# ATM Industry Steering Group

## Discussion Paper

# Direct Charging for 'Foreign' Automatic Teller Machine (ATM) Transactions In Australia

**4 March 2003**

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# Glossary and Common Terminology

**ABA** – Australian Bankers' Association
**ACCC** – Australian Competition and Consumer Commission
**Acquirer** – A bank, non-bank financial institution, switch or payment processor who participates in CECS as an ATM owner/operator or on behalf of an ATM owner/operator and engages in interchange activities with issuers
**ADIs** – Authorised Deposit Taking Institutions
**AISG** – ATM Industry Steering Group
**APCA** – Australian Payments Clearing Association
**ASIC** – Australian Securities and Investment Commission
**ASIC Code** – ASIC Guide to Good Transaction Fee Disclosure
**ATM** – Automatic Teller Machine
**ATM interchange fee** – a bilaterally negotiated fee, paid by the card issuer to the acquirer (that may also be an ATM owner/operator) for foreign ATM transactions initiated by the card issuer's cardholders
**ATM owners/operators** – Institutions, companies or businesses that own/operate ATMs (may also be an acquirer, issuer or IAO)
**CECS** – Consumer Electronic Clearing System, a system administered by APCA for clearing and settling EFTPoS and ATM transactions
**Direct charging** – A form of charging for foreign ATM transactions where an ATM owner/operator and perhaps the card issuer charge the cardholder directly for using a foreign ATM, as opposed to charging indirectly via a foreign ATM fee
**EFT Code** – Electronic Funds Transfer Code of Conduct
**Foreign ATM fee** – Fee charged by the card issuer when their cardholder uses a foreign ATM
**Foreign ATM transaction** – Transaction conducted on an ATM that is not owned or operated by the cardholder's card issuer
**IAOs** – Independent ATM Operators are companies and businesses that own/operate ATMs
**Issuer (or card issuer)** – A bank, non-bank financial institution or payment processors who participates in CECS and issues cards to cardholders for electronic transactions at ATMs, EFTPoS and other terminals
**Joint Study** – short title for the joint report produced by the Reserve Bank of Australia/Australian Competition and Consumer Commission entitled *Debit and Credit Card Schemes in Australia: A Study of Interchange Fees and Access*, October 2000
**RBA** – Reserve Bank of Australia
**Universal access** – the ability for all cards to be accepted by all ATMs

# 1. Overview

This paper was prepared by the ATM Industry Steering Group (AISG) - an industry working group to facilitate discussions around options for reform of ATM interchange fee arrangements. The paper provides background on the national ATM network and explains the basis for present discussions around reform. Comments are requested by 22 April 2003.

In October 2000, the Reserve Bank of Australia (RBA) and the Australian Competition and Consumer Commission (ACCC) released a report entitled *Debit and Credit Card Schemes in Australia: A Study of Interchange Fees and Access* (the 'Joint Study'). In its review of ATM networks, the Joint Study stated that cardholders using another institution's ATM (a foreign ATM transaction) were, in many cases, paying "substantially more"[1] than the cost of the service, raising questions about competition in ATM charging.

The RBA, ACCC and the Parliamentary Joint Statutory Committee on Corporations and Securities have asked the ATM industry to consider a direct charging system for foreign ATM transactions. This would replace the existing bilaterally negotiated interchange fees between card issuers, acquirers and ATM owners/operators.

A foreign ATM transaction is one where a cardholder uses an ATM that does not belong to their card issuing institution (their own bank, building society, credit union or card issuer). Such transactions presently incur interchange fees. Card issuers pay acquirers bilaterally negotiated interchange fees and recoup these costs through charges to their cardholders. Regulators consider that the bilateral agreements impede price flexibility and competition in the market for foreign ATM transactions and are not providing correct pricing signals to cardholders.

Australia's system of around 14,700 ATMs[2] presently provides universal access to all ATMs by all cardholders. Bilateral ATM interchange agreements established by financial institutions in Australia support this system. These agreements set the technical standards, settlement arrangements and legal framework to support linkages between different institutions' ATMs. They also set interchange fees that are paid to ATM owners/operators by card issuers when their cardholders use other institutions' ATMs.

Under the principles proposed for direct charging in this consultation document, the ATM interchange fee would be set at zero and the components of the foreign fee would be unbundled. In this way a fee may be charged directly to the cardholder by the ATM owner/operator, with the option of a separate fee charged by the card issuer that processes the transactions. The amount of the ATM owner/operator and card issuer fees would reflect the cost of providing access to ATM networks and a margin for a return on investment. It would be a requirement that the ATM owner/operator fee is disclosed in real time, at the point of the transaction and that any issuer fee should be transparent and clear to cardholders.

[1] Reserve Bank of Australia/Australian Competition and Consumer Commission, *Debit and Credit Card Schemes in Australia: A Study of Interchange Fees and Access*, October 2000, p 34.

[2] See APCA website www.apca.com.au.

The Joint Study noted[3] that the benefits of a direct charging regime could include:

- encouraging transaction fees more in line with costs and promoting transparency;
- providing an incentive for ATM owners to place ATMs in higher cost (e.g. remote) locations offering greater convenience for customers willing to pay; and
- making transaction charges obvious to ATM users.

As part of the move to direct charging the Joint Study expected that the industry would revisit interchange agreements to counter the inertia imposed by the existing arrangements where interchange fees are set bilaterally and have varied little:

- over time, despite changes in costs; and
- between ATMs, despite the different costs that are incurred at different sites and for different levels of service offered.

In February 2001, the Parliamentary Joint Statutory Committee on Corporations and Securities (PJSC), chaired by Senator Chapman, released its *Report on Fees on Electronic and Telephone Banking.* Drawing in part on the Joint Study by the RBA and ACCC, the Report recommended that interchange fees be abolished and replaced by direct charging.[4]

Prior to establishment of the AISG the RBA convened and facilitated a Working Group on direct charging that identified possible models and key issues in the Australian context. Encouraged by the RBA, the industry then established the AISG to consider existing ATM interchange fee arrangements and options for direct charging reform. The RBA has advised the industry of its preference for industry led reforms to be finalised in 2003. A list of participants in the AISG can be found at *Appendix A.*

The AISG has considered a number of principles to guide the reform process and seeks consultation on these principles in particular, as well as other key areas for stakeholder comment, to assist in the finalisation of an industry reform proposal. The principles for reform are provided at Section 6.

[3] Joint Study, op.cit., p 41.

[4] Labor members of the Chapman Committee issued a dissenting viewpoint that did not support the introduction of a direct charging regime without wider agreement on the level of bank fees. They were particularly concerned that ATM users in remote locations could face higher charges than those in low-cost locations. (The RBA/ACCC Joint Study noted the benefits of competition in these circumstances, refer page 41.)

The AISG is seeking comments from interested parties. The Reserve Bank of Australia (RBA) has posted the Discussion Paper on its website at www.rba.gov.au and will collect written submissions on behalf of the AISG. Submissions will not be considered confidential, will be shared with industry participants and others and should therefore not include any confidential information. Written submissions should be sent to the RBA by 22 April 2003 at the following address:

Payments Policy: ATM Direct Charging Reform
Reserve Bank of Australia
GPO Box 3947
Sydney NSW 2001

Or via email:
ATMS@rba.gov.au

# 2. ATM Interchange Fees: Status of Industry Work

Australia's system of around 14,700 automated teller machines (ATMs) - up from 11,900 a year earlier - presently provides universal access to all ATMs by all cardholders. Bilateral ATM interchange arrangements established by financial institutions in Australia over many years support this system. Together with the CECS rules these arrangements set the technical standards, settlement arrangements and legal framework to support linkages between different institutions' ATMs. They also set interchange fees that are paid to ATM owners/operators by card issuing institutions when their cardholders use another institution's ATMs.

Transactions performed at these in accordance with these interchange agreements are known as foreign ATM transactions. In 2000, the RBA estimated approximately 30 per cent of ATM transactions occurred at foreign ATMs[5].

ATM interchange arrangements are incorporated in more than 60 bilateral agreements[6] between industry participants. Australia's reliance on bilateral agreements differs from experience in some countries where central organisations operate extensive ATM networks.

In October 2000, the Reserve Bank of Australia (RBA) and the Australian Competition and Consumer Commission (ACCC) released a Joint Study entitled *Debit and Credit Card Schemes in Australia: Study of Interchange Fees and Access.* The Joint Study noted that "Although interchange fees are the predominant means by which ATM owners around the world are recompensed, there are other alternatives available."[7]

The Joint Study, however, criticised existing interchange arrangements for not providing cardholders with correct price signals as it claimed that cardholders using another institution's ATM were paying considerably more than the cost of the service. The Joint Study raised questions about the level of competition in the provision of ATM services and the relatively stagnant level of interchange fees over the last decade. In the Joint Study, the ACCC and RBA suggested a direct charging model for foreign ATM transactions to replace the existing charging arrangements in ATM networks.

In mid 2001, the RBA convened a meeting of the owners/operators of ATM networks in Australia to discuss ATM fee regimes for foreign ATM transactions. At that meeting, it was agreed that the industry would develop and consider options for reforming charging for foreign ATM transactions, in line with the findings of the Joint Study.

From a series of meetings that followed, the industry pursued for consultation the development of principles to guide voluntary reform under a direct charging model. There is a general industry consensus that any form of direct charging should embrace the fundamental principle of transparency, especially through the unbundling of the two components of the existing foreign ATM fee (i.e. card issuer and ATM owner/operator fees) so they would be obvious to the cardholder.

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[5] Joint Study, op.cit., p 33.
[6] Ibid., p 33.
[7] Ibid., p 41.

The Joint Study suggested that full fee disclosure would drive further market efficiencies around pricing the provision of foreign ATM transactions by empowering cardholders to choose between ATM owners/operators and card issuers or substitute payment forms:

> "If the consumer is to exert any direct influence on pricing ... this regime would achieve it more effectively than the present system."[8]

The high-level objectives of charging regimes for foreign ATM transactions are to:

- ensure that customers are receiving correct pricing signals; and
- recover the costs for ATM owners/operators and card issuers of providing access to ATMs.

The AISG has noted that if the industry moved to use of direct charging as its primary source of revenue, this would assist competition by making cardholders more aware of the costs of ATM services offered through different machines and by different ATM owners/operators. Increased competition brought about by the increased transparency of prices to cardholders should align fees more closely to costs without the need for any regulatory control of cardholder pricing.

As well as distancing ATM owners/operators from the pricing of their services, the existing interchange system is cumbersome because it involves bilateral agreements and subsequent legal agreements between all participants. This makes changes to interchange fees costly to pursue and weakens competition by restricting information available to participants about the going market rates for interchange transactions.

Perceptions of the intensity of demand for ATM services at locations with differing costs are often muted. Given the variance in pricing of own versus foreign ATMs, many ATMs are over- or under-used compared with the outcome that would apply if fees more closely reflected costs. Hence, locations may not be serviced because there is no mechanism for tapping the potential revenue from such sites to cover the costs of providing the service, despite cardholders' willingness to pay.

The AISG has developed a set of principles that it proposes to apply to the development of a direct charging model for foreign ATM transactions. It now seeks comment from interested stakeholders.

The proposed principles of reform have at their core the intention that pricing of ATM services should be at the discretion of ATM owners/operators and card issuers and that the framework of bilateral interchange fees be abolished. More flexible pricing of ATM transactions will facilitate a balance between demand for ATM services and the supply of these services that is efficient for the community.

Concurrently, AISG is considering a range of implementation and technical issues associated with the move to direct charging as well as overseeing research around cardholder and community views and preferences in relation to direct charging. As part of this process, the AISG is also seeking stakeholder views on the principles that should support such reform.

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[8] Ibid.

The RBA has advised of its preference to substantially complete reform in 2003.  This will require regulatory approval through authorisation by the ACCC (consistent with *Trade Practices Act 1974* requirements).  A model for reform will be finalised and presented to ACCC following consultation with stakeholders and the resolution of key implementation issues.

# 3. The Australian ATM Network

ATMs play an expanding role in the lives of Australians since being introduced at the beginning of the 1980s. Since 1997, the number of ATMs reported by APCA members has increased by 80 per cent from 8,000 to almost 15,000 and universal access has been established.[9]

The ATM network is part of the Consumer Electronic Clearing System (CECS) for proprietary card-based ATM and EFTPoS transactions, which also includes BPAY. A committee of management, made up of Australian Payments Clearing Association (APCA) members and system participants, manages the clearing system.

Most ATM transactions are cardholder withdrawals from ATMs owned/operated by their own financial institution or card issuer. ATMs form part of the access network provided by card issuing institutions to cardholders. When cardholders use ATMs other than those provided by their own financial institution, cross-institution clearing and settling is needed.

ATM networks are linked through technical and operational arrangements that require settlement between institutions to be bilateral.[10] In ATM networks, interchange fees are negotiated bilaterally and are paid by the card issuer to the acquirer (ATM owner/operator).[11] The Working Group identified some competition inherent in the process as interchange fees negotiated bilaterally between institutions vary from agreement to agreement. Card issuers generally pass on ATM interchange fees to their cardholders whenever they use another owner's/operator's ATM, through foreign ATM fees.

The processing of an ATM transaction can involve at least four parties:

- the cardholder (customer);
- the institution that issues the card to the cardholder;
- the institution that acquires the ATM transaction; and
- the owner/operator of the ATM.

Where the second and third parties are not the same institution or company, this is considered to be a foreign ATM transaction. In recent years, the number of foreign ATM transactions has been increasing, with 30 per cent of ATM withdrawals in 2000 estimated to be from foreign ATMs[12].

[9] Australian Bankers' Association website www.bankers.asn.au.

[10] Australia's reliance on bilateral agreements differs from the experience in some countries overseas where there are central organisations running extensive ATM networks.

[11] However, some connections between institutions can be one-way. For example, an issuer's cards can be accepted in a bank's ATMs, however not vice versa because the issuer does not operate its own ATM network.

[12] Joint Study, op cit., p 33.

## 3.1 Historical Perspective

ATMs were introduced into Australia at the beginning of the 1980s. The banking system consisted of four large nationally operating banks and a number of smaller banks, each operating within the confines of a single state. Non-bank financial institutions offering retail banking services (i.e. building societies and credit unions) also operated in regional areas.

The nationally operating and regional banks offered stand alone ATM networks exclusively for their cardholders. Non-banks, because their own ATM networks were small, led the way in expanding the numbers of ATMs their cardholders could access by negotiating access to other institutions' ATMs. The competitive imperatives to network ATMs are evidenced by the growth of linkages between institutions.

The incentives for ATM owners/operators to expand linkages with other networks increases the attractiveness of their network to cardholders and issuers alike by having a greater number of ATMs. This underpins financial economies by servicing larger numbers of transactions at individual ATMs. The incentives for issuers are to provide their cardholders with added convenience by maximising the number of ATMs they can access through additional linkages with other networks. This minimises substantial and ongoing investment by the issuer in its own ATM network.

In Australia the positive incentives for linkages have prevailed. As a result of a gradual negotiating process over a number of years, linkages have now been established between all ATMs.

## 3.2 Universal Access

Universal access is a significant achievement that offers cardholders access to any ATM in Australia. The ATM industry views retention of universal access - the ability for all issuer cards to be accepted in all ATMs - as a key objective of the reform process.

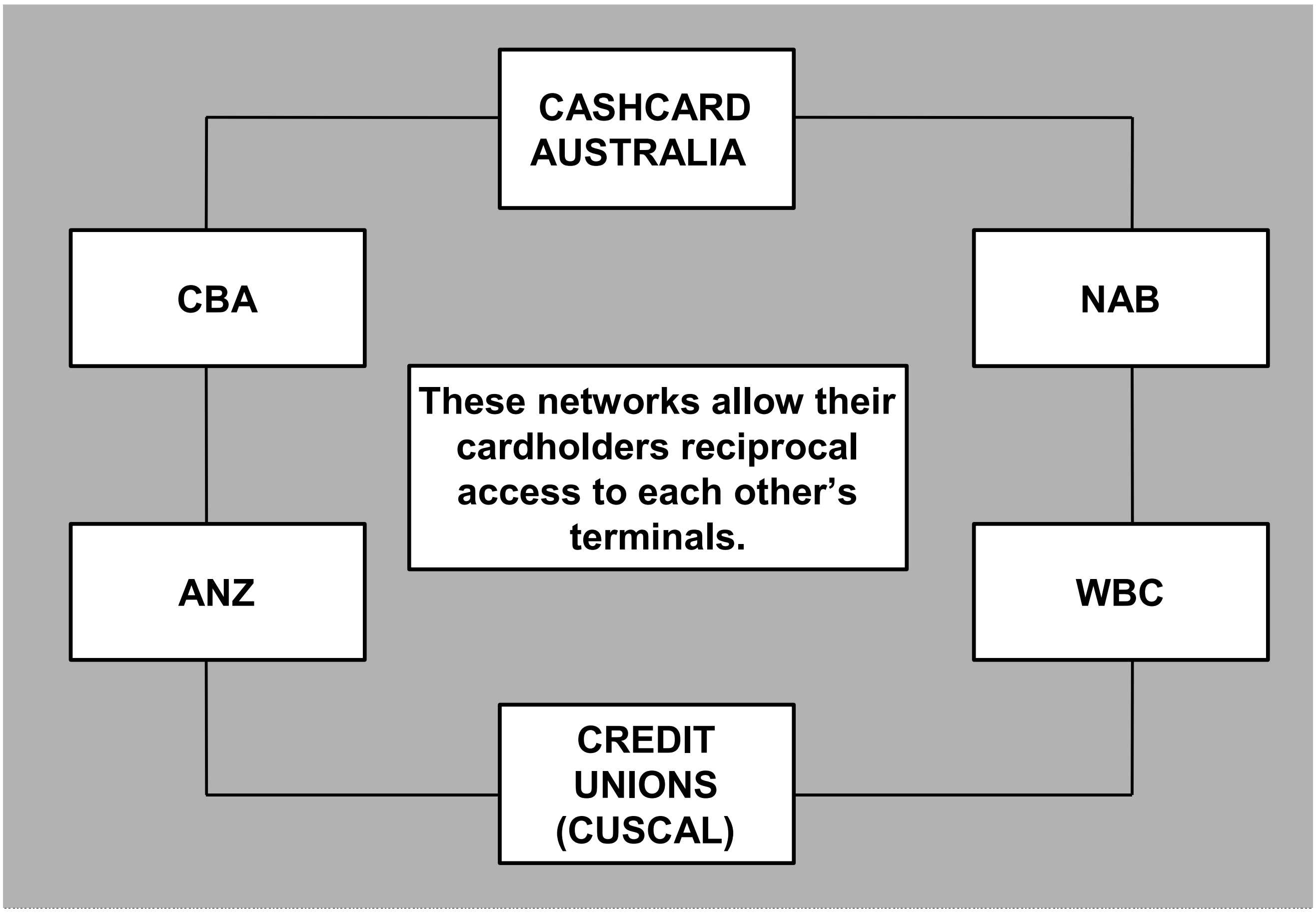
The move to universal access for foreign ATM transactions commenced in the mid-1980s. By the end of the 1980s, several banks had established links with each other and credit unions had begun the process of establishing access agreements with the nationally operating banks. During the first half of the 1990s, the building societies' network, Cashcard, established linkages with some of the other networks.

The networks of the four nationally operating banks were linked in 1996/97. At the same time, the credit unions were extending their cardholders' access by establishing links with more banks, both nationally operating and state-based. During the latter part of the 1990s, the remaining (former) state banks joined the Cashcard network. By 1999, there were six national networks, with almost complete access reciprocity between them. The credit unions' network had established reciprocal access agreements with all the other networks and the Cashcard network was only one link short of achieving the same status.

Complete reciprocity was achieved in 2001 with the establishment of the final bilateral link between two of the six networks. The present situation that allows cardholders universal access to ATMs is depicted in Diagram One below.

**Diagram 1: ATM Linkages - 2001**

For simplicity, the diagram does not depict all the financial institutions, bilateral links and market participants. It merely attempts to show that all these institutions are linked in the national ATM network and provide the framework for reciprocal access for all cardholders.




## 3.3 Independent Deployers

A striking feature of the recent evolution of the ATM industry in Australia is the growth in the number of ATMs deployed by traditional market participants and the new generation of independent ATM operators (IAOs). Much of the growth reflects an increase in the number of ATMs operated by IAOs that specialise in locating ATMs in convenience locations. This growth would not have occurred without the network reciprocity established by the longstanding industry participants underpinned by consumer demand for convenient access to cash. A corollary of the growth in the numbers of ATM operators is that the number of foreign ATM transactions has been increasing.

The IAOs are not financial institutions and do not have cardholders of their own. They rely on an arrangement (or series of arrangements) with a participating CECS acquiring institution to provide them with a flow of cardholders. IAOs account for more than 25 per cent of ATMs.

Switch providers have also facilitated the entry of IAOs with the switch standing between the IAO and financial institutions. This type of arrangement has allowed for an increasing number of participants in the market. Unlike in the United States where there are a large number of IAOs, the Australian market is limited to around 20 operators with networks ranging between less than 10 and 3,500 machines.[13]

## 3.4 Types of Participants

The ATM market consists of a range of differing participants. The four primary participants are the cardholder's institution (issuer), the acquiring institution (acquirer), owners/operators of ATMs (switches and IAOs) and site owners. Participants can play one or a combination of these roles.

These market participants have quite different business profiles and strategies. As well as the growing number of IAOs there are several other distinctive types of participants. Generically they are:

- The major banks (national issuer, acquirer, ATM owner/operator) that have geographically diverse cardholder bases and ATM networks to serve them. They all have extensive interchange agreements and their primary focus is existing cardholders, however there is a secondary business focus around providing ATM services to foreign cardholders. Together they have bilateral (or unilateral) arrangements with almost all card issuers as well as arrangements with switches and IAOs. They arrange settlement/exchange directly with other financial institutions for interchange transactions.

- The regional banks (regional issuer, acquirer, ATM owner/operator) that have ATMs that are generally concentrated around their cardholder base. A number of such banks however, have been deploying ATMs in other locations, outside their home market. BankWest, for instance, acquires for many ATMs in the eastern states. Almost all transactions at those ATMs are foreign transactions and earn interchange revenue for BankWest. Like the majors, regional banks have arrangements with card issuers, switches and IAOs and settle/exchange with other financial institutions for interchange transactions.

- The credit unions and building societies (small issuer, ATM owner/operator) have small numbers of ATMs, again focussed on servicing their cardholder bases. Most are members of the Rediteller, Cashcard or CreditLink networks. Settlement/exchange for institutions in these networks is conducted between other financial institutions and the credit unions' and building societies' settlement bodies. In several cases, credit union members are not charged foreign ATM fees by their institution, or incur lower than the industry average fees for using other institution ATMs.

[13] Source: Cashcard Australia.

- IAOs (non-issuer, non-acquirer, ATM owner/operator) are usually sponsored by financial institutions or switches). An example is Direct Cash, which owns and operates ATMs. There are an increasing number of companies like ATM Solutions, Direct Cash, Cashcard, Global Network Services, Bank Tech and Chubb that are the new generation of IAOs. They specialise in locating ATMs in convenient locations. Importantly, they are monoline market participants (i.e. they operate ATMs, however have no cardholders and are not involved in other aspects of the ATM industry). Their revenue comes from rebates paid by the sponsoring institution (underpinned by interchange and retail ATM fees) and rentals from site owners. To date only Cashcard has established agreements directly with issuers. Most IAOs are sponsored by financial institutions or switches that retain a portion of the interchange fee for providing access to card issuers through their interchange agreements and for arranging settlement with card issuers.

- The switches (non-issuer, acquirer, ATM owner/operator) are companies that sell transaction switching, ATM driving and sometimes settlement/exchange services.

- The site owners (non-issuer, non-acquirer, non-owner/operator) are companies and businesses that rent a location in their premises in which to operate an ATM. They range in size from large shopping centres, supermarkets, convenience stores and service station chains to hotels, clubs, newsagents, video stores and chemists.

It is critical to appreciate that the ATM market has these different participants, each incurring its own cost of operations. Hence, each has also developed fees, charges or rentals to cover those costs.

## 3.5 The Existing Charging Mechanism

At present, retail ATM fees are imposed by institutions on their cardholders. There are no fees charged by ATM owners/operators directly to cardholders. Where cardholders use their own financial institution's ATMs, the costs of providing ATM services are recovered through the banking relationship (e.g. account maintenance fees and transaction fees), which normally incorporates a number of fee-free transactions per month. Where cardholders access their account via a foreign ATM, the cardholder's institution will generally levy a foreign fee - although some institutions opt to refrain from charging this fee.

When cardholders transact through foreign ATMs, the cardholder's institution pays an interchange fee to the acquirer, who may be an ATM owner/operator or the sponsor for an IAO. The level of interchange fees is set bilaterally between institutions and varies from agreement to agreement.

The Joint Study presented information that suggested approximately half the institutions surveyed charged cardholders a foreign fee, which was in excess of the maximum interchange fee they incur. The remainder charged a foreign fee in line with the interchange fee incurred or waived the foreign fee entirely. Interchange fees also vary according to the type of ATM transaction.

# 4. Direct Charging for Foreign ATM Transactions

## 4.1 Joint Study Findings

The RBA/ACCC Joint Study acknowledged that there are a range of costs to issuers, acquirers and ATM owners/operators associated with conducting foreign ATM transactions:

> *"In Australia, financial institutions that own ATMs are also card issuers, and they offer ATM services to their own cardholders and the cardholders of other institutions. The provision of ATM services, whether to their own cardholders or others, involves a range of costs. There are infrastructure costs associated with the establishment and maintenance of the ATM network, as well as variable costs associated with stocking the machines with cash, the interest foregone on this cash (often known as 'float'), and processing and switching transactions. Financial institutions seek to recover these costs, and earn a return on the capital involved, through some form of charging."*[14]

The Joint Study has focused the discussion around foreign ATM charging on:

- Who should pay a fee for the service?
- Who should be able to charge for providing a service?
- What rate of return is reasonable in a competitive market?

ATM sharing arrangements have developed as card issuers sought means to provide convenient and cost-effective ATM services for cardholders. Cardholders, ATM owners/operators, acquirers and issuers generally have benefited from creation of ubiquitous access to ATM services.

The fundamental complexity of foreign ATM transaction pricing lies in the relationships between ATM owners/operators, acquirers and issuers. Existing bilateral interchange arrangements between these parties are regarded by regulators as inflexible and unresponsive to changes in cost.

It is important to note the distinction in business drivers for ATM owners/operators, acquirers and card issuers, as this underpins the value of introducing price independence. ATM owners/operators and acquirers are driven by the need to acquire transactions in a high volume, low margin business. Card issuers are motivated by a need to provide convenient access for their cardholders as part of transaction account and service offerings.

[14] Ibid., p 33.

In reviewing the fee options available to participants in the ATM system, the Joint Study noted that:

> *"Although interchange fees are the predominant means by which ATM owners around the world are recompensed for providing services to cardholders of other institutions, there are other alternatives available. For example, they could choose to charge such cardholders directly at the time the transaction is undertaken. Under this form of 'direct charging' regime, each ATM owner would decide how much to charge."*[15]

In assessing the merits of direct charging, the RBA/ACCC found that:

> *"The attractions of a direct charging regime are that it may encourage transaction fees more in line with costs, and promote transparency. For a start, it puts the ATM owner in a direct economic relationship with the cardholder, rather than only an indirect one via the issuer. If the consumer is to exert any direct influence on pricing – for example, by patronising the less expensive ATMs – this regime would achieve it more effectively than the present system.*
>
> *As an additional factor, under current arrangements, the ATM owner receives the same interchange fee for an ATM withdrawal from a given issuer, regardless of where that transaction is undertaken.*
>
> *Under a direct charging regime, in contrast, ATM owners could vary the transaction fee according to the per unit cost of individual machines. This would provide an incentive to place more ATMs in higher cost (e.g. remote) locations, offering greater convenience for consumers willing to pay."*[16]

The RBA has indicated to the members of the AISG that it would like to see reforms around a direct charging model, which address issues identified in the Joint Study, substantially completed during 2003. Moves to reform interchange arrangements and introduce direct charging are expected to require regulatory approval through authorisation by the ACCC, consistent with the *Trade Practices Act* requirements.

In developing a model for reform, the industry is aware that a range of stakeholders face different impacts and may have views and issues to contribute to industry deliberations. Consultation is sought to facilitate this process.

[15] Ibid., p 41.
[16] Ibid.

## 4.2 Objectives for Voluntary Reform

The AISG has identified eight key objectives to guide the reform process and consideration of charging models:

- Address the inertia inherent in the existing system of agreements around interchange fees through clear and transparent pricing and by implication, better align fees with costs through promotion of retail price competition.
- Maintain an environment where issuers are free to provide the universal access to ATMs that cardholders enjoy today.
- Ensure that there is no weakening of competition amongst industry participants.
- Have a high level of customer acceptance.
- Promote competition between service providers providing reasonable returns on investment.
- Be practical to implement.
- Maintain the integrity of the ATM system.
- Satisfy public policy requirements.

## 4.3 Potential Reform Proposal

Under the present interchange model, a cardholder (where charged for foreign ATM transactions) pays a single, bundled fee (that includes the cost of the interchange fee) to their financial institution or card issuer for a foreign ATM transaction. The card issuer transmits the majority of the foreign fee to the ATM owner/operator in exchange for provision of ATM access. Under direct charging the components of the foreign ATM fee would be unbundled and a model with no interchange payments implemented.

The unbundling of the foreign fee creates two elements. A charge set by the ATM owner/operator to provide the ATM and potentially, a charge set by the card issuer to enable it to process the transaction.

The absence of bilateral interchange payments is important as regulators consider that these agreements impede price flexibility and competition in the market for foreign ATM transactions. This contrasts with surcharging in the United States where a foreign ATM fee and a surcharge (or direct charge) are levied on cardholders.

Under direct charging, an ATM owner/operator may levy a direct charge on all cardholders that use its ATM service. The size of this charge is solely determined by the ATM owner/operator and debited to the cardholder’s account at the time of the transaction. It would reflect the ATM owner's/operator's cost of providing the service plus a margin for return on investment.

Direct charges would need to be disclosed in accordance with the various regulatory requirements. These include ASIC requirements and the recently revised EFT Code of Conduct.

In particular, all ATM owners/operators would need to satisfy the EFT Code requirements. Specifically, ATM owners/operators are required to disclose to the user, at a time that enables the user to cancel the transaction without cost to the user, the amount of any fee charged for the use of its ATM, which will be directly passed on to the user.

Direct charging removes the need for a card issuer to compensate the ATM owner/operator or acquirer for providing ATM services and thus the need for card issuers to recover the interchange fee from cardholders. It also provides a card issuer with the option of charging a transaction-based fee (or providing a rebate) for utilising foreign ATMs that would their recoup economic costs as well as attract cardholders by competitively pricing ATM usage (including charging no fee at all). Card issuers would be required to ensure any issuer charge is transparent in relation to using foreign ATMs, typically through normal account statements and fee schedule disclosure as exists today.

Under this unbundling of foreign ATM fees, no bilateral interchange agreements are proposed relating to fees or revenues between card issuers and ATM owners/operators. There will however, be access arrangements and fees for IAOs who need acquirers to sponsor them into the payments clearing system.

This will establish an environment for price competition between ATM service providers. Freedom to set fees would be expected to stimulate provision of ATM services and make them flexible and responsive to changes in costs and cardholder demand.

The industry makes no assumptions or predictions about how the freedom for ATM owners/operators, acquirers and issuers to set prices might be applied. The industry has noted however, that an outcome where issuer prices remained close to existing levels of foreign fees, while ATM operators charged additional fees, would be unlikely to be acceptable in terms of cardholder sentiment or satisfy reform objectives. The RBA has suggested in the Joint Study that greater competition and transparency holds the potential for overall fees to cardholders to fall, on average, relative to current levels.

It should be noted that:

- direct charging will substantially reduce (if not remove) the control issuers have over the price their cardholders are charged at foreign ATMs;
- arrangements for acquiring of ATM transactions initiated by cards issued outside Australia will not be altered; and
- arrangements for acquiring ATM transactions outside Australia for domestically issued cards will not be altered.

An outline of the possible unbundling of interchange fees against the objectives set to guide industry reform follows.

| Objective | Direct Charging | Comments |
|---|---|---|
| Clear and Transparent Pricing | Direct charge and issuer fee to be disclosed in line with ASIC and EFT Code requirements. Implementation group considering technical issues attached to disclosure. | These requirements will be an industry minimum. Price disclosure by issuers and ATM owners/operators will drive competition. |
| Cardholder Access | Incentives for universal access remain for issuers, acquirers and ATM owners/operators. | Competition is likely to retain universal access to ATM networks. |
| Retail Price Competition | Flexible pricing of ATM services to cardholders for issuers, acquirers and ATM owners/operators with no interchange fees. | A substantial improvement on the existing bilaterally agreed pricing arrangements. |
| Customer Acceptance | Explicit pricing by issuers, acquirers and ATM owners/operators should improve cardholder awareness and understanding of fees for ATM services. | Research project underway to ascertain key issues for cardholders in these areas. Stakeholder consultation will also assist in identifying key issues. |
| Competition Between Service Providers Providing Reasonable Returns on Investment | Issuers, acquirers and ATM owners/operators will be able to set retail prices. Issuers, acquirers and ATM owners/operators will be able to recover economic costs. | Principles of reform match regulatory imperative for competition, stability of system through ongoing investment and return on network costs. |
| Practical | Technical and implementation issues are key elements to developing practical reform. | Technical issues associated with disclosure and implementation are under review. |
| Integrity | The model will not change the system network standards that participants are subject to nor should compliance risks increase. | System integrity and stability are important considerations, for regulators, cardholders, issuers, acquirers and ATM owners/operators. |
| Satisfy Public Policy Requirements | Assist achieving the benefits outlined in the Joint Study: provide an incentive for ATM owners/operators to place more ATMs in higher cost locations; encourage transaction fees more in line with costs; ensure transaction charges are obvious to ATM users. | The RBA has indicated its preference for industry led reforms to be finalised in 2003. The principles of reform attempt to address reform priorities identified by regulators. |

# 5. Technical and Implementation Issues

A wide variety of technology is employed in the national ATM network. ATM owners/operators deploy dozens of different ATM models and various software applications exist to drive ATM devices, route transaction messages and authorise transaction requests. As a result, most participants in the ATM system must overcome unique system constraints when confronted with a request for process change. The following section details current technical issues under review by the AISG.

## 5.1 The ATM Transaction

In simple terms, a successful ATM transaction involves the following activities:

- Customer enters transaction information at an ATM – e.g. $20 withdrawal.
- ATM prepares transaction authorisation request and sends to ATM switch.
- ATM switch routes transaction authorisation request to card issuer for approval.
- Card issuer sends transaction authorisation response to ATM via ATM switch.
- ATM completes transaction based on advice from the card issuer, e.g. delivers cash and transaction record if funds are available.
- ATM transactions are presently delivered across ATM interchange links using specifications identified in the following documents:
- Australian Standard AS2805 - Transaction Message Formats.
- CECS Manual for Consumer Electronic Clearing System Three (CS3) - Part 8 Standard Interchange Specifications.

## 5.2 Issues for Consultation

The technical work required to deliver direct charging capability in the ATM network is substantial and will take some time to develop, test and implement to ensure system integrity and stability. Technical capability will, in particular, have a bearing on the nature of disclosure to cardholders.

The industry has identified areas with implementation and technical issues, including the following and seeks views around stakeholder preferences and the manner in which these might be addressed:

- Disclosure of the ATM owner/operator fee.

  What issues may arise for stakeholders in disclosure? What methods of disclosure are appropriate?

- Disclosure of the card issuer's fee.

  Technical issues and product design may impact disclosure of the issuer fee, where charged. What form of communication of any issuer charge would be most useful? Which technical constraints and cost issues should be considered in developing disclosure models for rebates or fees?

- Requirements for screen, transaction record and statement disclosure.

  How should disclosure formats be developed? Issues may include the length of transaction processing time, clarity of charges, costs involved in systems upgrades, summary forms.

- Transactions that would attract a fee.

  Is economic cost recovery an appropriate pricing mechanism?

- Variation of fee according to environmental factors.

  What issues are raised by the potential, as suggested in the Joint Study, of having different charges by ATM owners/operators for factors such as location of machine, time of transaction, issuing institution?

# 6. Issues for Consideration

The foregoing discussion identifies the general principles and issues under review in ATM interchange fee reform, however without wider input not all the advantages and disadvantages can be established. The AISG is seeking input from interested parties to assist in considering options for reform and to meet the regulatory objectives set for direct charging.

Submissions will be considered by the AISG and opportunities to meet with representatives of the group provided. The information from the consultation will be considered in refining models for interchange fee reforms in foreign ATM transactions. Comments on any aspect of the introduction of direct charging are welcome.

Key areas for stakeholder input are identified below.

## 6.1 Principles for a Direct Charging Model

The AISG has developed the following principles for the development of a direct charging model for foreign ATM transactions.

- The interchange fee would be reduced to zero.
- The existing foreign fee would be unbundled and become two fees, the ATM owner/operator fee and the issuer fee.
- ATM owners/operators would be permitted to charge a fee directly to any cardholder using their ATM.
- The amount of the fee would be at the discretion of each ATM owner/operator and fees may vary according to several factors.
- A cardholder would be notified of this charge prior to committing to the transaction.
- Card issuers would be permitted to charge a transaction-based fee to cardholders.
- The amount of the fee would be at the discretion of each issuer and fees may vary according to several factors.
- ATM owners/operators and card issuers would ensure that these charges are transparent and obvious to cardholders.
- The amount of the unregulated ATM owner and card issuer fee would reflect the cost of providing access to ATM networks and a margin for a return on investment.

## 6.2 Issues for Stakeholder Consideration

In particular, stakeholder input in the following key areas is sought:

- Are the principles identified for the reform process appropriately defined? Are there additional issues that should be reflected in principles?

- Are comments on the objectives for direct charging appropriately described?

- Are the public policy objectives of reform reflected in proposed principles?

- Are there advantages or disadvantages to direct charging that should be included in assessing the merits of options for reform?

- Are there competitive, equity or access issues that require further review?

- Are there specific issues for particular stakeholders that require additional consideration?

- Do stakeholders have views on the technical and implementation queries identified in section 5.2? For example, are there specific fee disclosure, product design, account statement or transaction record issues of particular importance to a direct charging environment?

- How do stakeholders view universal access? Are potential risks to direct access appropriately defined in the model?

## 6.3 Process for Feedback

The AISG is seeking comments from interested parties. The Reserve Bank of Australia (RBA) will collect written submissions on behalf of the AISG. Submissions will not be considered confidential, will be shared with industry participants and others and should therefore not include any confidential information. Written submissions should be sent to the RBA by 22 April 2003 at the following address:

Payments Policy: ATM Direct Charging Reform
Reserve Bank of Australia
GPO Box 3947
Sydney NSW 2001

Or via email:

ATMS@rba.gov.au

# Appendix A

Participants in the ATM Steering Group and its Working Groups are as follows:

ANZ
Australian Association of Permanent Building Societies (AAPBS)
Bank of Queensland
BankWest
Commonwealth Bank of Australia
Credit Union Services Corporation (Australia) Limited (CUSCAL)
Cashcard Australia (including EBS Limited)
National Australia Bank
Newcastle Permanent Building Society
St George Bank
Suncorp Metway
Westpac