

Australian Consumers' Association Submission to the ATM Industry Steering Group on Interchange Fee Reform

1. Introduction

1.1 About the Australian Consumers' Association

The Australian Consumers' Association (ACA) is an independent, not-for-profit organisation which represents consumers' interests and advocates on their behalf. As one of Australia's peak consumers advocacy groups, it takes a special interest in financial services, and banking issues in particular. Through its publications CHOICE and CHOICE Online, ACA can test consumer opinion relating to banking and other issues, but also provide information and advice to consumers.

The issue of payments system reform has garnered much attention over the past 18 months, notably through the development of reforms to the credit card system. In recent months, debit cards and Automatic Teller Machine (ATM) systems have also attracted attention. ACA has been pleased to participate in previous discussions on payments system reform, and welcomes the opportunity to provide a submission to the ATM Industry Steering Group.

1.2 Importance of ATM access

At the outset of this submission, it is worth noting that ATMs are different to other payments systems, in that they are the primary means for access to cash, perhaps one of the most fundamental elements of any consumer expectations of a banking system. Access to cash underpins other payments system reforms, as it always the 'payments system of last resort' for consumers not wanting to use other payment options such as credit cards or EFTPOS.

As banks have closed branches to reduce costs, ATMs have played an increasingly important role in providing access to cash for Australian banking customers. While the costs of maintaining ATMs differs, they are cheaper to operate than a branch, and Australian banks undertook an extensive campaign in the 1990s to replace large parts of their branch networks with ATMs. Banks and other ADIs have invested heavily in the infrastructure and networks of ATMs, and consumers have increased their usage, in part driven out of banks by high over-the-counter fees for transactions, and also drawn to the greater convenience ATMs can offer (though this is often tempered by security concerns).

1.3 Avoiding potential consumer detriment

As such, ACA believes that great care must be taken in the development of any reforms to the ATM network. Because ATMs are so fundamental to consumers' access to banking, changes to the cost of using parts of that network have the potential to impact the overall cost of banking for many consumers already vulnerable to changes to access, but also to the structure of retail banking as a whole.

ACA does not consider the Steering Group Discussion Paper adequately considers the potential impacts of the changes proposed to the Australian ATM network, and does not provide sufficient analysis of experience in overseas markets – namely the United States and United Kingdom¹, where consumers have expressed great dissatisfaction with the

¹ While ACA notes that the US surcharging environment includes the retention of interchange fees on foreign ATM transactions (not proposed in the Australian reforms) the consumer and market impacts from US ATM surcharging raise relevant issues for Australian reforms.

outcomes of the move to direct charging for foreign ATM access – the very reform being proposed here.

Accordingly, we recommend that these reform proposals not be rushed in to meet the implementation deadline set for other payment system reforms, but that appropriate time be taken to thoroughly investigate the assumptions which underlie the Australian proposals, and the potential for adverse consumer impacts.

2. Background

2.1 Foreign ATM fees and their components

A 'Foreign ATM fee' is presently the charge levied by a customer's issuing bank or Authorised Deposit-Taking Institution (ADI) when they access their account through an ATM not owned by that bank or institution. Part of the fee is a charge set by the bank for the transaction, and about \$1 will be an interchange fee set by agreement between the issuing bank and operator of the particular ATM.

ATM reform springs from the same source which produced credit card and EFTPOS reform processes and proposals. The existing interchange arrangements are viewed as too inflexible, bearing little relation to the cost of providing access through a foreign ATM.

Foreign ATM transactions form a substantial minority of ATM transactions, but are an important means of access for customers of 'non-Big Four' institutions, and those who cannot access bank branches or own-bank ATMs. They are therefore an vital supplementary form of access to banking.

3. Direct Charging Proposal

To bring greater transparency and flexibility to the pricing of foreign ATM transactions, it is proposed to shift to a direct charging regime, whereby the current interchange fee applicable to each ATM transaction would be removed and issuing and acquiring institutions would be free to set their own fees for foreign ATM transactions. In particular, operators of ATMs would be able to charge to recover costs plus margin, or garner market share.

3.1 Minimum requirements for direct charging

In our view, such a model would require at a minimum:

- Real-time disclosure of all applicable charges on the ATM screen and enhanced fee disclosure on statements to make it clear to consumers what the cost of transactions would be²;
- Free balance enquiries;
- Ongoing review and monitoring of the operation of the scheme to ensure costs would indeed come down as a consequence of the removal of the interchange.

4. Arguments in favour of direct charging

Proponents of direct charging advance two key arguments in favour of the model:

1. Lower cost through increased competition in high-volume markets (i.e., locations with high numbers of transactions).
2. Improved service delivery in currently under-served locations (i.e., the roll-out of ATMs in previously-unserved areas, on the basis that deregulation of fee levels would enable deployers to charge to cover the cost of establishing and maintaining terminals in such locations).

² Refer 5.10; 5.11, UK Banking Code, <http://www.bba.org.uk/public/consumers>

ACA is sceptical about the validity of these assumptions, based on overseas experience, and previous experience in the Australian banking market. We are also concerned about unintended impacts of such sweeping reforms on something so fundamental as access to cash.

It must also be noted at the outset of consideration of these reforms that they do not envisage uniform consumer benefits. Indeed, it is expected that consumer experience will vary according to geographic location in particular. Customers in high-volume areas are expected to enjoy cheaper ATM fees, whereas customers in low-volume or unserved areas are expected to pay increased costs, but enjoy greater physical access.

4.1 Assumption 1: Costs will drop as a consequence of greater competition

Advocates of a move to abolition of the interchange, the unbundling of foreign ATM fees and a move to direct charging argue it will facilitate lower costs for consumers by introducing flexibility and transparency into charging for foreign ATM transactions. They claim this will encourage competition, particularly in high-volume areas, as consumers would be able to 'shop around' for the lowest ATM costs.

Both local and overseas experience makes ACA sceptical of such claims.

Potential for competition on foreign ATM fees – geographic differentiation

The areas with the greatest potential for competition would be those enjoying a high number of transactions at existing terminals – principally urban and suburban locations, where consumers would have the opportunity to compare and contrast charges from different ATM operators.

Customers in lower volume areas are unlikely markets for such competition both on the basis that costs of establishing and maintaining ATM terminals in their areas are greater, and costs recovered through direct charges will therefore be higher, and they have less opportunity to shop around to exert downward pressure on prices. A clear analogy is petrol pricing, where urban consumers consistently pay lower petrol prices than regional and rural consumers.

This proposal therefore explicitly envisages urban customers paying less than regional and rural customers. However, a bank entering into such a differential pricing structure would run a very real risk of substantial damage to its reputation. Rural and regional bank customers have proven highly resistant to and resentful of the reduction in banking services they have suffered in recent years (and understandably so). At least one major Australian bank has already publicly undertaken to not charge its customers different ATM access fees across based on their location, and other major banks are likely to follow suit.

This reputation risk effectively 'pegs' the regional ATM fee to the urban fee, constraining the capacity of Australia's major banks, who operate the overwhelming majority of Australian ATM terminals, from engaging in any real price competition on ATM fees, either against each other, or against individual deployers.

There may be some limited competition offered by independent deployers, but it would be unlikely to force any substantial drop in charges by the major banks, who will simply not be in a position to respond to localised competition.

Where will the price drop come from?

This is not to say fees will not come down immediately following the implementation of such reforms. But what is far more likely is that any drop in price will emanate from the

very real understanding by ADIs that the payments system regulator, the Reserve Bank, expects charges to fall substantially upon the introduction of the reforms. To ACA, this appears to be price regulation by stealth. If the Reserve Bank intends to impose a de facto price control on ATM fees, we consider it may be more appropriate to do so openly, as was the case with the designation of credit card interchange charges, so the costs of providing a service can be considered, and an appropriate charging model devised upon extensive consultation with stakeholders.

Consumers otherwise have little guarantee that the current apparent commitment by the Reserve Bank to lowering ATM costs will continue beyond the short-term, and have no recourse to ongoing price monitoring to ensure costs do not creep up again when the regulator's attention is directed elsewhere. Australia has no formal system of monitoring of the cost of banking. ACA and other consumer representatives have long argued for such a process, to monitor and regularly report on fee changes and the cost of banking.

4.2 Assumption 2: That under-serviced areas will become more attractive to ATM operators, who will be able to recover the costs of setting up terminals.

This proposes allowing ATM operators, ADI or otherwise, to charge whatever the local market will bear to recover the costs of providing an ATM service. At present, it is argued, the additional costs associated with establishing and maintaining ATMs in many locations – especially regional and rural areas – are keeping operators away.

However, it must be remembered that these are the same communities that have suffered from the withdrawal of banking services to a greater degree than many other communities. Banks have closed a great many branches in regional and rural Australia, replacing them with kiosks in Post Offices and Pharmacies, and ATMs as a salve to angry communities. These communities are very much more dependent on ATMs (both own bank and foreign) as they do not have the back-up branch or own-ATM access available to urban consumers able to travel further or pay a dollar or two more for a transaction.

There is a strong community consensus in Australia that banks owe communities social obligations, based on the essential nature of the services they offer.³ We would be very concerned at a 'turbo-charged' user-pays model which would make access to cash contingent upon payment of potentially exorbitant fees.

In expressing this concern, we are guided by the experience of a number of communities in the United States, who have funded the roll-out of ATMs at a premium, with transactions costing up to A\$10 in some areas. Social exclusion in banking among lower-income and regional communities in Australia has been well documented, and this proposal is likely only to entrench that exclusion by removing any existing controls on foreign ATM transaction pricing in the communities most dependent on those services for access to cash.

The counter argument has been made that competition may develop in these areas once deployers can recover their costs or make a profit, but ACA finds it difficult to see how competition could ever develop to the extent that costs would be lower than at present for customers in those communities.

Addressing inadequate service delivery in regional communities should reflect the approach taken by the House of Representatives Economics Committee in its 1999 Report 'Money Too Far':

³ In the most recent CHOICE survey of consumer satisfaction with banks, 95% of respondents agreed with this proposition.

“The Committee’s main concern has been to find ways of ensuring that communities in regional and remote Australia, particularly those least able to take advantage of the new technology, maintain reasonable access to banking and like services in the short term and, ultimately, gain improved access in the long term.”⁴

5. Unintended consequences

In addition to our scepticism that the anticipated benefits of direct charging will be realised by Australian consumers, ACA believes several potential adverse consequences warrant further consideration.

5.1 Fee increases

Over the past decade, Australian banks have aggressively pursued a campaign to introduce a ‘user-pays’ retail banking system. Unfortunately for Australian consumers, this has actually meant ‘user-pays plus some’, with charges generally set well in excess of costs. Bank annual and interim reports regularly demonstrate the enormous contribution increased fee revenue has made to the above-average profitability of the Australian banking sector.

Australian banks do not have a good track record of passing on cost reductions to consumers, or keeping fees tied to the cost of providing a service. Fees continue to proliferate, with banks finding new ways of levying charges on consumers. From increased fees for over-the-counter transactions, to electronic, penalty and credit card annual fees, banks have used fees to boost profits and direct consumer behaviour.

ACA is therefore concerned that the unbundling of the foreign ATM fee will provide yet another opportunity for fee increases. We would be pleasantly surprised if banks elected to reduce their own issuer fee to zero or an amount which actually reflects the low cost of each foreign ATM transaction. However, a more realistically grim scenario is for the UK and US consumer experience to be replicated, and consumers find themselves paying high direct charges *and* a fee to their own bank, at a total higher cost than currently levied.

5.2 Concentration of market power in hands of owners of biggest ATM networks

This reform has the power to undermine existing competition in the retail banking sector. The institutions most likely to gain from high foreign ATM fees are those with the largest ATM network, who will be able to use that network to entrench their market share by penalising other-institution customers and advertising their lower access costs.

This has been a very real problem in the US for smaller institutions, who have seen their customers penalised for accessing the ATM networks of larger competitors. In that country, foreign ATM fee disclosure is used as a marketing tool by some of the largest ATM network operators, with offers to switch appearing next to the fee disclosure.

In Australia, ACA would expect this to disadvantage regional banks, credit unions and building societies, many of whom offer the best banking service to their customers, according to the ACA’s own customer satisfaction surveys, but whose customers could be subjected to punitive costs (i.e., well in excess of the cost of the service) for ATM access.

⁴ para 2.2, p. 7.

While ACA expects these institutions will develop competitive responses to ATM direct charging (such as enhancing networks or access) it is important that the regulatory and reform environment provides scope for such options to be developed.

ACA therefore urges the Steering Group to give greater consideration to the disadvantage unrestricted foreign fee pricing may present to non Big Four bank customers.

5.3 Rationalisation of existing networks

In addition to the concerns raised above regarding the likelihood of additional deployers in currently-under-serviced areas, another potential adverse impact is the rationalisation of networks in less lucrative, lower-volume markets. One example provides a stark illustration of this scenario:

In the United Kingdom last year, Abbey National, one of that country's largest banks, announced plans to close 100 of its more remote ATMs, leaving customers more reliant on other bank ATMs or independent terminals. Abbey admitted this would "create more opportunities for people to come in on the basis of applying a charge".⁵

So not only would regional customers face paying higher costs for any additional ATMs, but the application of the user-pays approach to ATM charging in the UK has meant that own-bank ATM networks have been reduced in less-profitable areas. Only a few years after suffering sweeping cuts to branch services, bank customers in less profitable Australian locations could face the very real prospect of losing their own-bank ATM networks.

6. Conclusion

Given the concerns outlined above, and the very real potential for consumer detriment as a consequence of the introduction of direct charging for foreign ATM transactions, ACA urges the Steering Group to devote more time and resources to exploration of alternative approaches to reducing ATM fees. Australian consumers have suffered from service reductions and increased costs in other areas of banking and ACA would strongly resist changes likely to compound that hardship and potential for further exclusion.

ACA recommendations

- 1. Need for far greater analysis of the overseas experience of direct charging for ATM access, with particular regard to the impacts on cost for consumers and impacts on competition in retail banking.*
- 2. If the industry is confident real-time disclosure can be done as part of a move to direct charging, that reform should be implemented in its own right as an important means of fee disclosure to consumers.*

To discuss any of the matters raised above, please contact me on 0411 670 329, or at cwolthuisen@choice.com.au

Yours sincerely

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⁵ Andrew Pople, Manager, Retail Banking Abbey National, "Daylight robbery at cashpoints", Daily Mail, 24 May 2002.

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