AUSTRALIAN BANKERS' ASSOCIATION INC.

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Dr. Philip Lowe
Assistant Governor, Financial System
Reserve Bank of Australia
65 Martin Place
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Dear Dr Lowe,

ATM reform principles

Thank you for organising the ATM industry meeting to discuss the Australian Bankers' Association's (ABA) proposed ATM reform model on 26 March 2007 at the Reserve Bank's Sydney offices. At the conclusion of the meeting, the ABA agreed to resubmit a reform model. We acknowledge the RBA's position that without adequate changes (e.g. the ability of the ATM owner to direct charge) to the proposed model, designation and regulation was inevitable.

ABA's revised model is summarised in table form in Appendix 1.

Overall, it is still the ABA's view that on balance the model previously presented which seeks to strengthen the current ATM bilateral agreement system by guaranteeing direct connection rights, making interchange negotiations more transparent and leaving direct charging to bilateral negotiation - is still the optimal model for Australia.

The ATM bilateral agreement system in Australia has overseen the roll-out of nearly 25,000 ATMs throughout the country. Every debit or credit card holder in Australia can use every one of these 25,000 ATMs. It is also a fact that the consumer cost of using ATMs in the city and country is the same.

Main comments responding to the ABA's model

Most meeting participants appeared supportive of the ABA's principles to facilitate direct connection through an APCA drafted ATM Access Code.

With respect to the ABA's proposal of leaving interchange fee negotiations to bilateral agreement, it was argued that even if transparency of existing interchange fees were made available to the access seeker, existing connectors still had a commercial incentive of offering new entrants comparatively low interchange fees, placing the new entrants at a competitive disadvantage and inhibiting effective access.

In commenting on the ABA's proposal to have direct charging subject to bilateral agreement, the main argument presented against was that an ATM owner has a natural right to charge cardholders directly for using their ATM so long as the customer's choice was supported by real-time disclosure.

As to the ABA's proposal that there needed to be adequate disclosure and dispute resolution regimes, meeting participants seemed generally supportive.

Revised ATM reform model - possible alternative

Since the meeting on 26 March, the ABA, in discussions with member banks and informally with some other meeting participants, has been considering possible responses to the RBA's request to change the original reform model. As a result of these discussions and analysis of the issues, the model we recommended for introduction is known as the "pure" direct charging model.

Direct charging

The ABA acknowledges the argument put that the ATM owner should have an ability to directly recover costs from cardholders using their ATM, so long as the direct fee is disclosed real-time and that the card issuer can obtain from the ATM owner a split of the transaction amount and the direct fee. The ABA is therefore amending the original reform model to acknowledge the ability of ATM owners to elect to direct charge, but this amendment is conditional on certain protections being put in place.

As outlined in the RBA's meeting, the ABA's main concern is that the card issuing institutions that manage the overall customer card account, will be held responsible by the customer for any problems or grievances associated with the customer's experience with direct charging.

To address this matter, we have been investigating mechanisms to ensure the ATM owner is held properly accountable for the foreign transaction service provided. One such mechanism relates to the Electronic Funds Transfer Code (EFT Code).

ABA's reading of the current Code is that a core principle underpinning the Code is that the account holding institution is primarily responsible for any customer losses associated with the use of the account, including loss resulting from a foreign ATM transaction. This is inconsistent with the notion that was argued by ATM deployers at the meeting on the 26th that the foreign ATM customer is their customer, not the card issuer's customer.

Before the ABA could support direct charging, we would need to see the EFT Code amended or clarified so that it is unambiguous that the ATM owner is responsible for any loss and/or disputes associated with the customer's use of that facility.[1] The ABA has commissioned some legal advice on what specific amendments or clarifications are needed to achieve this objective.

Related to this, the ABA support for direct charging is also conditional on all ATM owners being signatories to the EFT Code. It is a current deficiency in the Code that widespread adoption has not been achieved already.

Finally, for those banks that want the option of instantaneously rebating their customers for using a foreign ATM, then any messaging rule changes necessary to allow instant rebating should be discussed. For example, the best way to instantaneously rebate may be for the card issuer to directly pay the direct charge on behalf of the customer.

Interchange fee

[1] Note – with direct charging cardholding customers, the ATM owner is dealing directly at the retail customer level and charging directly for the service provided. This requires a more intensive set of consumer protections, including disclosure, dispute handling and resolution, liability for customer losses etc.

The ABA has considered the idea of keeping the bilateral agreement principle, but introducing a formal 'default' interchange fee that would apply if bilateral agreement was not concluded within the specified timeframe.

It was our working assumption that the only way to properly set this default fee was through a cost-based methodology drawing on production cost estimates supplied by ATM owners. Given this, it is our understanding that the default fee methodology would need some form of official authorisation – either under the Trade Practices Act (TPA) or Payments Systems Regulation Act (PSRA) processes.

While this default fee arrangement has the advantage of potentially providing scope for negotiating parties to agree on a higher interchange for customer service enhancements, it also might disadvantage card issuers, particularly smaller players, because the large ATM deployers may in time be able to use service differentiation as leverage in their bilateral negotiations. For example, the ATM owner may impose lower dollar limits on customer cash withdrawals unless the card issuing bank has agreed to a higher interchange fee.

Another approach examined by the ABA was for the introduction of a cost-based, common interchange fee. This has the policy virtue of transparency, but is let down by – amongst other things - the administration burden of having to undertake formal cost-studies.

In our final analysis, the only model seemingly addressing all the major identified concerns is that of zero-priced interchange. This was the original proposal made in RBA/ACCC Joint Study of October 2000.

Under this approach, no regular cost-study is needed, the fee is common to all participants, it is fully transparent and it removes the stated concern that the interchange fee negotiation can be used to frustrate direct entry.

Zero-interchange also supports the principle of transparent and fair retail pricing as the customer can be confident that the ATM owner is not recovering a production cost in the direct charge which the ATM owner is simultaneously recovering through the interchange fee.

For these reasons, the ABA's revised ATM reform model recommends a zero ATM interchange fee. The one downside with this approach compared to the ABA's original reform proposal is that the zero-interchange fee will need to be officially authorised. The ABA's preference is for this to be undertaken under the PSRA 'designation' powers.

<u>Direct connection</u>

Given the participant responses at the meeting, the ABA does not see any reason to amend the broad principles underpinning direct physical connection for access seekers. We are happy for Australian Payments Clearing Association (APCA) to design an appropriate consultative process and draft a Code that provides a guarantee of direct connection within appropriate timeframes.

One issue not discussed at the meeting was the methodology for determining the connection fee. In the EFTPOS Access Code, the connection fee is determined by taking the lowest cost estimate of existing participants. The ABA does not support this approach as it means all but one existing player must subsidise access seekers. The ABA's model proposes that this fee be determined by an average of such costs.

Regulatory certainty and timing of direct charging

In order to ensure as smooth as possible transition to a direct charging regime and retain high level integrity to this cash distribution system, ABA believes the appropriate access, disclosure, and dispute resolution rules should be in place, along with the amendments to the EFT Code, before direct charging commences.

Once the regulations are finalised, the necessary IT development, system (including statementing) changes, staff training and customer communications can be completed. Some of this work can be commenced in parallel, but even so, banks estimate the system changes could take at least 12 months from the finalisation of the regulatory structure.

Once again, I would like to thank you for organising the industry meetings to discuss ATM reform. We are happy for you to circulate this letter to your ATM industry group.

Yours sincerely,

David Bell

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Appendix 1: Table detailing ABA's Revised ATM Reform Model

Reform components	ABA position	Additional requirements	Regulatory instrument
Direct charging	Available	Dispute resolutions scheme	Access Code
		Disclosure regime	Access Code
		Amendment to EFT Code	EFT Code
		Adoption of EFT Code	EFT Code list of signatories, ASIC web-site
Interchange fee	Zero	Reserve Bank to assure legal certainty	PSRA Standard
Direct connection	Guaranteed	Industry self-regulation	Access Code
		Connection fee to be determined by industry averaged incremental costs.	Access Code