign ATM - is an ATM in Australia owned and operated by an ATM Operator other than the Cardholder's Card Issuer.

IAOs – Independent ATM Operators, being bodies corporate or persons that own/operate ATMs, however are not Card Issuers.

PIN (personal identification number) - the number that is either issued by a Card Issuer or selected by a Cardholder for the purposes of authenticating the Cardholder by the Card Issuer.

RBA – Reserve Bank of Australia.

RBA/ACCC Joint Study – the short title for the report produced by the Reserve Bank of Australia and the Australian Competition and Consumer Commission entitled Debit and Credit Card Schemes in Australia: A Study of Interchange Fees and Access, October 2000.

Switch – a body corporate that is not a Card Issuer, however may be an ATM Acquirer or ATM Operator, that sells transaction switching, ATM driving and settlement/exchange services. The switch stands between the ATM Operator and the Card Issuer or ATM Acquirer.

Universal access – the ability for all Card Issuers' cards to be accepted by all ATMs.