Payment Systems Regulator

Review of the structure of LINK interchange fees

Responses to consultation

September 2019

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Names of individuals and information that may indirectly identify individuals have been redacted.

PSR roundtable discussion on the LINK interchange fee structure

06/09/19

Introduction

1. Having a good choice of how to make payments, in ways that work for everyone, is important for all of us. Our overall objective is to support cash access which meets the needs of anyone making payments, including widespread geographic access for UK consumers who need or want to use it as a payment method.

2. We have a range of work in train to ensure that people have access to cash in the short to medium term, and for the longer term. This includes working with other authorities which have a role to play, to make sure we are all co-ordinated and get the right outcomes for everyone.

3. One element of our work is looking at the provision of ATMs. We want to make sure that there are robust incentives in place for ATM operators so that machines are provided in the areas where people want or need them.

4. On 6th June 2019 we published a Call for Views on the structure of LINK interchange fees. This closed on 5th July 2019 and sought views on:

   a. The description and framework for considering the costs of providing ATMs and the value they provide, including the objectives we set out in this paper.

   b. Whether there are any other factors we should take into account when analysing the incentives to provide ATMs.

   c. What incentives and impacts the existing LINK interchange fee arrangements, as described in the Call for Views paper, have.

   d. What structure of interchange fees would have appropriate incentive effects going forward.

5. On Friday 26th July, we invited stakeholders to attend a roundtable discussion on the future structure of LINK interchange fees. This followed our Call for Views on the structure of LINK interchange fees. Responses to this are published after this discussion note.

6. We would like to thank all those that responded to the call for views, and those that took the time to participate in the roundtable.

7. This publication provides a summary of a discussion of the roundtable, which was held under the Chatham House rule.

8. The summary is set out into two sections: discussion on the impact of existing arrangements as described in the PSR paper on the ATM network; and discussion on potential options for delivering appropriate incentives and outcomes.

Attendees

9. Attendees at the event represented the following organisations.

British Retail Consortium	Bank of England
Cardtronics	Competition and Markets Authority
Constantine Cannon LLP	Financial Conduct Authority
Deloitte	HM Treasury
HSBC	Payment Systems Regulator
Institute for the Faculty of Actuaries	
LINK	
Lloyds	
Mastercard	
Nationwide	
NoteMachine	
RBS	
UK Finance	
Visa	
Vocalink	
Which?	

Summary of discussion

Observations on the LINK ATM network and interchange fee structure

10. The PSR welcomed attendees and outlined the objectives of the roundtable. The PSR then gave an introduction on the issues which it set out in its Calls for Views on the structure of LINK interchange fees[1], highlighting two key observations:

- Cash use is expected to continue to decline, but there is likely to be a significant number of people using cash for some time.
- The geographic spread of ATMs is important, but there may need to be a reduction in the number of free-to-use ATMs to ensure sustainability.

11. There was general agreement with the PSR's observations that cash use will decline (albeit with different views on how fast) and that this will impact the sustainability of the ATM network.

12. There was debate on the pace of the decline in the use of cash and the implications for any steps taken. There was a view that there may be a sharper decline than most current predictions and that previous forecasts had underestimated the actual decline. Another view was that the situation was very unpredictable, that a very wide range of outcomes were all equally plausible and that a system guaranteeing free access to cash needs to cover both extreme bounds of the potential trend in the use of cash.

[1] https://www.psr.org.uk/psr-publications/consultations/cp196-call-for-views-psr-research-cash-access

Other stakeholders noted that a sharper decline may be triggered by a reduction in investment by industry.

13. There was also a discussion as to whether there was a need to maintain a network with a broad geographic spread. One stakeholder said that, instead, the focus should be on helping people transition away from using cash and drew a comparison between the current debate on access to cash and of the transition to decimal currency in 1973, when fears that vulnerable and elderly would be unable to adapt proved largely unfounded. HM Treasury noted that the summary of responses to its Call for Evidence explored the transition away from cash, and set out the government's commitment to support digital payments while safeguarding access to cash for those that need it[2].

14. Another topic that was raised was the optimal spread of free-to-use ATM locations:

- A view was expressed that the appropriate response was to protect 26,0000 free-to-use ATM locations. However, the analysis of the 26,000 locations would have to be careful as there may be locations with no ATMs currently that need one.

- Some participants doubted whether an analysis of the number of necessary locations on this granular level would not be possible by any individual commercial entity as it may not be possible to obtain data outside an its ATM fleet.

- There was a discussion regarding the 'Dutch model' and its distinction of protecting ATM locations versus protecting ATMs. One observation was that this model required all parties to buy into the model. Moreover, a stakeholder said that the main outcome of the Dutch model was that co-operation and co-ordination was necessary.

15. A view was expressed that purely relying on commercial incentives in a declining market will result in sub-optimal outcomes for consumers as the incentive for operators is to remove themselves from unviable areas. As a result, the industry needs a central steer which only the regulatory authorities could provide. Other stakeholders held the view that a reformed Interchange Fee would be beneficial, but also said that this would not be a long term fix.

16. A number of different policies were proposed to ensure that the geographic spread of ATMs can meet the needs of consumers in the future:

- One factor that was raised was whether the Interchange Fee should incorporate some form of indirect subsidy based on geographic zones. It was proposed that geographical zoning could be used so that the Interchange Fee rates could be adjusted depending on locality.

- Views were also expressed that site location could be improved and efficiencies subsequently made.

[2] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/799548/CfE_-_Cash___Digital_Payments_Response_020519_vf_digicomms.pdf?_ga=2.29652351.1774443578.1566563342-604225568.1502719931

- Another issue that some stakeholders thought was important going forward was that the proposed solution worked in several years' time.

17. There was also a broader discussion regarding potential improvements that could be made to help ensure that the geographic spread of ATMs can meet the needs of consumers in the future given the expected decline in cash use:

- There was a discussion regarding whether there was oversupply of ATMs in certain areas and undersupply in others, though there were also countering views that suggested that the existing spread of ATMs is adequate and that the priority should be maintaining this spread.

- One stakeholder had commissioned a piece of work with a grocery chain on resource and cost efficiency with regards to ATMs. They had concluded that the number of free-to-use ATM locations was a more significant factor for access to cash than the number of ATMs. They said that site identification could be improved and efficiencies could be made.

- Opposing views were expressed regarding whether the cost of servicing rural ATMs is substantially greater than urban ATMs. However, several participants agreed that some type of geographic zoning may be required in some areas where it would not be profitable for an IAD to provide and service an ATM.

- There was a discussion on economic inequality and the need to prevent ATMs in areas with relatively higher rates of poverty converting to pay-to-use. It was suggested that more economic incentives should be provided through the structure of the Interchange Fee to ATMs in such areas.

- There was also a discussion that the industry may risk focussing too much on a relatively small proportion of users at the expense of the majority. This situation was compared to access to postal services, where a small proportion of users who did not live near a Post Office were responsible for a large number of complaints.

Potential options for addressing issues

18. The PSR enquired whether restructuring the Interchange Fee was the most appropriate tool to reduce these problems. A range of views were expressed, a number of which, but not all, supported reforming the structure of the Interchange Fee. Many participants suggested this should be in conjunction with a variety of other policies, including retaining LINK's current Financial Inclusion Policy. One stakeholder said that even if restructured Interchange Fee was only a short-term fix, it would still buy breathing room to produce a different long-term solution. Potential approaches suggested included:

- A joined-up system in which ATMs, Post Offices and bank branches co-operated to provide widespread access to cash.

- A geographically zoned Interchange Fee.

- A Universal Service Obligation either to ensure that ATMs are geographically distributed or to ensure effective and reliable ATMs that are always working and filled and not just on the spread of ATMs. However, other participants disagreed that this was an issue and said that it was not for the industry to define the public policy issue of how the market should work.

- An Interchange Fee for deposit taking ATMs.

- An examination of the broader issue that the Interchange Fee could not solve the wider issue of areas where cash acceptance is low, as even if people are able to withdraw cash from an ATM they will be unable to use it if shops / retail outlets in that area only accept card payments.

19. Many agreed that a variety of objectives should be taken into account when setting the Interchange Fee:

- Several stakeholders said that protecting consumers and designing a system around the needs of consumers was paramount. There was a commitment to providing cash in a sustainable way.

- Views were expressed that the current distribution of ATMs, and subsequent access to cash for the public, was adequate at the moment, but that more action is needed to ensure that the ATM model is sustainable in the future, given the expected decline in cash use.

- There was support for LINK's current Financial Inclusion Programme.

- It was suggested that cash plays a role in system resilience in case card payments became inaccessible for short periods of time as a result of IT issues, for example. This would still require a broad spread of ATMs.

- The importance of taking into account all the factors which matter to consumers was also noted. Consumers were not just concerned at the conversion of free-to-use ATMs to pay-to-use and the distance to their nearest ATM, but also factors such as privacy, reliability and queues.

- A number of participants agreed that consumer interest and commercial interest needed to be aligned so that it would be commercially beneficial for IADs to run ATMs in areas with low numbers of transactions.

20. There was a discussion as to whether future reform of the Interchange Fee should look at all transaction processor systems rather than just LINK, with some stakeholders raising the fact that these processors had the potential to take on a major bank and grow their market share.

21. There was also discussion on whether, and to what degree, there are potential cost efficiency savings that could be made in the LINK system that might help address pressures:

- A participant said that the PSR should examine whether the industry can unlock cost savings of up to £200m in order to increase the presence of ATMs in remote locations.
- One view expressed was that a large proportion of the interchange fee goes towards balance enquiries and that this created unnecessary costs in the Interchange Fee.
- It was suggested that savings could be made by looking at the estates of ATMs and through better use of data, though efficiencies should also be looked at in the context of the wholesale distribution and recycling of cash and how SMEs use cash.
- However, there were certain doubts as to whether these savings would be significant, and that having multiple ATMs in one location is not necessarily a sign that the market is inefficient as there will always be duplication of service in a competitive market.

Next steps

22. In addition to our work on the structure of the interchange fees, we have also published a Call for Views on our research into cash access, use and acceptance and we encourage anyone with an interest in this subject to provide us with their views. The closing date for this particular Call for Views is 6th September 2019. A further stakeholder roundtable discussion will take place in October to discuss some of those initial responses.

23. We will take the submissions to both Calls for Views, along with the discussions with stakeholders at our roundtable events, to further help shape our understanding and inform our work. We will continue to update stakeholders on the key focus areas for taking forward the different strands of our work in this area, and engage with stakeholders throughout.

Association of Convenience Stores (ACS)

ACS Submission: Review of the Structure of LINK Interchange Fees

ACS (the Association of Convenience Stores) welcomes the opportunity to submit evidence to the Payment Systems Regulator on the structure of LINK interchange fees. ACS represents 33,500 local shops and petrol forecourts including Co-op, McColls, BP and thousands of independent retailers, many of which trade under brands such as Spar, Nisa and Costcutter. Further information about ACS is available at Annex A.

Convenience retailers have been responding to evolving customer demands for payment methods, offering contactless payments (in 80% of stores) and mobile payments (63%)[1]. Convenience stores are also positive actors on financial inclusion and access to cash, providing cashback services (58%), free-to-use (FTU) ATMs (46%), Post Offices (23%) and pay-to-use (PTU) ATMs (16%)[2]. The sector has a unique reach, trading across rural (37%), urban (37%) and suburban (26%) locations, including in city centres (12%), neighbourhood parades (36%) and as isolated shops providing the only local retail and service provision for an area (38%)[3].

Rural shoppers report that ATMs are the second most valued service in their local convenience stores, behind only Post Office branches[4]. Despite this, ATM provision in the sector is dramatically changing as a direct result of reductions in LINK interchange fees, forcing ATM operators to convert considerable proportions of their FTU ATM estate hosted in independent retailers' stores to PTU. LINK's most recent statistics suggest that almost 200 FTU ATMs are closing per month, most of which will likely be ATMs in convenience stores trading in non-central locations[5].

This call for views primarily concerns the effects of the interchange fee structure on ATM operators, but these effects will impact outcomes for retailers contracting with ATM operators too. For convenience retailers, set costs associated with hosting an ATM include energy usage and business rates bills. Retailers must also manage access to the site for operator maintenance, self-fill the ATM with cash in some cases, and take on the risk of ATM crime for the store.

A key element of supporting access to cash is making sure retailers and ATM operators are appropriate incentives to maintain a suitably wide geographic spread of ATMs to contribute towards a truly national network. The Payment Systems Regulator's analysis of the ATM market and associated operating costs based on the location of ATMs is too simplistic. Operating costs, for operators and retailers, vary according to hyperlocal conditions rather than a pure scale of population density. We believe the current structure of interchange fees with premiums where they are required could effectively deliver the geographic spread of the ATM network but is undermined by the declining level of fees and poor implementation of the Financial Inclusion Programme.

[redacted]

[1] ACS Local Shop Report 2018
[2] ACS Local Shop Report 2018
[3] ACS Local Shop Report 2018
[4] ACS Rural Shop Report 2019
[5] https://www.link.co.uk/about/statistics-and-trends/

Q1) Do you agree with the description and framework (including the objectives we set out) for considering the costs of providing ATMs and the value they provide that are set out in this paper? If not, please explain why and set out your view of the alternative way these issues should be analysed.

The starting point for the structure of interchange fees should be to support a national ATM network and ultimately facilitate choice in payment methods for all consumers. The Access to Cash Review has found that 17%[6] of the UK population would struggle to cope in a cashless society and 76% of convenience store transactions are paid for in cash, demonstrating clear consumer need in the sector[7]. For 97% of the population who carry cash, access to cash is valued to use for small transactions, act as a backup to digital payment methods, provide them with payment choice, help with personal budgeting and make informal transactions with friends and family[8].

The overwhelming majority (98%) of cash withdrawals are carried out at FTU ATMs, with most other transactions taking place using PTU ATMs, Post Office counters and cashback services. Post Office counters and cashback services do not provide equitable privacy for the consumer, while ATMs are an established infrastructure for accessing cash which can take away cash on the premises and the costs of supplying cash from retailers. The ATM network must remain a strategically valuable infrastructure for the payments industry into the future, when currently the value to the customer of each ATM does not always match the economic value of the interchange fee scheme.

The Payment Systems Regulator's analysis of the ATM market and associated operating costs based on the location of ATMs is too simplistic. This analysis should be caveated by the hyperlocal impacts of location. Unit operating costs will vary considerably regardless of location, for example, petrol forecourt sites hosting ATMs will attract high traffic in rural locations and ATMs in tourist areas may see significantly higher footfall in the summer months. ATMs in suburban and residential urban areas, for example housing estates or neighbourhood parades, can also be relatively isolated from the rest of the network.

We would also add to the given framework that the removal of a FTU ATM can still have a significant impact on an area even when another FTU ATM is available locally. For example, a now defunct FTU ATM could be removed from a neighbourhood parade when an alternative ATM is available within a short distance. In this situation, consumers would no longer be able to access cash on that neighbourhood parade, affecting its constituent businesses, and more consumers would be required to travel out of their way to specifically withdraw cash.

The funding model for the ATM network should reflect increasing operating costs. One significant increase in operating costs introduced after the original interchange fee arrangements were set in 2001 concerns business rates bills. 'Through-the-wall' ATMs are liable to business rates bills, averaging £4,000 per annum, and are a key consideration for retailers reviewing the commercial viability of their ATM offer[9]. Business rates bills should be considered a key cost of providing ATMs for retailers.

[6] Access to Cash Review: Final Report
[7] ACS Local Shop Report 2018
[8] Access to Cash Review: Final Report
[9] Retailers welcome ATM business rates ruling Talking Retail. 9 December 2018

Q2) Are there any other factors we should take into account when analysing the incentives to provide ATMs?

Convenience retailers are paid by operators for hosting a FTU ATM either according to a negotiated flat fee structure without reference to transaction numbers, commission paid after a minimum monthly level of transactions are met, or commission paid on all transactions. Retailers receive a share of the amount charged to consumer for operating PTU ATMs, there are no interchange fees for PTU ATMs.

Retailers therefore benefit from hosting an ATM through the fees they are paid by the operator and footfall from ATM transactions when it translates into shop sales. ACS has been collecting case studies on the impact of ATMs switching from FTU to PTU as a result of interchange fee cuts. Retailers suggest there is a significant decline in shop turnover as a result. Retailers also host ATMs because consumers still value cash as a payment method of choice; 76% of consumers report they paid in cash after visiting a convenience store[10].

The value of hosting an ATM for retailers is declining with commissions falling, operating costs increasing and threats of crime increasing. There has been a growth in ATM ramraids, we estimate 353 incidents in the convenience sector over the past year[11]. ATM ram raids have a huge monetary cost not only due to the loss of cash, but also structural and operational damage to stores where heavy machinery pulls ATMs from internal and external fixings.

Beyond these additional factors influencing retailers' decisions on hosting ATMs, the level of the interchange fee and impact this has on ATM revenue is the most significant factor for retailers. We would encourage the Payment Systems Regulator to consider LINK's incentives to reduce interchange fees, which has been driven by the network body seeking to prevent its member banks from leaving to join rival ATM networks Visa or Mastercard, which do not have responsibility for ensuring national ATM coverage.

Q3) What incentives and impacts do the existing LINK interchange fee arrangements as described in this paper (including in Annex 2) have?

The reduction of LINK interchange fees is causing ATMs to switch to PTU or withdraw machines across the convenience sector, particularly impacting rural and non-central locations where the next local ATM is an inconvenient alternative for consumers. The convenience sector hosts a large proportion of non-branch ATMs away from high streets where the clustering of ATMs may occur, trading as isolated shops (38%) and in small neighbourhood parades (36%)[12].

Current interchange fee arrangements will continue to shrink the FTU ATM network, even where ATMs are highly valued by consumers. Most FTU ATM closures over the past year have been ATMs that were hosted by independent convenience retailers, whose operator has converted the ATM to PTU as a direct result of changes to interchange fees. Multiple retailers have typically negotiated ATM contracts offering more protections and preventing switches to the PTU model at short notice, but the size of their ATM estates will likely be affected by changes to interchange fees when these contracts expire.

[10] ACS Local Shop Report 2018
[11] ACS Crime Report 2019
[12] ACS Local Shop Report 2018

LINK's Financial Inclusion Programme (FIP) is also failing to protect national coverage of the ATM network. Before LINK confirmed its decision to reduce interchange fees and triple the FIP subsidy from 10p to 30p, LINK struggled to guarantee nationwide free access to cash for consumers. LINK had identified 2,651 deprived areas in the UK that were eligible for a FTU ATM subsidy, but 824 (31%) of these did not have free access to cash within a kilometre radius, 10 years after the introduction of the Programme[13]. Since expanding the programme, LINK's own data has shown that 168 (7%) 'protected' ATMs are already no longer transacting[14].

LINK's decision to then introduce 'super premium' interchange fees for low-transacting isolated FTU ATMs is clear evidence that the combined impact of LINK's changes to interchange fees and the FIP are having negative impacts on the ATM network. These recent changes also demonstrate the power of LINK to change the funding model of ATMs at short notice, when an appropriately funded long-term strategy is needed to secure the ATM network. The ATM funding model should be predictable to encourage investment from operators and confidence from retailers to host ATMs where consumers value them. Interchange fees should reflect costs for operators and retailers and changes in their structure must not leave retailers to subsidising machines.

Q4) What structure of interchange fees would have appropriate incentive effects going forward?

Interchange fees should be structured to fund and sustain a geographic spread of ATMs. This structure should prevent cases where ATM closures inconvenience consumers by requiring them to travel out of their way to access cash, which can have a negative economic impact on local businesses, especially in rural and suburban locations.

ACS' comments on the three proposed structures are available below:

Multi-Part Tariff

Adopting a multi-part tariff approach would either require a fixed payment per ATM to be set at a level which sustains low-transacting isolated ATMs or a payment per ATM which accounts for differences in servicing costs and the consequent impact on retailers' costs and revenues.

The per transaction payment, similar to the current interchange fee, would have to be set at a level which covers costs to for retailers and ATM operators. This should account for the impact of declining transaction numbers, which declined by 6% across the LINK network from 2017 to 2018[15].

Banding Structure

We would not support a banding structure approach. Setting interchange fees on a per ATM basis to account for varying costs to supply would introduce significant complexity to the existing interchange fee system. Despite this additional complexity, a banded approach would create losers at the edges of the set interchange fee bands and not necessarily support low transacting isolated ATMs.

[13] LINK Financial Inclusion Programme: 10 Year Anniversary p.4
[14] LINK Scheme ATM Footprint Report. April 2019
[15] https://www.link.co.uk/about/statistics-and-trends/

Standard Fee with Premiums (Current Structure)

We agree with the Regulator that the existing structure incentivises operators to lower their operating costs. However, the current structure of standard interchange fees and the Financial Inclusion Programme is not preventing ATM closures where they create gaps in network coverage.

The current structure could support a stable ATM network. Interchange fees should be set at a level which accounts for the operating costs and commercial viability of hosting an ATM. Although LINK has postponed a previously scheduled fee cut for 2020, more cuts are expected. LINK interchange fees used to be set by an independent KPMG cost study before LINK's announcement to arbitrarily cut the fees.

The Financial Inclusion Programme can be amended by LINK at short notice, which detracts from operator investment to install ATMs in locations where they would attract subsidy. The procurement process between LINK and operators is complex and not preventing gaps from emerging in the network, while new ATM openings can affect existing ATMs' eligibility for FIP subsidy. The Payment Systems Regulator should ensure operators and retailers are provided with certainty by LINK about medium-term eligibility of an ATM for FIP.

Annex A

ABOUT ACS

The Association of Convenience Stores lobbies on behalf of over 46,000 convenience stores across mainland UK on public policy issues that affect their businesses. ACS' membership is comprised of a diverse group of retailers, from small independent family businesses running a single store to large multiple convenience retailers running thousands of stores.

Convenience stores trade in a wide variety of locations, meeting the needs of customers from all backgrounds. These locations range from city centres and high streets, suburban areas such as estates and secondary parades, rural villages and isolated areas, as well as on petrol forecourts and at travel points such as airports and train stations.

ACS | the voice of local shops

WHO WE REPRESENT

INDEPENDENT RETAILERS

ACS represents over 19,000 independent retailers, polling them quarterly to hear their views and experiences which are used to feed in to Government policy discussions.

These stores are not affiliated to any group, and are often family businesses with low staff and property costs. Independent forecourt operators are included in this category.

SYMBOL GROUPS AND FRANCHISES

ACS represents over 14,000 retailers affiliated with symbol groups. Symbol groups like SPAR, Nisa, Costcutter, Londis, Premier and others provide independent retailers with stock agreements, wholesale deliveries, logistical support and marketing benefits.

Symbol group forecourt operators and franchise providers like One Stop are also included in this category.

MULTIPLE AND CO-OPERATIVE BUSINESSES

ACS represents over 12,000 stores that are owned by multiple and co-operative retailers. These businesses include the Co-Operative, regional co-operative societies, McColls and others.

Unlike symbol group stores, these stores are owned and run centrally by the business. Forecourt multiples and commission operated stores are included in this category.

THE CONVENIENCE SECTOR

SALES

In 2018, the total value of sales in the convenience sector was £39.1bn.

The average spend in a typical convenience store transaction is £6.50.

SHOPS

There are 46,262 convenience stores in mainland UK. 72% of stores are operated by independent retailers, either unaffiliated or as part of a symbol group.

JOBS

The convenience sector provides flexible employment for around 365,000 people.

24% of independent/symbol stores employ family members only.

ENTREPRENEURS

24% of shop owners work more than 70 hours per week, while 19% take no holiday throughout the year.

70% of business owners are first time investors in the sector.

COMMUNITIES

Convenience stores and Post Offices poll as the two services that have the most positive impact on their local area according to consumers and local councillors.

81% of independent/symbol retailers have engaged in some form of community activity over the last year.

INVESTMENT

Between August 2017 and May 2018, the convenience sector invested over £814m in stores.

The most popular form of investment in stores is refrigeration.

OUR RESEARCH

ACS polls the views and experiences of the convenience sector regularly to provide up-to-date, robust information on the pressures being faced by retailers of all sizes and ownership types. Our research includes the following regular surveys:

ACS VOICE OF LOCAL SHOPS SURVEY

Regular quarterly survey of over 1,200 retailers, split evenly between independent retailers, symbol group retailers and forecourt retailers. The survey consists of tracker questions and a number of questions that differ each time to help inform ACS' policy work.

ACS INVESTMENT TRACKER

Regular quarterly survey of over 1,200 independent and symbol retailers which is combined with responses from multiple businesses representing over 3,000 stores.

ACS LOCAL SHOP REPORT

Annual survey of over 2,400 independent, symbol and forecourt retailers combined with responses from multiple businesses representing 7,669 stores. The Local Shop Report also draws on data from HIM, IGD, Nielsen and William Reed.

BESPOKE POLLING ON POLICY ISSUES

ACS conducts bespoke polling of its members on a range of policy issues, from crime and responsible retailing to low pay and taxation. This polling is conducted with retailers from all areas of the convenience sector.

For more information and data sources, visit www.acs.org.uk

Considering the incentives to deploy free-to-use ATMs in the LINK network

Review of the structure of LINK interchange fees: Call for views (CP19/5)

June 2019

Name of the originator	Association of Independent Risk and Fraud Advisors - AIRFA

Contact Details	[redacted]
☑	The comments provided here CAN be published

Q1 Do you agree with the description and framework (including the objectives we set out) for considering the costs of providing ATMs and the value they provide that are set out in this paper? If not, please explain why and set out your view of the alternative way these issues should be analysed.

AIRFA Response:

We welcome the consultation – the objectives, approach, analysis and interim conclusions, as well as additional questions to be addressed. This provides a timely opportunity to consider the need for appropriate cash access for consumers in the UK and access to fee-free ATM locations.

It also provides a broader opportunity to consider the relevance of cash today and in the future and how it sits alongside many other efforts and initiatives to drive electronic payments in retail and merchant environments, plus person-to-person payments, to displace coins and notes.

For many citizens there is indeed reduced reliance on cash (notes and coins), as other forms of payment, i.e., card - debit/credit/prepaid, contactless, digital wallets, bank account payments, etc., and become more enabled, prevalent and accepted.

However, there are no doubts that consumers are being adversely impacted through one of more of the following:

- 6% reduction in the year-on-year fall in ATM transactions is highlighting the natural reduction in cash access needs and the inevitable challenge of increasing per ATM transaction costs[1]
- Ongoing reduction in the number of accessible ATMs, as confirmed in the consultation paper
- Remaining ATMs typically located in urban/suburban areas, leading to levels of localised saturation, versus more remote/rural environments, and linked to bank branch closures
- Remaining ATMs increasingly IADs versus bank-owned
- Remaining ATM owners increasingly introducing fees for a cardholder to access their own funds
- Consumers' personal security concerns about access to remotely located ATMs
- Though adoption of electronic "card" payments is happening at the vast majority of merchant and retail locations, there are still numerous locations that either prefer or consciously do not accept card payments, primarily due to cost reasons.

[1] https://www.link.co.uk/about/news/link-update-to-interchange-rate-implementation/

Association of Independent Risk and Fraud Advisors (AIRFA)

Review of the structure of LINK interchange fees: Call for views (CP19/5)

June 2019

The LINK Financial Inclusion Programme goes towards recognising the importance of free to use ATMs in the most remote areas and equally the multitude of fixed and variable cost considerations for ATM deployment, usage levels, ongoing ATM replenishment and maintenance.

The LINK Board previously agreed a cash disbursement fee infrastructure that acknowledged

- Branch versus remote ATM locations
- Cash and non-cash transactions

There is a conflict for the LINK Board, (as they are made-up from net issuers of LINK transactions) as they have cancelled a plan for interchange fee reductions in 2020 – i.e. that would have reduced the income for their own organisations. This is in the context of them having been 'comfortable' with two interchange fee reductions in 2018/2019 and a further reduction under consideration in 2021.

In April 2019, LINK announced the introduction of the new "super premium" of up to £2.75, that will increase interchange payments to ATM operators of the most remote ATMs. The premium is to be available to around 3,500 potentially eligible free-to-use ATMs in the most remote, rural and deprived areas of the UK.

This approach needs to be assessed in more detail to determine how much of the up to £2.75 is being paid by LINK issuers and additionally what is the projected impact on current and future deployment of ATMs in the most remote areas.

Q2 Are there any other factors we should take into account when analysing the incentives to provide ATMs?

AIRFA Response:

Access to financial services remains a citizen's right. However, many citizens are required to use cash as a primary means of payment and for one or more of the following reasons:

a) Personal choice
b) Dislike/mistrust of electronic payment methods
c) Concerns at levels of fraud on card usage, contactless payments and fraud scams on account transfer payments
d) Cash is still king in certain retailer/merchant environments
    - Discount for cash
    - Minimum spend for card usage stipulated in some retailers / merchants
    - Some retailers / merchants express a preference for cash versus electronic payment methods
        i. cost of payment card transactions
        ii. cost of device / terminal rental or purchase
        iii. other direct/indirect costs associated with electronic payments and passed through to retailer / merchant
    - Though some merchants are willing to accept cards and their associated costs, the presence and strength of good telecommunications / WIFI typically determines this is not sufficiently practical or reliable.
    - Concerns at costs incurred by retailer/merchant for accepting card payments
    - Some retailers/merchants are cash-only for payments
e) Cash is still king in certain merchant environments to support "grey economy" activities

f) Where provided, other banking and non-banking services, including PIN change, balance enquiry, balance transfer, statementing, bill payment, etc.

ATM deployment has been uneven, with a focus on urban versus rural areas. This has led to ATM saturation in some urban environments and sparse coverage in more rural and remote environments.

This was less of an issue when retail banks had a presence in urban, suburban and rural areas. However, with the systematic closure of many bank branches, with the corresponding removal of in-branch / external ATMs, citizens have been forced to obtain cash in a variety of new ways

a) Before leaving a major town/city and entering suburban/rural areas
b) Look for bank and non-bank ATMs in other retail/merchant locations including – supermarkets, petrol stations, convenience stores and pubs.
c) Locate a retailer / merchant that facilitates purchase with cashback transactions, whether formally within payment network rules or by just rolling up to the nearest £10.
d) Maintain larger than necessary amount of personal cash in case of no local cash access

The convenience and security of electronic payments at point of purchase, counters the perceived convenience of cash access at ATMs. That said, consumer choice is being negatively influenced by:

- Reduced number of accessible ATMs
- Remaining ATMs increasingly introducing fees for a cardholder to access their own funds
- Personal security concerns about access to remotely located ATMs
- Continued evidence of ATM attacks and thefts – both cyber and physical
- Continued and growing use of ATMs to access "mule" accounts
- Though adoption of electronic "card" payments is happening at the vast majority of merchant and retail locations, there are still such organisations that either prefer or consciously do not accept card payments, primarily due to cost reasons.

Convenience and innovation in the deployment and use of ATMs appears to have been overlooked. The deployment of ATMs was and is primarily for the disbursement of cash to consumers. However, such devices are typically very secure and customer convenient – screen and pin pad.

ATMs can and could offer many other banking and non-banking services that provide consumer utility and potential revenue earning opportunities to the ATM deployer and LINK issuer.

Q3 What incentives and impacts do the existing LINK interchange fee arrangements as described in this paper (including in Annex 2) have?

AIRFA Response:

At the end of the day this comes down to the economics of ATM provision.

If an ATM deployer has an average per transaction cost that is greater than the cash disbursement / interchange fee, then the ATM owner will be forced to consider the future of that device.

The variability of fixed and variable costs has been correctly called out. Despite technology and innovation attempts to reduce ATM costs, the cost of more complex device security has had an impact along with increasing costs of humans to deploy, replenish and maintain such devices.

The Financial Inclusion Programme recognises the extreme variances in ATM deployment and ongoing maintenance costs.

In parallel, banks and financial institutions need to consider and be more prescriptive in their payments strategies to drive the expansion and reach of electronic payments and deliberately displace cash – both coins and notes.

It must also be noted that the demand for cash from ATMs appears to have peaked and is potentially now in decline: which over time may accelerate over the forthcoming years and ultimately within (possibly) a short period of time remove the need for a large part of the ATM estate. If (when?) this happens, we must be careful not to fight the general trend in this direction and to let these things happen in line with a general trends without unduly trying to support and prop-up an industry with ever increasing interchange fees in the name of Social inclusion.

Q4 What structure of interchange fees would have appropriate incentive effects going forward?

AIRFA Response:

As AIRFA members we are not experts in cash disbursement costs, ATM deployment and maintenance economics, so will leave this to the industry stakeholders.

However, AIRFA members believe that:

- The LINK infrastructure strategy and that of its many members – both issuers and acquirers need to be more transparent and public
- Decisioning at the LINK Board level needs to be more transparent
- Decisioning at the LINK Board level needs to be subject to greater challenge
- PSR / FCA need to be more engaged on both economic and conduct aspects of the management of the LINK infrastructure
- Consideration should also be given by the PSR to possible alternatives to the LINK network – i.e. whether there could be alternative infrastructures operated in order to evoke or create competition e.g. Visa, Mastercard, others?
- Consideration is required of the broader electronic payments strategy including cash access in the UK. There is an ongoing challenge and conflict between driving electronic payments and protecting and securing cash access.

Submitted to the PSR via email to PSRcashaccess@psr.org.uk on 3rd July 2019

ATMIA

ATM Industry Association Response to PSR “Review of the structure of LINK interchange fees: Call for views.”

1. Background and Overview

*It is good that the PSR now recognises the need for Payment Choice, a concept developed by ATMIA Europe, both for the public and businesses. In particular, the PSR now recognises the importance of cash to tens of millions of UK citizens who choose to use fiat currency for payments.

*There is categorically no viable alternative to ATMs as the primary distribution channel for cash in every significant community in the UK. The most often mentioned alternative – “Cash Back” – has been available for 30 years, yet accounts for only around 2% of the total cash issuance to the UK public. Nowhere on the planet is Cash Back considered a viable alternative to ATMs.

*The PSR “Call for Views” referred to “considering the incentives to deploy free-to-use ATMs”. The perfect incentive already existed up to 2018, certainly from the public interest perspective. LINK ATM interchange.

*LINK should not have been allowed to move away from Office of Fair Trading approved transparent methodology for calculating LINK ATM interchange. Allowing the LINK Board to arbitrarily set interchange was the recipe for the disaster that has emerged, with 10% of all UK ATMs removed and thousands switching from free-to-use to pay-to-use. The ATMIA warned of this disaster two years ago - but the Association was ignored.

*Both the LINK Board and several major banks have used the excuse of falling demand for cash to justify changes to interchange payments. In fact, those banks in particular have created much of the fall in cash use by removing thousands of busy ATMs. The cash-use predictions of UK Finance have been rendered a self-fulfilling prophesy by the actions of banks and LINK.

*The ATMIA estimates that 300 million free-to-use ATM cash withdrawals will disappear in the UK in the next year due to ATMs moving to pay-to-use mode. This is part of the “self-fulfilling prophesy” and could well be used as an excuse for further reducing ATM numbers.

*LINK also cited as evidence of the need for change the fact ATMs were too concentrated in city centres. In fact, Banks are responsible for much of the concentration of ATMs in urban areas - and particularly city centres. Many remaining bank branches in such locations have 6 or more ATMs. Banks clearly favour such concentrations of ATMs. They pay no direct Business Rates on ATMs, however many they locate at a branch; there are no third-party site rental payments; they create economies of scale, combining branch and ATM cash deliveries.

*Banks do not want Independent ATM Deployers (IADs) installing ATMs in city centre locations, even though the IAD ATMs being installed may be convenient for customers. Banks do not want the public to be offered alternative ATM access, since consumers may choose to use an IAD free-to-use ATM at a retailer they are visiting, rather than making a special journey to a city centre bank branch. The “clustering” of bank branches in certain locations e.g. Market Street, Manchester, exacerbates this issue. Customers may not be visiting that “banking street”. Instead, they may choose to use an IAD ATM in a different street they ARE visiting. The banks do not want this choice to exist. This is why banks may favour lower interchange rates in urban locations. Banks' ATM-related costs are lower in such locations. Lower interchange would therefore still be profitable for the banks, whilst making many IAD ATMs uneconomic to operate.

*There was no rational justification for arbitrarily cutting ATM interchange, beyond the obvious desire of banks to reduce costs. LINK conceded at a recent meeting of the Scottish Affairs Committee that cost per transaction at UK ATMs were probably the cheapest in Europe before the arbitrary cuts.

*The admission by LINK is not surprising, since an analysis of the movement in LINK interchange fees shows that they have gone down over the last decade, both in absolute and real terms.

*The PSR is two years behind in questioning what is happening. Free-to-use ATMs have been lost, either removed or switched to free-to-use. So "protecting the current spread of free-to-use ATMs" is plainly not adequate. Reinstatement of free-to-use ATMs is required, along with incentives to encourage innovation to provide, at a minimum, more cash-related services at ATMs e.g. Universal Deposit, a transaction that has been on the shelf at LINK since 2016 but has yet to be implemented by any UK Card Issuer.

*It needs to be understood that there is no transparent and sustainable ATM interchange fee structure now. There was until the LINK board moved to the position where they set interchange arbitrarily. Without a structure, there will be no investment in the Smart ATMs every community needs to replace lost bank branches and bank ATMs.

*A fee structure was in place which suited every party, including supermarket banks such as Sainsbury and Tesco, EXCEPT banks with an inadequate number of ATMs to meet the cash requirements of their own customers.

*"Premium" LINK interchange rates as an incentive to ATM operators to provide ATMs in specified locations have not worked. Only a few hundred ATMs in the UK benefit from such premium rates. The thinking behind such rates was flawed in many respects, including the focus on providing only one ATM in such locations. ATMs are electro-mechanical devices which suffer downtime. Every community therefore needs at least two ATMs to provide acceptable access to cash, with one machine providing 24/7 access.

*Since the free-to-use UK ATMs currently average around 3500 cash withdrawals per month, another way to look at community ATM provision is to accept that where a community is capable of achieving more than 3500 cash withdrawals per month, a second ATM will be required. Broadly, UK adults use ATM 3 times per month, so any community with a population/catchment in excess of 1200 ATMs will required 2 ATMs.

***Tinkering with "premium" interchange rates cannot provide guarantees of cash access. Only a transparent methodology for calculating interchange will create the stable economic environment for ATM operators required to stimulate the investment needed to see new ATMs installed and, in particular, Smart ATMs with enhanced transaction sets (including Universal Cash Deposit), replacing lost bank branches.**

***Further comments and observation from the ATMIA are at Appendix 1.**

2. ATMIA Recommendations for Safeguarding and Improving Free Access to Cash in the UK

*LINK Interchange must return to being calculated using a cost-based transparent methodology, with a long-term commitment from LINK issuing members that they will adhere to the outcome of the calculations, made at agreed time intervals. This will encourage investment in ATM innovation.
*The previously used transparent methodology should be reviewed, under the supervision of the PSR, to establish whether any changes are required to further improve the transparency and accuracy of the calculations. This review should be carried out within a three month period, starting at the latest on 1 August 2019, to arrive at a revised transparent methodology.
*The current LINK Interchange rate will be frozen, with no further reductions. The rate currently established will be used as the starting point for adjustments made once the revised transparent methodology for the calculation of Interchange is re-established.
*The revised transparent methodology will be used for the calculation of all LINK Interchanges, including Universal Cash Deposit. Such interchanges will be implemented by 1 August 2020, at the latest.
*Free-to-use ATMs have been lost in many parts of the country in the last two years. The PSR will set up a Working Group to include the PSR, LINK, UK Finance and the ATMIA to evaluate which losses need to be corrected and the steps which need be taken to do so. The general principal of having two ATMs in every community will be the basis of this evaluation. Factors such as the presence of a Post Office would be taken into account by the Working Group, on the basis that a community Post Office without an ATM could replace one of the two ATMs otherwise required in every community.
*Where the Working Group consider that there is a requirement for a reinstallation of an ATM or for an ATM to be provided where there has been no machine before, ATM operators – banks and IAD's – should be offered a £5000 (1) grant by LINK towards the costs of providing an ATM. The acceptance of such a grant would include a commitment to installing an ATM within 6 months of the date of granting and the contract for the operation of a free-to-use ATM being for a minimum of 3 years from the installation date. The grant would be payable when the ATM goes live on site.
*Where an ATM has been switched from free-to-use to pay-to-use before 5 July 2019, the ATM operator should be offered a £2000 bounty by LINK to switch the ATM back to free-to-use for a minimum of 3 years. The bounty would become payable after the first free-to-use cash withdrawal is made.

(1) £5000 is the estimated typical cost of providing an in-store ATM, covering machine purchase and all aspects of installation.

Appendix 1

Further ATMIA Comments and Observations on Specific points in the PSR Document

*ATM interchange fees should not be referred to as “multilateral interchange fees” (MIFs). To do so confuses them with fees paid by merchants to Card Schemes in connection with POS payment processing.

*Reference is made to “vast majority” of ATMs being operated by banks and building societies in 2001. Detail inadequate; what % did IAD’s operate?

*The PSR document needed to clarify that transactions other than cash withdrawals receive interchange payments.

*It is not clarified in the PSR document as to the number of ATMs that actually receive the 2006 “financial inclusion” premium. It is reportedly under 400.

*The “Since 2001...” statistics provided are wholly inadequate and even those provided are not explained in any way.

*Why is the closure of bank branches mentioned but not the closure of bank ATMs?

*It should be clarified that “UK Finance” are a Trade Association.

*Where is the claimed 17% decline in cash withdrawals substantiated?

*It is stated the “cash withdrawal volumes have been falling year-on-year since 2012”. Which “volumes” are being referred to here? Much more clarity required.

*Why is there no detail on the value of cash withdrawn? ATM withdrawals are a means to an end, not an end in themselves. The “end” is customers wanting cash. Knowing the overall amount of cash the UK customers have withdrawn each year from ATMs is a vital part of understanding what is happening in terms of the public’s desire for cash, for use as a payment method and for other uses.

*Why is there no mention in the PSR document of the potential for 8000 - 10,000 ATMs to switch from free-to-use to pay-to-use during 2019? This is a major and verifiable threat to access to cash at free-to-use ATMs.

*Why is no attempt made in the PSR document to evaluate the impact of the 10% reduction in LINK ATM interchange on ATM operators margins e.g. have they been completely eliminated, meaning every transaction loses the operator money?

*Why no mention of site rentals in the PSR document? They can be the most significant component of overall costs?

*The PSR needs to be very careful in identifying what is “reasonable” in terms of costs associated with cash. Some banks have been pushing back against the level of interchange for a decade or more. What they might define as “reasonable” may render all ATMs unprofitable to operate.

*Why no mention of the importance of any of the more complex business relationships between site operators and ATM operators EG it can be a significant economic advantage for Tesco Bank and Sainsbury Bank to site their ATMs on their parent companies sites?

* Why no mention that it suits banks to put multiple ATMs in their remaining bank branches? They pay no direct Business Rates on such ATMs; they internalise site rental payments; they create economies of scale.

*Economies of scale mainly apply to banks operating multiple ATMs at branches.

*Urban/ City Centre locations are high rent sites for IADs. It is NOT normally cheap to operate in such locations.

*Rural ATMs are NOT necessarily either low-transacting machines or costly machines to operate.

*Fixed costs are invariably higher at genuine third-party sites i.e. not at bank branches or major supermarket banks.

*Apart from the menus of LINK interchanges for various transactions, the only significant other revenue for free-to-use ATM operators is Dynamic Currency Conversion. This is probably only significant at under 5% of UK ATMs.
*Consumers value certainty of cash supply and less queuing. That is why they tend to rely on locations with multiple ATMs.
*The economics of ATM operation should allow extra free ATMs to be installed and receive the LINK interchange until the local average transactions per ATM fall below an agreed level e.g. 4000 transactions per month.
*The statistic of 80% of free-to-use ATMs being “within 300 metres of another free-to-use ATM” needs clarification e.g. how many are actually on the same site, such as at a bank branch or at bank branches located close to each other or at major supermarkets?
*Most people surely make regular journeys on which they know they will have access to cash, so they plan to pick it up en-route? This is becoming more difficult as free-to-use ATMs decrease in number i.e. convenient access to cash declines.
*If one is driving along a road and stops at Petrol Station to get cash, is that stop defined as a “specific journey”?
*Why is no reference made to 24/7 access? This is a crucial factor?
*No reference is made to the fact that a % of consumers continue to favour/trust bank ATMs.
*Very busy ATMs ALWAYS have queues during busy hours; often 12 hours a day.
*Off-branch ATMs are often very busy. The busiest ATM in the UK is not at a bank; it is located at a supermarket in Liverpool.
*The recent LINK initiative of paying up to £2.75 per FTU transaction may be of PR value only. Very few ATMs are likely qualify for the highest level of payment.
*In Annex 2, point 2.5, Table 1, charging bands are set out in relation to the new LINK initiative. It needs to be confirmed as to whether the payment on each band reduces to the level of the highest band reached as transactions increase.
*To reiterate, the PSR needs to be very careful in its description of the current situation. There is no “structure” in place now. The LINK Board set interchange levels based on their “judgement”.
*The previous structure i.e. pre 2018, worked well in terms of free access to cash for the public and produced the lowest per transaction ATM interchange in Europe.
*Competition demands that all ATM operators much be able to install machines in busy city centre locations.
*Complex interchange structures do not work. They are a disincentive to investment.
*The interchange structure in place before 2018 worked for most parties, including most banks, in every important respect, including in the public interest.

Barclays

Barclays' response to the Payment Systems Regulator's call for views on the review of the structure of LINK interchange fees

[redacted]

Barclays welcomes the opportunity to comment on the PSR's call for views, and sets out its responses below. In summary, we do not consider that significant changes to the structure of LINK interchange fees are warranted. There are further issues such as surcharges imposed by independent ATM deployers ("**IADs**"), which also need to be taken into account. Further, any changes need to be considered as an integral part of the wider Access to Cash Guarantee being defined.

Q1 Do you agree with the description and framework (including the objectives we set out) for considering the costs of providing ATMs and the value they provide that are set out in this paper? If not, please explain why and set out your view of the alternative way these issues should be analysed.

Barclays agrees with the description and framework of the current interchange fee structure outlined in this paper.

Q2 Are there any other factors we should take into account when analysing the incentives to provide ATMs?

There are a number of additional factors that should be taken into account when considering the structure of interchange fees for ATM transactions:

- Firstly, LINK is the UK's domestic ATM scheme and is used for routing the majority of cash withdrawal transactions on UK debit cards through ATMs in the UK. There are however a number of alternative switching service providers available to the issuers of debit cards in the UK, the largest alternative schemes being VISA and Mastercard. Each of these global payments schemes determine their own levels of interchange (subject to legal requirements), and these are generally set at levels lower than the current LINK interchange rates. In order to remain competitive, the levels of interchange set by LINK have to keep pace with their competition. In the event that a major UK card issuer chose to route their domestic ATM transactions through one of these alternative schemes, the incentives payable by LINK become irrelevant.

- Secondly, the current incentives highlighted in this paper are based solely on the availability of cash via ATMs. Barclays notes that there are alternative methods of obtaining cash. In addition, LINK are currently discussing an "over the counter" LINK withdrawal service which itself will attract remote withdrawal interchange rates, whilst removing some of the costly elements of providing a physical ATM (i.e. no opportunity cost of cash or carrier costs as it utilises the retailer's own cash from the till; no maintenance costs or rent as no physical ATM in place). Thus, in determining incentives, alternative sources of cash provision within the immediate area should also be considered, not just the location of the nearest free-to-use ("**FTU**") ATM.

- Another factor to consider is the significant increase in the number of ATMs in the UK over the past decade resulting in one of the highest number of ATMs per capita in the world. At the same time the number of ATM withdrawal transactions has shown a declining trend, as highlighted by this paper. As per the PSR's own assessment, this has led to over-abundance of ATMs in certain areas, however the current model of interchange should result in the thinning out of ATMs in areas of over-supply.

- Finally, the impact of interchange rates between members on the positioning of ATMs in the UK is only one aspect of an overall programme of review into the future of access to cash in the UK. ATM interchange fees should not therefore be considered in isolation, but as part of the overall picture of cash access, including current alternative cash access channels, new and developing alternatives for accessing cash and cash industry initiatives to address gaps in cash provision.

Q3 What incentives and impacts do the existing LINK interchange fee arrangements as described in this paper (including in Annex 2) have?

The annual cost study undertaken by LINK members is, in Barclays' opinion, the best way of assessing and agreeing the correct level of interchange per transaction. By calculating the overall cost of providing an ATM service in the UK and dividing this cost by the number of transactions undertaken on those ATMs, it is possible to determine clearly the average cost per transaction. Barclays accepts however that the average cost is not reflective of the cost of providing an ATM service in rural or low usage locations, and that high usage ATMs benefit from over-recovery of costs. The steps taken by LINK to address this issue, namely by offering additional premiums over and above the average interchange, are consequently a fair and equitable way of subsidising low-use machines in such locations.

In addition to the Financial Inclusion premium of up to £0.30 per transaction, the introduction by LINK of 'Super-premium' rates of interchange, taking the level of interchange available on a number of FTU machines up to £2.75 per transaction, is an extremely positive step. Machines that undertake an extremely low average of up to 199 transactions per month can now expect to achieve an interchange revenue of around £550 per month, potentially higher than a pay to use ("**PTU**") machine would have achieved in the same area.

[redacted]

Q4 What structure of interchange fees would have appropriate incentive effects going forward?

Barclays believes that the changes to Financial Inclusion premiums put in place by LINK, including a sliding scale based on the average number of monthly transactions, are a positive step and should encourage ATM operators to retain ATMs in low transacting areas. LINK's focus on maintaining a network of Protected ATMs further enhances this position and ensures that over 2,300 ATMs in the UK are immune from reduced rates of interchange. This should guarantee the presence of a network of ATMs in remote/rural locations, which Barclays believes will be further enhanced by any industry guarantee on Access to Cash.

Cardtronics

Cardtronics' Response to PSR 'Call for Views'
The structure of LINK interchange Fees - July 2019

Introduction to Cardtronics

Cardtronics runs over 18,000 ATMs in the UK, which equates to approximately 1/3 of the network. Partnerships with many major retailers, such as Co-op; Waitrose and Shell, as well as thousands of individual retailers ensure that access to cash can be guaranteed for the majority of the UK population. Our machines, often the only access to cash for local communities, distribute over £30bn into the UK economy each year. With peak daily transaction numbers exceeding two million transactions a day, Cardtronics is an essential and critical element of the country's cash supply chain.

Access to cash and basic banking services needs to be protected

Consumer payment habits are changing. The decline in the use of cash and fall in the number of ATM withdrawals is well documented. However, it is an often overlooked fact that cash in circulation is continuing to rise year-on-year. And, whilst withdrawal transactions are declining across our network, the amount of cash dispensed remains relatively flat demonstrating that consumers are continuing to withdraw a similar amount of cash, but are do so less often and in higher amounts within a single transaction.

The driver for consumers' choice of payment method are many and complex. Technology plays an obvious role as does the availability of smart phones and mobile/internet connectivity. However cash continues to be a preferred payment method with many people and for many reasons. They prefer cash because it is easily understood, aids budgeting, is accepted (almost) everywhere, is anonymous and holds a special place in the daily lives of the majority of UK consumers.

Increasingly, we are told that the UK is rushing headlong into a cashless society by organisations with a vested interest in making it so. But, as the Access to Cash Review makes clear, any such move would leave a large proportion of our population financially excluded and as a society we must continue to provide a sustainable cash ecosystem for all.

Today, over 50% of the UK's ATMs are managed by IADs who have become a critical component of the overall cash ecosystem. The impact of bank branch closures are often mitigated by IAD operated ATMs providing basic access to cash for the community

The market uses the number of FTU ATMs as a key metric. However, a ubiquitous service that delivers access to cash for all needs to consider the location as well as the number of FTU locations. IADs play a huge role in providing access to cash outside of urban areas. Of the c52,000 FTU ATMs in the UK, approximately 14,000 are in duplicate locations, therefore the number of discrete ATM locations serving the UK population is more accurately described as c40,000. Within this number, 4,000 are Post Offices, and another 5,000 are internal devices, often filled with varying reliability by store owners; these machines offer lower availability and service levels than traditional locations meaning that IADs wholly manage c60% of the 35,000 FTU locations.

The LINK scheme has been at the centre of the UK's free to use (FTU) infrastructure over the last 10 years. The LINK scheme exists in a delicate balance of issuers and acquirers, and is therefore compelled to maintain the membership of all the major banks in order to ensure its continued existence. This led to the reduction in interchange and led to scheme members struggling to right-size businesses affected by arbitrary and sudden cuts in interchange. Inevitably this has challenged the innovation agenda of the IAD community, who will be fundamental to delivering the future of access to banking services.

In this paper, we will outline a solution that will more accurately reflect the cost of operation for today's ATM network whilst incentivising the innovation the market needs to ensure that the ecosystem continues to meet the needs of all stakeholders.

This paper answers the questions posed in the call for views:

1. The description and framework for cost drivers for ATM providers and the value provided
2. Other factors for consideration in ATM incentives interchange model
3. The impact of the current LINK interchange arrangements
4. A new interchange model

Q1: The costs of providing ATMs and the value they provide.

The original interchange methodology was originally based upon a cost study run by KPMG to calculate the level of interchange required to recover the cost of operating the ATM network. In recent times, the output of the cost study has been ignored and replaced with the intent of reducing the cost for banks of participating in the scheme. The current approach therefore is neither a fair reflection of the costs to operate the network, nor transparent. It is clear then that the current methodology has to be changed.

Whatever methodology is chosen for the next stage of the market's evolution, an independent cost study is essential in order to drive behaviour which delivers efficiency and protects access to cash for UK consumers.

Financial Inclusion and Protected ATMs

LINK's Financial Inclusion scheme has been existence since 2006 in one form or another. The current methodology uses ONS data to define levels of depravation of postcode areas, based upon many different criteria such as percentages of the population on benefits. The top-up methodology for financial inclusion ATMs has ensured that these cash based local economies can be served by ATMs even when security and transaction profiles would normally dictate that an ATM isn't viable. However, the agreements governing the LINK scheme permit a maximum of 750 ATMs country-wide to benefit from this initiative. This cannot be a reflection of the number of ATMs required to deliver cash access to deprived areas and more work is required to determine how many more locations should fall into this category.

The most recent addition to the scheme has been the development of the 1km protected zones. Initially, after the implementation of the 2018/19 interchange cuts, c2,400 ATMs received the pre-reduction interchange rate. Under the direction of PSR, these protected ATMs now receive additional top up payments depending on transaction levels. These additional top ups, which came into force in April 2019 have made an immediate positive impact on these ATMs, and as a result Cardtronics has committed maintaining its protected FTU machines. However there remain thousands of FTU machines under threat as a result of the decision by the LINK board to reduce interchange by over 10%, when taking into account that interchange should have increased as a result of the last LINK cost study conducted.

Q2: Other factors for consideration in ATM incentives

Following on from Natalie Ceeney's report into Access to Cash and the overall sustainability of cash as a payment system, significant regulatory activity has started to look at various elements of the cash supply chain.

Two work-streams have been set up to look at the £5b supply chain cost which supports the cash industry. One is looking at Cash Wholesale options, and the other, is looking at how banks control the front end of cash. Whilst it is surprising and disappointing that IADs are not involved in working collaboratively with banks to define a good outcome for consumers in this second work-stream, we believe that the objective around making cash sustainable by reducing costs is the right focus. With IADs making up over 50% of FTU locations, it seems strange that they are not involved.

The best way to reduce the costs of cash is to address the core issue. LINK and the PSR have a role to play here. As banks have continued to close branches in high cash volume areas in order to reduce their costs, they have left their customers within these communities without local, convenient access to basic banking services. In many of these cases, the IADs have stepped in to replace access to cash to consumers previously available via bank branches and ATMs.

<u>The requirement for innovation</u>

At Cardtronics, we have built the capability for ATMs to act as mini bank branches, with transaction processing capabilities that enable utility based deposit functionality. This means that anyone could bank their deposits securely for any UK bank account in a new ATM and thereby replace the need for traditional bank branches.

This technology also comes at a cost. Deposit taking ATMs are significantly more expensive than standard machines, and the investment in back-end technology is significant. Without interchange providing a funding mechanism, there is no encouragement for anyone to make these investments. Working together with the banks, we can develop a new, cost effective future for local banking.

Q3: The impact of the current LINK interchange arrangements

The LINK interchange mechanism has been exceedingly successful in delivering FTU access to cash through a period of extreme change in the way banking services are delivered. Since the scheme and the original interchange setting mechanism was put in place, there have been many changes to the way cash is managed

- Many banks sold their remote ATM estates to IADs to reduce the cost burden of running access to cash
- Approximately 6,000 bank branches have been closed to reduce the cost of providing a basic banking infrastructure.
- IADs have become the predominant operators in terms of FTU locations

The recent interchange reductions have had a huge impact on the UK market and consumers' free access to cash, driving a shift away from free-to-use machines. We understand that ubiquitous free access to cash is one of the defining factors that differentiates the UK from any of the other markets in which we currently operate. And therefore we support a system which can continue to provide this free service to consumers, but where there is a system that fairly balances the cost of investment and the cost to serve the network.

The current interchange mechanism actively encouraged the entry to the market of pure acquirers as the card issuing LINK members have chosen over time to close both branch and remote ATMS due to cost considerations. This has encouraged IADs to site ATMs in many locations where access to cash was required.

Q4: A new interchange model

In any new scheme, the following objectives need to be met:

- A displacement strategy to remove ATMs from over-served urban areas
- Remove ATM duplication in the same location, particularly in urban areas – focus on Single Site ATMs (SSAs)
- Maintain the incentives to ensure FI and Protected ATMs remain viable and allow a mechanism for adding additional ATMs in any new areas that require them
- A wider perspective of cash management in the new regulatory environment
- A fair and transparent solution where issuers and acquirers can co-exist
- Simplicity

There is a significant difference in cost to serve for rural and urban ATMs. Cardtronics therefore proposes a zoning methodology for interchange using ONS definitions as the core of its calculation. The Industry is already comfortable with this principle in the financial inclusion schemes. We believe that ONS definitions offer the best and most transparent way of identifying the major zones.

The new solution must maintain widespread FTU access to cash to satisfy current demand.

Cardtronics recommends the following for a solution to the current situation

- A zoning approach which defines a number of different zones with differential interchange rates which accurately reflect the cost to serve based on an independent cost study.
- Cost study process and outcome to be independent from the LINK scheme.
- Additional zones introduced as required for the geographical extremities of the UK. This is common in logistics based industries, where cost to serve is inflated due to stem mileage. .
- The Financial Inclusion and Protected ATM methodology as issued by LINK should be maintained to support the most vulnerable communities.
- For the sake of simplicity, the current LINK Direct Commissioning process should be abandoned. It will not create material change for the UK and is extremely complicated in its design and expensive to administer.
- Interest rate changes must be reflected immediately within the interchange rate. Currently, any increase in cash costs feeds into the cost study up to 2 years later.

Appendix: Response to specific questions / points in the Call for Views Document

1.5 The structural proposal above provides a simple, cost effective approach looking to reduce urban proliferation of ATMs and increasing distribution in areas of rural / less concentration. The proposal is bases upon ONS statistics so is practical and unambiguous.

1.6 The key to future investment and innovation is predictability and transparency. Any future methodology must enable operators to be clear about volume and revenue expectations in order for the business to be managed effectively. Predictability will lead to development and innovation and ensures sustainability.

1.12 The cost study was not used for 2018 and 2019 interchange calculations. As described above, the cost study showed interchange should have increased. The major issue with this is that the cuts were almost immediate this is impossible to manage without significantly impacting consumers.

1.15 We support the Financial Inclusion Programme. The interchange top-ups must be maintained in order for IADs to continue to support deployment in these areas, however the Direct Commissioning process is too complicated and a more efficient method needs to be implemented to prevent wasting hours evaluating individual ATM sites.

Observation 1:

This is incorrect. The operation of the ATM network incurs both fixed and variable costs. One of the largest costs to operate a network is the cost of cash, which IADs 'rent' from the leading banks.

2.11 Often it is impossible to get planning permission for external devices, and a large number of devices are internal, meaning access is constrained by store opening times which can be difficult for some groups in society. We considered a separate interchange rate for external vs internal, but with the objective of simplicity in mind, this was discounted. Operators will always look for external devices and will only implement an internal device if no other options exists, or where there may be concerns over security.

2.16 The current structure already has caused over 3,000 devices to be moved to PTU, within our estate alone. The continued operation of these devices demonstrates that there is demand for ATM services in these locations that cannot be supported under the current LINK interchange strategy. As discussed elsewhere, urban concentrations of ATMs and duplicate ATMs in single locations are likely to continue to be viable for operators as they are likely to be in low cost to serve areas and are therefore affected to a lesser degree by the interchange cuts.

CMSPI

CMSPI's Consultation Response to the PSR's *CP19/5 - Call for views: Review of the structure of LINK interchange fees*

ABOUT CMSPI

CMSPI is an independent payments consultancy working exclusively with merchants to optimise their end-to-end cash and card supply chains. Clients include Aldi, Marriott, Subway and Shell.

Note:

As requested, CMSPI's response will focus on the structure of ATM interchange fees rather than the levels of interchange fees. We will address all four questions posed by the PSR consultations within our response.

We would be happy to discuss any of the ideas discussed in this document with the PSR.

BACKGROUND

ATMs play a pivotal role in the payments ecosystem. They are a vital utility of both consumers and merchants. From a merchant perspective ATMs serve a number of useful functions including:

1. Cash spending is still the number one competitor to card payments and ATMs are the main vehicle consumers use to access cash.
2. The cost of cash acceptance is similar to the cost of card acceptance for merchants largely due to the Merchant Indifference Test (MIT method of PS interchange setting used by the European Commission. However with scheme fee increases coming in regularly in recent years the cost of cards is likely to increase above the cost of cash. In turn, this will maintain the relevance of cash.
3. On-site ATMs provide merchants with a source of revenue, both directly from a share of the interchange fee and indirectly from an increase in consumer spending.

ATMs require interchange fees to cover costs. In the absence of this fee ATM deployers need to impose surcharges that are damaging to consumers. Cash usage is higher among vulnerable members of society such as elderly and lower income consumers so widespread ATM surcharging would be damaging from a welfare perspective. This is what happens in the US, where consumers can be charged upwards of $5 (c£4) per transaction.

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Issues with ATM interchange fee setting

Ideally ATM interchange fees would be set in a competitive way. However, the 2001 OFT report cited by the PSR's consultation document identified the errors with this approach, including the high transaction costs associated with several negotiations between ATM acquirers and card issuers.

Another approach is to keep interchange setting with the ATM schemes. However, there will always be downwards pressure on interchange fees within LINK given that it is a net cost for banks, who are key voting members. Meanwhile, Visa and Mastercard have a clear incentive to attract issuers away from LINK by setting low interchange fees. This means that there will continue to be downwards pressure on ATM interchange fees – to the detriment of merchants and consumers – unless the PSR intervenes. Indeed, the decision made by LINK to move away from the cost recovery model has inevitably resulted in closures of free to use ATMs which is clearly harming low income consumers.

We are very pleased that the PSR has decided to address this issue and we welcome the opportunity to respond to this consultation. We believe the issues discussed above mean that the ATM interchange fee needs to be exogenously set by the PSR.

STRUCTURE OF ATM INTERCHANGE FEES

The PSR's consultation document correctly identifies some issues with the current ATM interchange model. In this section, we will present some ideas about how the PSR may be able to address these issues.

LINK Pricing Model

As discussed above, there will always be an incentive within the LINK scheme for interchange fees to sink below costs, indirectly harming vulnerable consumers. As a result, ATM interchange setting should be returned to the independently set cost recovery model not just for the LINK scheme, but for all ATM schemes.

Protected ATMs

We are in favour of LINK's protected ATM model because it addresses many of the access to cash issues the PSR has identified. However, the current approach to protected ATMs need reviewing for the following reasons:

1. We believe the current protected criteria of 1 kilometre from the nearest ATM is too simplistic and results in too few ATMs being protected. The strategic importance of an ATM can be ascertained by characteristics including the remoteness of the ATM's location, the

number of competing machines in the immediate vicinity and potentially local average income metrics.

2. As identified by the PSR, the tiered protected ATM structure results in a "saw tooth" effect whereby operators can make a loss from any additional transactions. To avoid the "saw tooth" effect, we believe that protected ATM interchange fees should be set as steps rather than tiers.

Surcharging

A cost recovery and protected ATM model could be applied in conjunction with a ban on surcharging ATMs to protect consumers - consistent with the goals of the Payment Services Directive II (PSD2) - to prevent ATM operators from receiving two independent revenue streams.

CONCLUSION

We have identified three distinct categories of ATMs. We believe different approaches should be applied to these different ATM types:

- **Strategically important ATMs** require the protected ATM income to become commercially viable because the linear nature of a transaction-based fee means that ATMs are not profitable at low levels of usage
- **Non-important ATMs that are profitable** will be able to continue with the cost recovery model
- **Non-important ATMs that are not profitable** should not be subsidised by protected ATM fees. A fixed fee or enhanced fee would allow these ATMs to continue operating but this would be economically inefficient and is referred to in the PSR's document as "over-supply".

We would welcome the opportunity to discuss these views with the PSR.

[redacted]

[redacted]

Member of the public

[redacted]

Dear Sirs,

I refer to Report CP19/5 which I have only recently had sight of but found very useful in expanding my knowledge of the background to the interchange fee and its impact since 2001.

[redacted]

We are seeing a decrease in volumes of ATM withdrawals year on year since 2017 in particular which is in line with the decreasing use of cash and move to contactless payments in our shops. [redacted]

Despite only a 10% decrease in interchange rates, they are seeking significant wholesale changes to contracts and significantly higher disproportionate %age decreases in commission rates. This appears now to be prevalent in the IAD market which essentially is a duopoly now.

With regards to para 2.9 of your paper, I would agree that the relationship you describe on the structure of interchange fees is broadly accurate. We still find that ATM use is highly dependent on the demographics of the area in which it is located. In less affluent areas, there is still significant reliance on cash. People tend to budget more and spend what they have got and frankly like to know what they have left. There appears less access and desire for a credit environment. In other areas (excluding rural) there is less of a reliance on cash and a growing acceptance of card use and contactless payments in particular. To this end there may be less of a demand for regular ATM use. In built up areas where there has been significant growth in ATM numbers in the years up to 2017, volumes can be affected by how close a competitor's ATM is.

In rural areas, ATMs generally have lower volume use even if the nearest alternative FTU ATM is more than 1km away. Due, in some way, to the ruralality of locations there may be closer relationships with village stores and post offices and the use of "cash back" facilities remain.

In general, the observations you make in para 2.12 are accurate from our experience.

With regard to para 2.13, ATM operators may locate an ATM in areas where usage would be below the cost recovery threshold if they have a broad group, all encompassing, contract with the ATM site host whereby they "take the rough with the smooth" accepting that they significantly win on some and lose on others but overall they more than cover their costs and generate an acceptable profit margin.

With respect, I think it is for the ATM providers, particularly the IADs to answer the questions you pose in para 2.19

With regard to the alternative fee structures you suggest in para 2.21, I think it is important from an ATM host perspective to have some assurety as to net income streams. We would like to see the cost structure of operating ATMs fully audited in order to determine the profit margin to ATM operators which is then shared with the ATM host.

I appreciate the above does not fully address many of the issues you have raised in your paper but may go some way to understanding the perspective and viewpoint of the ATM host rather than either the ATM operator (ie the IAD) or the end consumer (general public).

If considered appropriate, I would be happy to attend the proposed round table discussion in the summer as a representative of the ATM hosts within the convenience store market.

I would ask that before any of my comments are disclosed, I am contacted to be made aware. The above views reflect those of myself rather than the company I work for and who actually host the ATMs.

[redacted]

[redacted]

[redacted]

[redacted]

Please consider your environmental responsibility - think before you print!

HSBC

HSBC UK BANK PLC

CONSIDERING THE INCENTIVES TO DEPLOY FREE-TO-USE ATMs IN THE LINK NETWORK

REVIEW OF THE STRUCTURE OF LINK INTERCHANGE FEES: CALL FOR VIEWS

RESPONSE TO PSR CONSULTATION DATED JUNE 2019

05 JULY 2019

COVER SUBMISSION

HSBC UK Bank plc welcomes the opportunity to respond to the Payment System Regulator's Call for Views (CP19/5) regarding the structure of LINK interchange fees, with particular consideration on the incentives to deploy free-to-use ATMs in the LINK network.

The Call for Views is timely given the current momentum to address the UK's wider access to cash needs, stimulated by the recent Independent Access to Cash Review. There is no doubt that the UK is seeing a significant shift in how consumers use cash, accelerated by the rapid take up of contactless card payments as well as other alternative payment methods becoming more readily available, cheaper and increasingly more accepted by our customers, businesses of all sizes and consumers in general.

However, rather than the UK moving towards a cash-free society, our view is that it is transforming to an economy where cash is less important than it once was, but will remain an important payment method that continues to be valued and preferred by many. Critically, there is evidence of a reliance on cash by some consumers, including those who may be vulnerable, and it is important to HSBC that such consumers are not disadvantaged.

For HSBC, our position is clear: whilst we continue to promote innovation in digital payments and to develop new ways to help our customers better manage their money, we believe in our customers' choice to choose the payment type they consider right for the payment they want to make or receive.

There is a clear tension, however, with the high fixed costs of running the cash industry in the context of declining volumes. Our view is that in order to sustain access to cash for as long as possible - and therefore customer choice - a broader strategy is required to make the full spectrum of costs in running a cash industry as efficient as possible, for both distribution and acceptance. In our view, making the economics of cash sustainable is the best way to protect its availability and acceptance for the short to medium term, and to avoid unintended consequences of creating a service provision that cannot evolve over time.

This was the view that HSBC put forward in our response to the Independent Access to Cash Review. Clearly the LINK ATM network is a critical component of providing access to cash for consumers, including wide geographical spread, and for retaining choice for customers who need or want to pay by cash. The commercial structure of how that network is operated is therefore also a critical component to protect cash access in the UK for the future.

In our view, the commercial structure must be based on transparent, objective and full independent economic analysis to ensure that decisions are taken in a way that will best ensure the sustainability of the LINK scheme, in the interests of the end customers.

In broad terms, HSBC believe that the LINK ATM network provides a good service for both ourselves and all consumers, be they HSBC customers or otherwise, and we have consistently supported the principle that any interchange settlement, and therefore any interchange structure, must fully take into account the need to preserve free access to cash for consumers, the economic interests of all stakeholders, and the sustainability of the scheme.

HSBC fully supported the Independent Economic Review of Interchange as proposed by the LINK Independent Governance Review led by Lord Hunt in 2015, and remain disappointed that the work undertaken by Frontier Economics was not completed because the support and buy-in of all LINK members, including independent ATM deployers (IADs) could not be achieved. HSBC have previously expressed this view to the PSR in our letter dated 7th February 2017.

HSBC participated in the LINK Member Interchange Working Group during 2017 which involved senior leaders from the eight largest LINK members. A number of alternative models were proposed, with an option primarily favoured by the IADs evaluated in great detail and debated very rigorously, however, no consensus could be reached.

In summary, it is the opinion of HSBC that any proposal to change the structure of LINK interchange fees must therefore be supported by a thorough and agreed analysis of the economics that underpin the provision of the LINK ATM network, and that any alternative structures must be tested widely to ensure that the objective of delivering materially better outcomes for UK consumers is met. It is clear that in an environment of declining cash use, the provision of ATMs needs to be managed and coordinated in order that distribution continues to meet consumer needs, and the structure of interchange is an important factor in achieving that.

1. **Do you agree with the description and framework (including the objectives we set out) for considering the costs of providing ATMs and the value they provide that are set out in this paper? If not, please explain why and set out your view of the alternative way these issues should be analysed?**

HSBC fully support the policy objectives and agree with the broad approach proposed for this review. As described in the Call for Views, ATM ownership and deployment has undergone considerable change since the OFT exemption in 2001, coupled with significant and on-going change in consumer behaviour. The objectives described reflect our own position on supporting access to cash, including widespread geographic access, ATM interchange fees that protect the interests of end users and achieving a practical system that does not have excessive transaction costs and creates appropriate incentives for individual parties.

The issues under review are inherently contentious, commercially sensitive, with longstanding conflicting views across the LINK membership. The difficulty in resolving the underlying issues indicate that independent analysis is required, which must, in our view, include full economic analysis to ensure an objective, fair and evidence-based path forward.

2. **Are there any other factors we should take into account when analysing the incentives to provide ATMs?**

As volumes in cash use and demand for cash falls, we also believe the UK must also have an open mind to how consumer acquisition of cash can be achieved from sources that are not an ATM. By 2027, ATM withdrawals are forecast to have dropped by at least £1billion per year compared to 2017[1], calling into clear question, the economic viability of sustaining the full geographic breadth of the current network. Cashback and Post Office counter access is well established but not available 24/7 like an ATM and the Post Office network is being consolidated.

Alternatives such as convenience store counter services or even postal services (as is used for foreign currency) could prove efficient alternatives to support continued access for those who need it, and we believe that there would be merit in the PSR considering the incentives for such options alongside incentives for providing ATMs.

As the PSR is aware, the industry is already working together to consider how we can create the right environment for providing whatever provision works best in whichever area needs it. Whilst we continue to support a wide geographic spread of ATMs, it may be that other means to provide access to cash should be considered in

[1] UK Payments Market Report, 2018

planning the incentives to provide ATMs in the long-term and to ensure the sustainability of the LINK scheme. Building this into incentives could promote an economically efficient spread of ATMs reflecting the value consumers and society place on such access. A strategy which ensures continued access, albeit perhaps more planned and time-restricted compared with the access we have today, may be preferable to an approach which means access is prohibitively expensive to maintain without charging and ultimately a cost to the UK economy, however it is paid for.

3. **What incentives and impacts do the existing LINK interchange fee arrangements as described in this paper (including in Annex 2) have?**

HSBC does not have a remote estate, all of our ATMs are located in our branches (with a handful of exceptions such as HSBC/first direct sponsored venues) and are sited as part of our core customer service proposition rather than the result of any incentivisation through revenues. We do not therefore have meaningful data that allows us to comment with any authority on the impacts of incentives as they are considered by third party ATM deployers.

We do continue to support the principles contained in the November 2017 LINK Board Consultation on LINK's Interchange Rate including:

- the recognition that LINK interchange should recognise changes in consumers' use of payment methods, and should over time facilitate a corresponding change in the cost and nature of the LINK network
- that interchange rates should support a geographical location of ATMs that is in line with consumers' needs, and through the Financial Inclusion Programme should increase the number of ATMs in areas that could not otherwise support them.

We acknowledge that the November 2017 consultation was specifically in regard to setting Interchange Rates, but believe that these principles are equally valid in consideration of any proposed Interchange Structure.

We recognise the potential impacts of any fee structure described in the paper. In terms of the impact of the current structure, we are aware that there is a concern that some third party ATM deployers may be operating with an inefficiently high cost base, in particular with excessive ATMs in some areas. This concern merits proper investigation to understand the impact of the current structure of interchange fee, not least because the cost is passed on to card issuers via the MIF and so becomes part of the issuer's cost base they need to recover from retail customers. Whilst HSBC has no desire to see third party ATM deployers' cost recovery squeezed in such a way that would lead to a reduction in ATMs that are genuinely needed by customers, it is in the interest of all end users and stakeholders that there should be a detailed, independent and evidence based review of what the efficient level of cost recovery via the interchange fee should be.

4. **What structure of interchange fees would have appropriate incentive effects going forward?**

HSBC believes that the current recently introduced LINK structure of a Financial Inclusion Programme provides good incentives. It helps to improve the economic viability of ATMs through the use of Protected ATM Premiums and Low Volume Premiums, with Direct Commissioning offering a backstop.

This is a relatively new programme and it is perhaps too early to gauge whether as currently defined it is meeting the objectives for all stakeholders. We are supportive of this type of structure and feel that it would be possible to make minor adjustments to the premiums and qualifying criteria in order to achieve most of the PSR's objectives.

HSBC notes that the immediate reaction of IADs to the small reductions in rates under the revised LINK Interchange Structure was to threaten to convert thousands of free-to-use ATMs to pay-to-use. HSBC would not wish to see this happen in line with our support of the important principle of preserving free access to cash for consumers.

Given the lack of industry consensus as to the optimum charging structure, it is important that any forward-looking change is based on a transparent and objective economic analysis.

We are not convinced of the merits of a multi-part tariff structure. We believe a fixed fee per ATM may increase incentives to introduce new ATMs where there is no genuine customer need, thus increasing the costs of operating the overall ATM estate without the corresponding consumer benefit, and making it harder to fund ATMs in under-served locations. In our view, the current charging structure – with possible minor adjustments – creates better incentives in this regard. We look forward to engaging further with the PSR on this point once its analysis is further advanced.

LINK

Link Scheme Holdings Ltd

Call for views

Considering the incentives to deploy free-to-use ATMs in the LINK network

LINK Response – July 2019

A. Introduction

This document sets out LINK's response to the Call for Views document published by the PSR in June 2019. Section B below provides a short summary of LINK's views and Section C sets out LINK's detailed responses to the PSR's four specific questions set out in Section 3 of the Call for Views document.

B. Summary

LINK is completely satisfied that the current LINK Interchange structure meets LINK's objectives of a wide free-to-use access to cash network. The current structure, which has not changed significantly since its introduction in 2001, comprises a multilateral interchange fee with four main categories, equates ATM use with "value", and incentivises LINK's Members to install ATMs where consumers will use them. It allows LINK Members to compete for locations, negotiating with potential hosts as necessary, and provides a direct incentive to operate ATMs as efficiently as possible. This is supplemented by LINK's two Policies under its Financial Inclusion Programme (one dealing with ATM provision in deprived areas and the other dealing with Protected ATMs across a defined geographic area) which provide subsidies for ATMs in areas where low use would make them potentially uneconomic but where there is need for the local community to have a free-to-use ATM.

LINK believes the current interchange structure, which provides a broad series of multilateral interchange fees supported by a Financial Inclusion Programme, has proved to be the most effective interchange mechanism available during the long period of rising ATM growth and remains so now cash and ATM use are declining. LINK believes there is no "perfect" alternative interchange fee structure that is demonstrably better than the current system and that can be easily adopted and operated by the market participants within a "competitive market" approach and the confines of competition law. Looking forward, LINK does however recognise that the continued decline in cash usage, where consumers are only using cash for one in ten of their payments[1], will necessitate a more comprehensive change in the way that cash is both distributed and accessed by consumers. LINK is supportive of the Access to Cash Review recommendations and is of the view that a more "utility" based approach rather than a "competitive market" approach may well be required in the future to ensure that the UK's cash ecosystem continues to serve the interests of consumers in the years to come.

[1] UK Finance – UK Payment Markets 2019.

C. Responses to PSR's Specific Questions

1. *Do stakeholders agree with the description and framework (including the objectives we set out) for considering the **costs of providing ATMs**, and the **value they provide**, set out in this paper? If not, please explain why and set out your view of the alternative way these issues should be analysed.*

   LINK agrees with the objectives as set out in 1.5 to 1.9 and completely supports the objective of maintaining wide, free access to cash. However, we would also like to note that any system must incentivise ATM operators to manage their costs and not allow participants to "game" the interchange mechanism and install or operate ATMs without reference to costs or indeed consumer demand. The following sections set out LINKS's views on (i) ATM costs; (ii) additional income streams and (iii) ATM value.

   (i) ATM Costs

   While LINK has no access to Members' detailed cost or income models, LINK believes the average costs per transaction will depend on a wide range of factors, in addition to cash withdrawal volumes. While busier ATMs do usually incur higher costs, we believe that the simple straight line described in the Call for Views is an oversimplification as there are a wide range of business and operational models at play which are discussed below:

   - Rental is a significant proportion of a remote site's costs and it may be (i) flat; (ii) have a fixed element and an additional pence per cash withdrawal fee; or (iii) be entirely volume based. In other cases, LINK believes rental cost is a proportion of the LINK interchange fee itself. Which structure is used will depend on the negotiations between the ATM operator and remote site host.
   - Replenishment costs will vary by business model as well as volume. Cash replenishment using a third-party security carrier is relatively expensive. However, if that model is used, additional costs will increase only in large steps. For example, if only one replenishment is required a week, the amount of cash can be increased significantly at little extra cost until a second replenishment is required. Some LINK Members have their own internal cash delivery service and may use this entirely or alongside a third-party service. The level of internal cost for these deliveries will depend on the efficiency and capacity of this function. An operator may also choose a merchant fill alternative for cash replenishment where the store owner fills the ATM with surplus cash from the till. This can reduce the cash costs effectively to zero (the merchant will also carry any risk of robbery) provided the store generates enough cash to fill the ATM.
   - The issue of marginal costs is also very significant and should be fully understood and taken into account in any analysis. Figure 2 in the Call for Views document might suggest that at any one-time half the ATMs are "unlikely to be profitable" and at risk of closing. The stability of the network and, until recently, its significant growth, suggests this is not the case. This comment also ignores the point that an ATM may be unprofitable on the basis of historic costs, but that a decision on closure it more dependent on the relationship between marginal revenue and

marginal costs. In many cases the fixed costs of the ATM are low or fully written down and the ATM operator therefore only has to cover the ongoing marginal costs when considering whether to keep an ATM in place. Marginal costs are also a factor when installing an ATM. If the ATM operator is using its own staff to replenish and maintain the ATM and these staff have spare capacity, then the ongoing costs of adding another ATM near existing machines may be very low. This may explain why there are clusters of ATMs operated by the same LINK Member. Conversely, operating an ATM a long way from existing facilities may be very expensive.

- Installation costs. If the ATM is being installed in a new building or structure the costs of the bunker, alarms etc will have to be paid for by the operator up-front and depreciated over the lifetime of the contract (likely to be 5-7 years). If the ATM is removed before these costs are written off, then the value is lost. However, once these costs have been written down the ongoing costs of the ATM may be low and therefore it is more efficient to keep it going.
- The decision to install or keep an ATM is not necessarily related to each individual ATM's own costs or income. Many ATMs are installed as part of multi-site deals and therefore the ATM operator will be prepared to accept some ATMs which are poor performers because there are other ATMs which will perform well. Branch machines in particular are more likely to be installed on the basis of available space, competitors' facilities nearby and internal objectives of customer service or counter displacement. Some operators have also installed ATMs for social or status reasons. ATMs in hospitals or military bases may have a wider social purpose and ATMs in high status locations such as head offices or the House of Commons may be chosen to reflect on the ATM operator.
- The costs of deinstallation are a significant barrier to ATMs being removed and an important part of any ATM operator's decision process in deciding whether to keep an ATM. As noted above, for many ATMs the fixed cost of the machine itself and its installation may be fully written down. On an ongoing basis, the machine therefore only has to cover its marginal costs which in the case of a merchant fill machine may be very low indeed. Removal of the ATM will incur new costs for deinstallation, transport, making good the site and if the ATM is reinstalled elsewhere then the new location needs to be markedly better than the old location as a new set of installation costs will be incurred. If the ATM is not reinstalled then the ATM operator has an asset which is no longer even generating marginal income.
- Balance enquiries are another important part of an ATM operator's commercial considerations. They have a marginal cost of close to zero; they rarely form part of any rental arrangement and there appears to be little increase in average unit costs as volumes decrease.
- Maintenance costs are also a complex area. For a high volume through-the-wall site which is carrier filled they can be quite high as the host may not be involved with the ATM whatsoever. This means cleaning, routine maintenance such as journal rolls, first and second line maintenance will have to be carried out by a third party (in some cases the security carrier) or the ATM operator's own maintenance staff. If this is done by a third party, then servicing and maintenance costs may increase with volume (assuming the ATM needs more maintenance or breaks down

based on usage). However as noted above, if the operator is using internal resources then these costs may be more fixed or related to how close the ATMs are to each other. For example, an engineer may be able to cover 20 ATMs within 20km of his home but only 10 if they are within 40km of his home. In addition, if he is looking after only 18 machines within 20km of his home there may be spare capacity. If the ATM is internal and merchant filled, then its use is likely to be much lower and the ATM may require only routine scheduled maintenance (ie an "annual service") with all housekeeping and first line maintenance being covered by local store staff as part of the rental agreement.

(ii) Additional Income Streams

While these are not considered as part of LINK's interchange decisions and may not be processed by LINK, services like Direct Currency Conversion (DCC) can be a significant part of an ATM operator's business decisions. This is particularly the case in locations which are likely to attract overseas cardholders where a margin can be obtained when converting the sterling cash withdrawal into to their own currency. In addition, foreign currency dispense ATMs usually offer euro and US dollars to UK account holders and they can also prove profitable in the right location, again with the additional income from the currency conversion. Lastly, ATM advertising has been around for many years and while the evidence is that it is marginal to the overall business case for ATMs, in the case of a narrowly profitable ATM it might make a difference.

(iii) ATM Value

LINK completely supports the view that UK consumers value free access to cash and providing wide free access to cash is LINK's core objective.

LINK's interchange structure, a multilateral interchange fee with four main categories, equates ATM use with "value" and therefore incentivises Members to install ATMs where consumers will use them. It allows LINK Members to compete for locations, negotiating with potential hosts as necessary, and has a direct incentive to operate ATMs as efficiently as possible. This is supplemented by LINK's two Policies under its Financial Inclusion Programme (one dealing with ATM provision in deprived areas, and the other dealing with Protected ATMs across a defined geographic area) which provide subsidies for ATMs in areas where low use would make them potentially uneconomic but where there is need for the local community to have a free-to-use ATM.

However, a consumer's relationship with a specific ATM and the "value" they perceive from using it may be complex and depends on a wide number of factors. An important point is that given the large number of available free-to-use ATMs, for most people access to cash is not an issue and therefore not a subject of conscious decision making. Most people are easily able to obtain cash where they shop, work, go out, or as they travel between their home and these locations. Most people can therefore incorporate cash access into their daily routine and their marginal time and effort involved in cash access is close to zero. It is very rare for people, for example, to leave home, obtain cash from an ATM and then go home again. The "value" of an individual ATM is therefore likely to be low as alternatives are readily available, although as creatures of habit, some consumers may well have “favourites”. As the Call for Views document notes, most consumers appear to prefer not to queue as it is increases this marginal effort and are happy to use other ATMs nearby or postpone their cash withdrawal until they don’t have to queue. There are exceptions to this and some examples are below. Where a consumer has no access to these machines or their access is removed then it can have an impact.

- Lack of alternative ATMs. This may well be the case in rural or remote communities which rely on a small number of ATMs. This may also mean that the marginal effort in getting cash may be higher as the consumer may have to make a specific trip to get cash or modify their journey somehow rather than it being a part of their daily routine. The removal of such a machine can have a big impact if there are no alternatives available.
- Immediate demand for cash. While many consumers can keep a stock of cash either on them or at home (the Natalie Ceeney Access to Cash Review found that 97% of people carried cash and 85% of people kept cash at home), some consumers on tight budgets may not be able to keep stocks of cash and they may not be able to wait until they next have a convenient visit to an ATM. They may need cash immediately, whether to pay an urgent bill such as rent or utility payments or simply pay for day-to-day living. For these consumers, who cannot wait to get their cash, access to that specific ATM, at that time may be vital.
- Brand preference. While any card issued by a LINK Member can be used in any ATM connected to the LINK network, it is quite possible that some consumers seek out ATMs from a specific operator whether it is a bank, building society or IAD. This may be for a wide range of reasons, some of which are discussed below, but may include familiarity, ease with screen design or transaction flow, previous experience of that ATM operator, perceptions of the ATM operator or bank, or expectations of charging. While LINK rules ensure there is clear signage on all charging machines it is possible some consumers may feel they *may* be charged and avoid (some or all) IAD machines, or free-standing machines, for example. It is worth noting that around 16% of all cash withdrawals are on-us, ie consumers using their own bank or building society’s ATMs, and banks have had campaigns in the past to encourage their customers to use their own ATMs.
- Non-routine demand. In certain instances, consumers may want to take out a large amount of cash in one go, for example, to take on holiday, pay a builder or buy a large value item such as a car. In these cases, there is evidence that consumers like to choose locations which give them a greater feeling of security and certainty. They may therefore choose a bank owned ATM, especially from their own bank and an internal ATM rather than one on the street. The extra effort involved in visiting the specific machine is justified by their enhanced sense of security.
- Security/reliability. While many consumers may be confident and unconcerned when using ATMs and happy to use any LINK connected ATM, others may feel vulnerable and therefore choose ATMs which they feel are safer or more reliable. While LINK has no direct evidence, anecdotal comment suggests bank owned ATMs have a higher perception of safety and

reliability when compared to ATMs operated by IADs, and some consumers place a higher value on such machines.

- Additional features. Bank owned ATMs may offer their customers a range of additional services such as deposits, mini-statements, bill payment, account transfers etc. These may be attractive to certain customers at certain times. As noted some ATMs offer foreign currencies and while some consumers may only use these rarely, a regular traveller may well like the convenience of buying their euro or dollars at their local Tube station, for example. Some ATMs also offer features like audio assistance or braille and these machines may be of particular value to consumers who use or rely on these features.
- Travel/unfamiliarity. While most people obtain cash in regular patterns where they live and work, when travelling or on holiday consumers may be less aware of where ATMs are or visit areas where there are less ATMs and therefore must rely on a smaller number of locations. August sees a marked peak in pay-to-use cash withdrawals which may suggest consumers may have less opportunities to get free cash when on holiday, or perhaps are unwilling to spend precious holiday hours seeking out or traveling to a free machine.

Finally, it should be remembered that ATMs are not a consumer's only channel for cash access and that for a consumer who is familiar with and happy to use a post office counter, or cashback, then access through ATMs may be of little concern/value.

2. *Are there any other factors which the PSR should take into account when analysing the incentives to provide ATMs?*

LINK is of the view that the PSR should also take into account the competition that exists between the LINK Scheme and rival ATM schemes that operate both in the UK and internationally such as Visa and Mastercard. In this context, the PSR should note that in contrast to LINK, both Visa and Mastercard are commercial profit-making organisations that may not share LINK's objective of maintaining free access to cash. LINK Members however do have the ability and incentive to switch between schemes, so the impact of any proposed changes needs to be carefully assessed.

3. *What incentives and impacts does the existing LINK interchange fee arrangements as described in this paper (including in Annex 2) have?*

See response to Question 1 above. LINK is completely satisfied that the LINK interchange fee arrangements, which have broadly been place for many years and which are now being carefully developed and enhanced by the LINK Board including through the Financial Inclusion Programme, meet LINK's objectives of a wide free-to-use access to cash network, provided this is supported by other channels such as post office counters, bank branches and cashback. LINK does however believe that as we see cash usage fall to less than 10% of all payments during the next 10 years, changes to the cash infrastructure system will be required to ensure this demand can still be met.

4. *What structure of interchange fees would have appropriate incentive effects going forward?*

Before looking at alternative structures, LINK reiterates that it is happy with the structure of the market and fully supports the recommendations in the Access to Cash Review, which LINK commissioned in 2018. This comprehensive Review was commissioned as a response to the rapid decline in cash use and to the growing concerns about whether people who can't use or access cash in an increasingly digital society are being left behind. Chaired by Natalie Ceeney CBE, it had an independent panel of consumer champions and industry experts and was funded by, but independent of, LINK. It conducted extensive research into payment method trends, international developments, consumer needs and behaviour across the UK and the financial and economic drivers of the cash economy. The Review Panel met with regulators, banks, industry experts and consumer groups to understand the economics and practicalities of cash and digital payments.

The Access to Cash Review published its final report in March 2019 with the following recommendations:

1. Guarantee access to cash.
2. Ensure cash remains widely accepted.
3. Create a more efficient, effective and resilient wholesale cash infrastructure.
4. Make digital payments an option for everyone.
5. Ensure joined-up oversight and regulation of cash.

LINK welcomes this report and believes it provides a blueprint for how LINK and others can help maintain access to cash for many years to come.

In terms of the recommendations themselves and LINK's role going forward, LINK makes the following comments:

<u>1 Recommendation One: Guarantee access to cash.</u> LINK already has its Financial Inclusion Programme that encompasses policies to support access to cash in remote, rural and/or deprived areas, as well as those which may lose their free cash access because of the only free-to-use ATM within a 1km area being removed or moved to charging. LINK therefore welcomes a wider guarantee of cash access which would create a framework for this and incorporate other channels such as post office counters and cash from retailers' tills, over which LINK has no direct control. LINK believes that ATMs are part of a range of cash access channels and that to maintain wide free cash access as consumers' use of cash declines, a joined-up and coordinated approach will be required. LINK is therefore already speaking to consumer groups, its Members, other industry participants, regulators and HM Treasury about how to deliver this.
2. <u>Recommendations Two: Ensure cash remains widely accepted.</u> The cost of cash acceptance is a key element in whether retailers will still be happy to accept cash. So far, cashless retailers are largely

limited to cafés and the like in city centres where the impact on consumers is low. LINK recognises this issue and is keen to support innovation in this area to maintain low-cost cash acceptance for retailers. This might include, for example, consumers and businesses being given the opportunity to deposit cash automatically, ie not to be limited to ATMs or terminals belonging to their own bank or building society.

3. Recommendation Three: Create a more efficient, effective and resilient wholesale cash infrastructure. It will be possible to maintain an ATM network only if there is the back-end infrastructure to ensure that ATMs have the cash they need. LINK will therefore actively participate in the work recently announced by the Bank of England to ensure that the scale and structure of the cash infrastructure is as efficient and effective as possible and able to support the LINK ATM network.

4. Recommendation Four: Make digital payments an option for everyone. LINK has less of a direct role in this recommendation as this is mostly focused on alternatives to cash. However, where innovations impact on ATMs – such as contactless ATM use, the potential for card-less ATMs or even cashless ATMs which, instead of giving out cash, issue a receipt which can be exchanged for cash at the till – then LINK will support ATM operators and card issuers.

5. Recommendation Five: Ensure joined-up oversight and regulation of cash. LINK is committed to working closely with its regulators, the Bank of England and the Payment Systems Regulator, as well as liaising closely with HM Treasury, industry bodies like UK Finance and consumer groups. The launch of the Joint Authorities Cash Strategy Group is especially welcome.

Alternative Fee Structures

Section 2.21 of the Call for Views document raises some alternative fee structures. The current structure of LINK has been in use since 2001 and during that period a large number of individuals and organisations have considered and proposed, changes or alternatives. In some cases, this was to improve certain elements or address anomalies, but most usually it was to improve their own position. Whatever change is proposed or made there are a number of considerations that need to be taken into account:

- Firstly, in the case of this response we are considering changing the structure of interchange and not the level. In other words, how it is distributed, rather than the total amount of interchange paid. Therefore, it should really be anticipated that any change which resulted in a potentially higher figure in one situation would result in a lower figure elsewhere. This means issuing Members may have little interest in any modifications to the structure alone (assuming their customers' use was distributed evenly) as their proportion of the same total interchange bill will not change.
- Secondly, any change needs to be operationally and technically implementable. LINK connects some 60,000 ATMs and has 35 Members who are either issuers or acquirers or both. Behind this is a complex system of settlement and reconciliation which produces net monthly interchange positions for each Member in relation to all the other Members. Any structure therefore needs to be capable of being implemented in such a way that it is technically feasible.
- Thirdly, certainty and predictability. ATMs are usually installed on five to seven-year contracts, can have significant installation costs and the ATMs themselves have a material lifespan

significantly longer than that. It is therefore vital for ATM operators and the merchants that when they agree terms they have a broad understanding of short and medium interchange rates and therefore what the income will be and what the results of their investment decisions will be. A system which involved constant recalculation and change would make any sort of long- term decision making extremely difficult.

- Fourthly, measurability. The current structure is simple to operate and the definitions of cash/non-cash and branch/remote are self-evident and reasonably easy to define and monitor. A factor whose definition was difficult, or which changed over time, or which could be manipulated to produce a more favourable outcome, would cause problems. In addition, it is difficult, if not impossible for LINK to actually visit and check each location and any definition must therefore be set by the ATM operator itself and some reliance put on self-policing or other Members keeping an eye on their competitors. A factor which had no obvious physical characteristic, such as a business model, would be particularly difficult to check.

While there are an almost infinite number of alternative structures possible they could potentially include the following:

- **Network Contribution Interchange**. This was the system which operated before 2001 and basically had more attractive rates for those Members who "invested" more into the system. A large issuer would pay a lower fee per transaction as they were adding a lot of cards to the system while a large acquirer would receive a higher fee as they added a lot of ATMs. A large bank which had a large ATM network could achieve both, ie issue at a low rate and acquire at a higher one. A small bank would pay more for the benefit of having access to every ATM in the country despite having few cards and ATMs themselves while a small ATM operator would get a low fee for their transactions as they didn't add many ATMs to the total. A complex system of netting is required behind the scenes to balance each Member's position. Such a system is probably unacceptable as it introduces significant barriers to entry, either for start-up banks or new IADs.
- **No Interchange**. This was tried in Australia and is perhaps the purest model in that customers pay for the service they use, although it largely eliminates free access to cash except at the customer's own bank's ATMs. The experience in Australia was not necessarily positive. There was a proliferation of ATMs as banks wanted to offer their own customers free access (for which they ultimately paid) and IADs installed large numbers of charging machines which were perceived as expensive. Complaints from consumer groups, MPs and others over charges has led to the major banks dropping all charges at their ATMs, but this has led to concerns that ATMs will disappear as banks receive no income for their ATMs and IADs' charging ATMs cannot compete with free bank ATMs nearby.
- **Blended Rates, Removing Branch/Non-Branch Split**. This has the benefit of simplicity but would mean that branch ATMs were in effect receiving interchange for rent they did not pay (the main differential) and therefore their rates would rise while non-branch rates would fall. This would put pressure on non-branch locations and we would be unlikely to see a corresponding rise in branch ATM numbers as they are driven by other factors, and more branch ATMs are probably not needed anyway.

- **Non-Cash at Marginal Rate.** This apparent anomaly has been considered on several occasions. The structure of interchange means that balance enquires, with their income much higher than their marginal cost, are very profitable and this can lead to heavy promotion of balance enquires at some ATMs. It also makes balance enquires at ATMs an expensive way (for the issuing bank) for customers to check their balances compared to on-line or phone apps. However, reducing Non-Cash to the marginal cost would move this cost onto the cash transactions which would rise significantly. The effect of this across Members would not be even, some would win, some would lose and there would be little incentive for them to offer balance enquires at all if there was no income. LINK rules currently mandate that balance enquires are requirement and they remain an important way for those who are on tight budgets to check their balances. As around 30% of LINK transactions are still balance enquiries it appears consumers still value them as a service.
- **Cash Replenishment Model.** ATMs operate with a wide range of business models and by choosing a cost effective one an operator can reduce their costs compared to the average. Their replenishment model is perhaps the largest of these. Cash replenishment using a security carrier is expensive and by choosing a merchant fill alternative (where the store owner fills the ATM with surplus cash from the till) the cash costs for the operator can be reduced to close to zero (ie close to the non-branch rate). This means that merchant fill ATMs are being subsidised by carrier fill and therefore subdividing the category on this basis may appear attractive. However, this would decrease the interchange at merchant fill sites, which are usually low usage locations and thus potentially make them uneconomic while increasing it at carrier filled sites which are usually busier and therefore less likely to be at risk. In addition, the split between carrier and merchant fill is not even. Two LINK IAD Members are almost entirely merchant fill and they would be disproportionately affected compared to others. It would be difficult for LINK to tell whether an ATM was carrier or merchant fill and verify that ATMs were receiving the correct interchange. An audit process to check the ATMs would be complex and expensive and the situation where an ATM switched between carrier and merchant fill on a regular basis would also add complexity.
- **Internal/External/Working Hours or 24/7.** ATMs which are external, ie facing onto a public highway, are usually more expensive in themselves and require more expensive installation, anchoring and are subject to business rates. Internal ATMs by contrast are smaller, cheaper (they do not require weather protection) and often merely bolted to the floor. As with other options a change to the structure of interchange would result in lower fees for cheaper internal ATMs and higher for expensive through the wall machines. However, this would penalise the internal machines which usually see lower use and are in locations such as convenience stores while higher footfall [external] ATMs in locations like supermarkets and petrol stations would see a higher interchange rate.
- **Geography.** As noted the current structure is a single tier across the whole of the UK but with specific support for ATMs in remote, rural and deprived areas. This means that outside the Financial Inclusion Programme the "value" of an ATM transaction is the same whether it is in Scotland, Northern Ireland or Central London and regardless of the costs, proximity of other ATMs etc. Interchange rates could be modified to reflect an ATM's location in a number of ways:
    - Administrative criteria, eg; Region, District, Post Code or Super Output Area.

- Characteristics of the area the ATM is in, eg; deprivation, urban/rural.
- Characteristics of the ATM itself, eg: distance to nearest free ATM, last ATM in town.

- **Administrative Criteria.** These will usually be easy to understand and relatively easy to administer, assuming a reasonably small number of interchange rates and criteria are used. This could mean, for example, the interchange rates paid in Northern Ireland were greater than those in say, London. As we are only considering the structure of interchange at this point, then an increase in one area would lead to a decrease elsewhere. However, areas are not of equal size and do not have the same number of ATM transactions. Therefore, a 5p increase per withdrawal in say Northern Ireland, would have a smaller counter effect per transaction in London, as Northern Ireland only accounts for 4% of LINK volumes while London is 15%. Boundaries in whatever form will inevitably present a problem where an ATM just outside the area will not qualify for the effect but may be just as worthy as one within it.
- **Characteristics of the Area.** Here a range options could be considered. Some of these are easily determined, such as the ranking of an area's deprivation which is calculated for the whole country at a detailed level using the Index of Multiple Deprivation. It is however a ranking, like other criteria, and separate indices apply for England, Scotland, Wales and Northern Ireland. Therefore, the level of absolute deprivation may not be comparable and determining at which point an area qualifies will be necessarily arbitrary to some extent. Other criteria can also be conceived, such as urban/rural however these may not be readily so defined and therefore whether an area qualifies or not may be difficult to work out and subject to subjective views. While an area's characteristics do not change that often, they may evolve over time (deprivation is usually recalculated every 10 years) and while most areas will not change their characteristics markedly, those at the boundary of qualification may do so.
- **Characteristics of the ATM's location itself.** LINK already does this for "remoteness" in that ATMs which are more than one kilometre from the next nearest free-to-use machine are protected and eligible for subsidies. However, while this is possible to manage where a limited number of ATMs are concerned a more complex system of multiple density bands could prove very complex to administer as the position would be constantly evolving as ATMs being installed or removed would influence the interchange other nearby ATMs would receive. Protecting the "Last ATM in Town", for example, may also prove to be difficult to define as there is no obvious definition of a town, which in some cases will be a discrete settlement which is identified and understood as such, but could equally be a part of a much larger conurbation where ATM access was not an issue. The question of what would happen to a "Last ATM in Town" should another ATM be installed nearby would also need to be carefully considered.

Other criteria can certainly be envisaged but in each case, whatever is chosen, it must have a rational link to the value consumers place on the cash access which is to be protected or preserved. Objective criteria are likely to be arbitrary to some degree and therefore it is likely that some qualifying ATMs will be subject to an effect which does not match the objective of "value" however it was being determined. For example, ATMs could end up subsidised which consumers do really need, or which would be economic in any case, and worthwhile machines elsewhere may not be subsidised because they don't meet the criteria.

It is evident from the above that there is no "perfect" alternative interchange fee structure that is demonstrably better than the current system and that can be easily adopted and operated by the market participants within a "competitive market" approach and the confines of competition law. Looking forward, LINK does however recognise that the continued decline in cash usage will necessitate a more comprehensive change in the way that cash is both distributed and accessed by consumers. LINK is supportive of the Access to Cash Review recommendations and is of the view that a more "utility" based approach rather than a "competitive market" approach may well be required in the future to ensure that the UK's cash ecosystem continues to serve the interests of consumers in the years to come.

Lloyds

PSR CALL FOR VIEWS: INCENTIVES TO DEPLOY FREE-TO-USE ATMS

SUMMARY

The PSR's paper identifies that ATM services and economics are a local, not a national, issue, and correctly identifies issues with the interchange regime that has been in place for eighteen years. The PSR offers some suggestions to tailor interchange to local needs. LBG supports the overall analysis and agrees the PSR's three suggestions have merit.

This paper offers some additional suggestions. First, the interchange analysis should apply local logic in over-served as well as under-served areas, recognising the diminishing marginal benefit where ATMs are thickly-populated. As part of this logic, the PSR should work with industry to produce a workable definition of where support is / is not required, noting that the "Protected ATM scheme" applies only to existing ATMs, and not to filling in gaps elsewhere. Second, and in order to deliver the greatest benefit to customers, the PSR should evaluate any changes to LINK interchange as part of a broader set of issues relating to cash provision, particularly the ability of non-ATM and non-LINK arrangements to meet local needs for cash. The PSR could also consider the incentives to ATM deployers to convert ATMs to "pay-to-use" (PTU) where this has the effect of putting nearby ATMs into Financial Inclusion or Protected status. Third, the PSR should also consider whether any mechanistic pricing scheme is capable of fulfilling the localised needs of customers in a changing technical and economic environment, and what scheme-level incentives and governance could better align interests around those needs.

PSR OBSERVATIONS ON INTERCHANGE

The intention of LINK interchange, in 2001, was as described in the paper: to ensure incentives *"for ATM providers to become more efficient by incentivising lower than average costs. In due course, this would feed into lower MIFs in subsequent years, sharing the benefit of these efficiencies".* The unintended consequence has been, as the PSR paper notes, under-supply in higher cost/lower demand areas and over-supply in lower cost/higher demand areas. Since 2011 all categories of interchange has risen alongside the supply of free-to-use ATMs, even as demand for withdrawals flattened off. The ATM industry as a whole costs the UK ~£1bn a year and it is certainly right to ask whether customers are getting good value for their money.

The PSR's analysis of interchange economics is broadly accurate, in differentiating between **profitable areas** with high demand / lower costs and **less profitable or uneconomic** areas with lower demand / higher costs. As the PSR notes, there is a "feedback loop" in profitable areas, via which the installation of extra ATMs (regardless of marginal benefit) drives overall costs up faster than the number of transactions, putting upward pressure on interchange and thus further increasing profitability in those areas.

The challenge, as characterised by the PSR, is to *"maintain a **suitably wide** geographic spread of ATMs…which would promote an **economically efficient** spread of ATMs".* In practice the term "efficiency" requires careful definition. Due to feedback, the interchange calculation itself affects what is "economically efficient" ATM deployment, which may or may not deliver "suitably wide" ATM access in a given area. In more profitable areas ATM proliferation has been widely reported[1] as engaging

[1] https://www.bbc.co.uk/news/business-42360363

more resources than are necessary to meet customers' needs, with numerous examples where there are more than 50 ATMs within 400 metres. LBG suggests that "efficiency" should be clearly defined to relate to local needs rather than nationally-calculated economics.

As the PSR's analysis suggests, "*in high-demand locations, fewer ATMs with higher individual usage (and hence lower unit costs) may be a preferable outcome and more economically efficient*" while *"where the density of demand for transactions is low, the benefits of an ATM with low usage may still be worthwhile as…potential users would need to travel a long way to reach the next available free-to-use ATM".*

As such, LBG agrees with the PSR's **four observations** relating to supply and demand:

- **Observation 1:** The average cost per withdrawal (or other service) will fall significantly as volume of usage increases. This will be particularly apparent at the low volume end of usage.
- **Observation 2:** The ATMs that consumers value the most are those which provide free access to cash and where there are no other free ways to withdraw cash (including alternative free-to-use ATMs, regardless of who provides them) nearby as long as those ATMs represent a reliable and accessible way to withdraw cash.
- **Observation 3:** Consumers will also value free-to-use ATMs most which provide convenience in terms of allowing access to cash as part of their daily routine (i.e. are where they need to spend cash or are on transport routes).
- **Observation 4:** Customers would rather not queue, even at busy times.

PSR PROPOSALS

The PSR's **three indicative proposals** have merit, in providing for more localised ATM economics, however they raise calculation challenges in terms of defining bands, thresholds and rates, which together suggest a high risk of unintended consequences. Structurally, none of them necessarily address the problem of over-provision and excess cost in high-demand areas.

Multi-part tariffs combining elements of fixed and variable revenues could theoretically approximate the cost curve on page 10. This could help lower-usage ATMs ensure recovery of their fixed costs, while in high-usage ATMs reducing the excess of variable interchange over variable costs. This reflects localism in demand – but remains susceptible to the challenges of localism in supply. It would be challenging, on a generalised basis, to design "rules" and thresholds reflecting variance of fixed and variable costs between ATMs. Specifically, setting the wrong thresholds could lead to:

- In remote areas, encouraging the deployment of ATMs but failing to encourage expensive variable services such as prompt re-load and repair
- In high-traffic areas, encouraging further proliferation of ATMs owing to the "de-risking" of the installation element of costs

Banded interchange to reflect local economics can be considered as an extension of the "financial inclusion" principle, recognising there is private and social value in delivering cash where there is no other ATM available. The banding could ensure that excess provision in high-traffic areas led to excess profit in those areas alone, rather than driving up pricing across all areas. Increasing the number of bands from 3 to, say, 8 could considerably help align local economics to local needs, however the challenge would remain how to define the stated bands at a national level. Specifically:

- The theory of greater accuracy might yield in practice to greater bureaucracy, greater controversy, and to ongoing pockets of excess- or under-supply
- Even if the bands and rates were "correct", balancing out issues **across** the bands, there would be risk of over- or under-supply **within** the bands; there would still be no mechanism to manage interchange downwards within the segment of more profitable areas

Additional premiums offered to ATMs that face specific demand and cost conditions appears to be a subset of the "banded interchange" proposal. All ATMs face "specific demand and cost conditions"; our challenge is to identify what those are and then to establish what economic rules are optimal for those conditions – if indeed such rules are possible. Most importantly, the principle of adjusting interchange to local conditions must be applied in highly profitable / over-served areas as well as less profitable/under-served areas.

LBG ADDITIONAL OBSERVATIONS ON INTERCHANGE

LBG's view remains that there are opportunities to rationalise the UK's ATM estate without jeopardising access, particularly in "financial inclusion" areas. Nationally, there could be fewer ATMs operating at higher utilisation, at lower overall cost and with lower interchange. Locally, there could be measures (the Financial Inclusion and Protected ATM scheme being examples) that recognise the benefit of "the last ATM in town", and also the inefficiency where there is over-provision. Outside the ATM network, there are opportunities for banks, schemes and local businesses to work together to fulfil the requirement for cash – these could be supported either within LINK or as an alternative to it. Regardless of these considerations, it is questionable whether **any** national pricing scheme is capable of meeting local needs in a changing environment.

LBG would therefore add the following observations:

LBG Observation Five: ATM economics and pricing are a local rather than national issue

LBG Observation Six: breaking down the national mechanism into more localised or banded segments has potential to create greater accuracy, but

- **this brings complexity, bureaucracy and expense**
- **given calculation issues, there is no guarantee of addressing the underlying issues or doing so on a sustainable basis**

LBG ADDITIONAL PROPOSALS

LBG Proposal 1: Localised pricing should be applied to over-served as well as under-served areas, via an automatic and managed reduction in interchange.

The Financial Inclusion and Protected ATM elements of LINK pricing recognise that nationally-calculated interchange fails to deliver an ATM estate that efficiently meets local needs. They generate subsidies for ATMs that are otherwise uneconomic. The same principle should be extended to more profitable areas, where there are more ATMs than are required, and an interchange "haircut" should be applied. For example an annual interchange reduction could be applied to ATMs in proximity (e.g., -5% within 50m and -1% within 400m). Potentially, such a reduction could apply in conjunction with the PSR's suggestion of multi-part tariffs for fixed and variable costs.

It is not yet clear that the industry has arrived at a workable definition of which areas require help under the “protected ATM” scheme; the PSR can help facilitate a focussed discussion on this, noting that the scheme considers only the existing estate. At the same time, the discussion must consider a definition for areas that are over-served and merit an interchange reduction.

LBG proposal 2: Discussion of LINK interchange should account for impact on the broader cash and payments ecosystem and should allow for innovation beyond ATMs

The PSR’s paper would benefit from setting the question of LINK interchange in a broader context. On the demand side, customers value not the ATM itself, but the ability to pay for goods and services with reasonable convenience. On the supply side, the ATM is not the only way to meet the customer’s need for cash, while cash is not the only way to meet the customer’s need to pay for goods and services. While the PSR states the overall objective is “to support cash access which meets the needs of users”, the PSR should consider how interchange affects non-ATM cash provision, and also the effects of interchange on the evolution of digital payments. Specifically, the PSR should consider how interchange, and the LINK system itself, affect

- the **incentive to innovate and deploy** alternate mechanisms for cash delivery; such as sponsored cashback
- the ability of card issuers to use **schemes other than LINK** to deliver ATM access
- the ability and incentive for card issuers and other players to **innovate in payments beyond cash** from both the customer and merchant perspective

Designing an interchange system that accurately reflects local needs is challenging and complicated. Consumers and businesses would be better served by managing this complexity through flexibility. There are alternatives to 24/7 ATMs which could be more proportionate and efficient in remote areas, enabling more widespread deployment of a reduced service. For example:

- **Local retailers/pubs/forecourts** could earn LINK interchange in return for cash provision from the till. These businesses often call for the availability of cash: enabling LINK to serve those outlets would empower them to solve their own issues, while avoiding the introduction of expensive low-utilisation infrastructure.
- **Cash delivery teams** could be set up, paid via LINK, to distribute cash directly to customers (akin to mobile branches); instead of visiting towns and villages to load ATMs, they could provide regular slots for local people to collect cash. While forgoing 24/7 access, this would have the benefit of avoiding expensive low-utilisation infrastructure while being highly flexible to adjust on a week-by-week basis, for example to reflect seasonal needs.

If LINK is unable to support such initiatives flexibly and efficiently, then issuers should be encouraged to explore them directly. The PSR should be aware of the risk of LINK ATMs **crowding-out** such initiatives at the local level. Specifically, **there must be scope for the removal of “protected” status** from ATM operators where other local alternatives come into play.

In the same vein, the role of Pay-to-Use ATMs should be reassessed. They can be a last-resort way to provide cash, however there is also potential for them to take advantage of localised market power. When interchange is set at less than 30p per transaction, it is unclear why pay-to-use tariffs are usually several multiples higher. In particular, it could be possible for a deployer to switch a machine to PTU, thus pushing a nearby FTU machine into Protected Status. It would be reasonable for the PSR to review local economics where transitions have been made from FTU to PTU, and to review the level and prevalence of PTU charges more broadly.

LBG Proposal 3: LINK governance should be reviewed and the management given incentives to drive efficiency and resolve economic issues.

It is unclear that any nationally-determined interchange mechanism is capable of reflecting local issues, even if local bands or adjustments are applied. It is even less clear that such a mechanism can account for future trends in demand and supply of payments, driven by changing technology and behaviour. While there is advantage, as the PSR notes, in a favourably predictable environment for investors in infrastructure, there is also disadvantage in a rigid mechanism that cannot respond to changing circumstances. It would seem preferable to establish principles and governance that could ensure flexibility at scheme level, regardless of proposals to adjust the structure and level of interchange regime.

LINK was established to administer a mechanistic cost-recovery system, which has delivered the perverse consequences identified by the PSR. Attempts to highlight the problems and establish solutions faltered under the previous LINK governance, and it remains unclear that LINK Board has the right incentives and structures to deliver the changes envisaged by the PSR, and expanded upon in this paper. Meanwhile, banks are under considerable pressure to maintain **"suitably wide"** financial access via ATMs, but it is unclear whether there is an incentive or mandate, at scheme level, to deliver **"economic efficiency"**. Incentives at scheme level should complement initiatives regarding pricing of machines and transactions.

The PSR should take the opportunity to consider how LINK can be given the incentives, as any well-run organisation, to do more with less. As a major debit card issuer, LBG upholds the commitment to serve customers across low-profit areas; LINK should play a role in helping the industry build greater efficiency in higher-profit areas.

Nationwide

PSR: Call for Views LINK interchange fee structure June 2019

Nationwide welcomes the opportunity to provide input on how the structure of LINK ATM interchange fees may be reviewed. We also appreciate the consideration and focus the PSR is providing, through this call for views, on the important subject of the provision of access to cash throughout the UK. We agree with the position of UK Finance and believe they have captured all elements within their response.

We also believe that the PSR has successfully considered all relevant variables in relation to the LINK interchange structure review. However, our view is that it will be particularly difficult to have a meaningful debate on LINK interchange if looking at it in isolation. In part, since interchange fees levied are influenced by many aspects of the whole end-to-end cash and ATM infrastructure provision. Further to this, viewing ATMs in isolation and any further re-structuring of the LINK interchange fee without full consideration of all the elements involved may enhance the risk of alternative potential solutions becoming economically unviable. For example, how we can effectively leverage cashback facilities or provide a focus on digital tools that look to better support consumers.

An important aspect of this debate is the various business models of those active within the ATM market. Due to the fundamental difference in business models between the IADs, whose primary focus is on margins, and banks or building societies with a diversified provision of financial services can have more of a focus on customer service in relation to ATMs, it is difficult to believe that the interchange, in its current form, could get to a position that commercially works for all parties.

Nationwide would like to be engaged with any further discussion in this area as it evolves. However, at this stage we do not believe we are in the appropriate position to effectively, bilaterally, respond to the questions below in full due to what is described above. However, we would welcome any attempts to look at cash provision, as a whole, in the coming weeks and months.

Q1: Do you agree with the description and framework (including the objectives we set out) for considering the costs of providing ATMs and the value they provide that are set out in this paper? If not, please explain why and set out your view of the alternative way these issues should be analysed.

N/A

Q2: Are there any other factors we should take into account when analysing the incentives to provide ATMs?

We believe that all relevant factors have been considered for analysing the incentives of the current interchange structure. However, we firmly believe that it is difficult to take a meaningful look into the structure of interchange fees without first addressing the need for reform within the cash wholesale infrastructure that is currently costing the UK economy over £5Bn a year.

Once a review has taken place that looks to consolidate the current system it could provide more opportunities to have a meaningful assessment of interchange and the appropriate structure.

Q3: What incentives and impacts do the existing LINK interchange fee arrangements as described in this paper (including in Annex 2) have?

N/A

Q4 What structure of interchange fees would have appropriate incentive effects going forward?

Due to points raised above we are unable to currently provide a thoroughly robust structure, however, it seems evident that there is a requirement to look at the fundamentals of the fee structure that looks at the ATM estate as a whole. With this in mind, we believe the following as an option that could be considered that looks to balance the social need with commercial viability.

Our proposal relates to the cost of providing a base level of geographic coverage, something that is of keen interest to all parties. If we believe that an optimal geographic spread of free to use ATM's is our main objective, then that suggests a base network of ATMs. Some thorough analysis would be needed to take place to understand the base number that would provide the optimal geographic spread. This base number of ATMs would incur cost in terms of rent, connectivity, security, management overhead. These costs relate to the number and nature of geographic coverage of ATMs that is deemed necessary and are independent of the actual volume of use that these ATMs experience. Separately, the base network will also incur costs of cash servicing that derive from the volume and value of cash that is withdrawn.

A scheme could aggregate the fixed costs of base provision and allocate these costs over the total number of cards in issue which would wish to have access to the base network. That allocation could be recoverable from the card issuers in the form of a subscription to allow their cards to be able to access the network i.e. the card issuer would bear a proportionate share of the cost of the base network, in order to enjoy the benefit and utility of broad geographic ATM provision. The scheme could assess the marginal cost of a withdrawal, balance enquiry and other activity in terms of the variable costs associated with those activities. The scheme could assess separately the cost of activity on these ATMs in terms of the marginal cost. The scheme would recover marginal costs through a per-activity usage charge.

This would provide a basis for recompense to ATM operators for operating a base network of ATMs, at an extent determined by the PSR working with parties such as UK Finance to meet the UK's social requirement. To provide some pressure to maintain efficiency, the scheme could model the efficient level of these costs and provide some challenge to the ATM operators so that they don't pad out their costs. Alternatively, if the fixed and variable cost of operating one of the ATMs in the base network was set at X, any operator who managed their costs down below X would be making a profit. This is not so simple in practice, as the cost of operating each of the base network of ATMs is likely to vary considerably by geography. ATM operators might choose not to offer to operate those ATMs deemed necessary to serve the remoter, harder or more expensive to serve areas. One way to address that might be to package up the ATMs in the base network in a way that combined a number of the harder to serve ATMs with some of the easier ones, so that an operator could bid on a package that allowed it to achieve a reasonable average cost overall.

There is a question about how to recompense operators for ATMs who choose to offer services over and above the 'base' network. This must be on a commercial basis, i.e. the operator's decision as to whether it can make money. If the operator were to only receive compensation for the marginal cost of operation, then it would not cover its fixed costs and the operator would struggle to survive.

NoteMachine

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[redacted]

[redacted]

Attached is a resubmission of our response to the PSR paper.

The 3 key points we went to make are:

There should be a:

- 'Universal' MIF for cash
  - has to apply for all card schemes for Free Access to cash (not just the LINK scheme)

- Regulated utility for free cash is essential for the economy – achieved through a cost study.

- Much lower infrastructure cost is feasible using technology – 'white paper' proposes how. Cash 'inbound' fee and mechanism is proposed to enable devices to replace banking branches and enable cash payments despite fewer bank branches, in a great many locations.

[redacted]

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NoteMachine submission to the PSR's call for views on incentives to deploy free-to-use ATMs in the LINK network

July 2019

Introduction

1. NoteMachine welcomes this call for views and understands that its primary focus is on the interchange fee's structure. However, it cannot and should not overlook that the fundamental issue arises from the level of the fee and the urgency around finding a solution. Further, we contend that a 'LINK network', as stated in the consultation's title, is actually a card scheme. LINK is an ATM scheme that sets the operational rules and terms of trade between members.

2. Whilst we agree with many elements of this consultation, it is based in part on how things once were. The world has changed drastically since the 2001 Office of Fair Trading (OFT) ruling. For example, the role of cash provision at ATM locations considered remote has shifted from the banks to the independent ATM deployers (IADs). As such, any changes to the interchange fee's structure resulting from this consultation must be tested to ensure they are compliant with competition law which, as we have argued, is not the case for the recent arbitrary cuts to the interchange fee itself.

3. IADs have played an instrumental role in ensuring the provision of free access to cash. Many UK financial institutions have withdrawn from the remote ATM market as their ATMs are mostly branch-based, though there has been a major fall in withdrawal numbers in these locations. Through remote placement, IADs are providing an invaluable service to people in areas where cash is most needed, stimulating local economies and helping to revive high streets whilst ensuring the UK's most vulnerable have free access to cash. IADs have also been able to fill the gap left by the two to three bank branches that are now closing each day on average.

We are calling on the PSR to:

1. **Support the cancellation of LINK's third planned reduction of the interchange fee in January 2021 and the reversing of the previous reductions as an interim measure. This should include supporting the establishment of a mechanism that is independent of the card scheme to provide economic access to cash.**

2. **Urgently reinstate a scheme broadly similar to the original KPMG cost-study that set the interchange fee to stabilise the market, encompassing all UK issued cards for free access, whilst a longer-term solution is found.**

3. **Commission an independent economic study from a regulatory point of view looking at how value is distributed throughout the supply chain and addressing monopolistic behaviour from the banks and card providers.**

4. **Creation of free access to cash as a utility with regulated pricing and ensure that cash's infrastructure reflects this with an accompanying Universal Service Obligation. This must include:**
    - **Better use of data and AI to determine local demand, 'just in time' cash flows, and the local recycling of cash;**

- **Increasing the number of cash input devices and rolling them out to every major retail centre in the UK;**
- **Application to all card schemes in the UK; and**
- **Reducing large infrastructure costs through a simplified supply chain.**

5. **The PSR should explore the market trends for branch and remote ATMs separately before making recommendations at a whole market level.**

Current interchange fee structure and its impact

4. The current interchange fee structure has led to a reduction in the number of free to use ATMs, restricting people's ability to access cash. This runs counter to what the Treasury Committee and Natalie Ceeney's Access to Cash report have advocated and has disproportionately impacted upon society's most vulnerable, especially those living in rural areas.

5. The reduction in ATM cash withdrawals has been driven in part by falling numbers of branch-based ATMs as bank branches have closed. This is because the interchange rates have risen in these locations due to a combination of reduced footfall and installations of expensive new hardware. The PSR should therefore explore the market trends for branch and remote ATMs separately before making recommendations at a whole market level.

6. The current interchange fee paid by banks to IADs when a consumer withdraws cash has been reduced by ten per cent in the last six months and is making ATMs uneconomical to run, especially on a free to use basis. This reduction involved two separate five per cent cuts in July 2018 and January 2019, with a third five per cent cut under review for January 2021. Factoring in the removal of the volume adjustment this has resulted in a decrease of 12 per cent.

7. This fee was calculated by an audited KPMG cost study, which used the real cost prior to 2018 of maintaining the UK's current free to use ATM network. It did this by adding up the total annual costs of operating the free to use ATM estate and dividing it by the number of relevant transactions in that year to give an average costs per transaction for the following year.

8. However, the first two cuts (July 2018/January 2019) were not based on an assessment of this kind. In doing so, LINK did not consider the impact this would have on consumers and the wide-reaching consequences for the network which has led to thousands of ATMs being converted to pay to use from free to use operations.

9. This poses a significant threat to consumers as their ability to withdraw cash has become greatly reduced. As a result, IADs are considering which ATMs are no longer economically viable to run. NoteMachine is considering the future viability of over 1,000 of its free to use machines. Further, declining ATM usage among consumers exacerbates the challenges associated with the reduced interchange fee for IADs as fewer transactions mean a higher relative cost of the interchange fee per transaction. We are extremely concerned by this vicious cycle as it risks more operators moving away from free to use and further reductions in ATM numbers.

10. The interchange fee structure and the fee itself is highly detrimental to consumers and many retailers, particularly the smaller ones where their ATMs provide access to cash in the absence of any alternative. Both these should be considered key stakeholders and the PSR should consider the impact of the interchange reduction on retailers. The convenience sector cannot be expected

to provide a service which the banks have chosen not to offer or fund. Convenience stores have become a one stop shop for services including bill payments, the Post Office, and ATMs.

11. The impact of removing an ATM or moving it to pay to use is having a massive impact on shops' turnover (see case study 1 in the appendix). The Association of Convenience Stores has shown the average store's sales decline ten per cent after its ATM has converted from free to pay to use.

12. Whilst IADs and retailers struggle as a result of the reduction to the interchange fee, the banks' profits have benefitted hugely as they pick up lower interchange costs or none at all where consumers pay to access cash. This is unfair and cannot continue at the expense of vulnerable consumers. This is especially the case considering the banks do not now want to install and run ATMs and have since been happy in many cases, to sell their ATMs to independent operators.

13. Simultaneously, banks have reduced branches and associated ATM(s). They can still supply cash to consumers via IADs and benefit from the reduction in costs of closing a branch. Alongside this, they have been pushing the use of cards and have invested heavily in contactless and mobile payments meaning they can accelerate card growth which off sets any MIF reduction and generates more revenue (paid for by merchants who prefer cards irrespective of the merchant indifference test that was used to set the MIF).

14. Converting machines to pay to use would not be a moral choice for us, as we have always operated a free to use model where possible, but a necessary one if our machines are to remain economically viable. Without continued free access to cash, household debt will increase for vulnerable consumers and the wider economy will suffer yet another hammer blow. Whilst the establishment of the Joint Authorities Cash Strategy Group (JACS) was welcome, unless there is immediate action, the infrastructure that supplies cash to communities is in danger of disappearing altogether. Once this infrastructure has gone it will be nigh on impossible to replace.

15. It is imperative, therefore, that the PSR ensures the regulatory and economic environment in which IADs operate is one which facilitates continued free access to cash. At a minimum, as an interim measure this must include cancelling the third planned reduction of the interchange fee in January 2021 and reversing the previous reductions, as well as establishing in the near-term a mechanism that is independent of the card scheme to provide economic access to cash. An immediate return to the original LINK cost-study methodology, and strict observance of its findings, based on the results of the 2019 study, is also paramount whilst a solution on the way forward can be discussed and agreed.

16. We also disagree with the idea that interchange fees should be geographically based due to our belief we are providing a utility. Moreover, such a structure would be very difficult to implement and manage. LINK's Financial Inclusion Scheme only affects a relatively low proportion of the UK ATM estate. We envisage that a larger scale differentiation of fees would be considerably more difficult to administer. We do not think that the suggested "multi part" tariffs are appropriate due to the different proportions of fixed versus marginal costs incurred by different operators with different operating cost structures. Other LINK measures have also proven ineffectual, like the 'super premium' for example (see appendix 2).

17. It is critical that operators have reasonable certainty of future pricing if continued investments are to be made. It is also clear that regulatory and compliance costs have escalated sharply in the last few years and there is no sign that this will abate. There must be a clear mechanism that

recognises these costs in interchange pricing, otherwise the network will decay because it is now uneconomic to make the capital investment needed to maintain it.

ATM costs / structures

18. The consultation implies decisions regarding ATM placement are largely driven by the costs of deploying and maintaining machines in non-urban areas. This is not the case. NoteMachine has always operated on a utility basis of averaging costs across the network with decisions based on the availability of a suitable location to place an ATM, combined with a prediction of likely usage. The only other major consideration is security.

19. For example, we bear most of the costs associated with cash losses from raids, and therefore the suitability of the proposed premises and the history of attacks in the area are key considerations when deciding whether to locate an ATM. If our policy was to only deploy ATMs in urban locations, the logical conclusion would be that outlying areas would be ignored by the independent industry. Our-wide distribution of ATM network makes it clear this is not the case, and our placements follow the distribution of the UK population.

20. The costs of space and physical installation are often cheaper outside the major conurbations and there are both supply and demand effects arising from placing an ATM. If it is convenient, then more people will use it. ATMs which do not reach the projected transaction levels are removed and re-sited.

21. We also believe access to a wider range of banking services could be provided through the LINK scheme if interchange fees were set at realistic levels. For example, cash deposit, which is technically possible as a LINK transaction. However, no meaningful implementation on a large scale has been possible due to the lack of agreed interchange rates and the ability for issuers to decide whether or not they wish to support deposit transactions. Resolution of this could help financial institutions carry out branch closure programmes, but the compensation to providers must be set at realistic levels which reflect the true level of cost avoidance on the part of the banks, the fees that they levy on their customers, and the considerable hardware, software and servicing costs that operators will face.

22. Other services could be provided through ATMs if financial institutions permitted them and were prepared to pay IADs for providing them to their cardholders. For example, mini statements are popular. The challenger banks for whom we provide services almost universally request this feature, and consumers find it a great benefit in budgeting to know what has recently come in and gone out of their accounts. The mechanism exists to provide this service and the financial institutions should support it and pay providers a fair sum for doing so.

The case for a more "utility approach" to cash

23. The consultation repeatedly refers to the notion of "incentives" to provide ATM services. In our view this is a misnomer. We are firmly of the view that we are providing a utility service – without independent operators consumers would have great difficulty in accessing widespread free to use ATMs – and all we require is to be fairly and predictably remunerated at a level that provides an acceptable return on investment. A further reason why "incentivisation" is an inappropriate term is because it is very unlikely that any new entrants will be attracted at this mature stage of the market.

24. We do not recognise the PSR's characterisation of the dynamics of ATM supply and reiterate that an ATM only survives in a location if there is enough demand to warrant its continued existence. Regarding the service as a utility will be a more fruitful way of maintaining access to cash. To do this, deployers need an interchange structure which adequately compensates them for the investments they have made to serve the customers of the financial institutions, and one in which changes are justified, understandable, predictable and not applied in an arbitrary manner.

25. The interchange structure needs to recognise that space costs money which is why site owners also require compensation that at least equals the opportunity cost of using the space to offer some other product or service. Initiatives such as publicising banking services in Post Offices are cosmetic and not convenient for most consumers. . The benefit to local economies that arises from access to cash and local circulation must not be underestimated.

26. Maintaining free access to cash is essential for the economy and consequently the model for providing free access to cash needs to ensure IADs are able to continue to service customer need. A regulated utility model must recognise the realities of ATMs and free cash supply, and be designed accordingly.

Changes to the cash infrastructure

27. To support a more utility approach to cash, its infrastructure needs to account for demographic need and be equally weighted between those areas where there is significant demand for cash and a high population and those areas where there is significant demand for cash but a low population. Currently, the infrastructure does not reflect the needs of the population to have free access to cash. Instead, it reflects the needs of only those areas with the largest population which doesn't necessarily reflect genuine demand.

28. Reform to the infrastructure is urgent as large banks continue to close their local branches. A radical overhaul is needed to reduce large cash centre operations and introduce a cash input mechanism across the UK. This should be implemented via devices that enable retailers and businesses to deposit cash in real time into their accounts and receive same day value. This would help avoid retailers having to travel long distances to their local bank branch to deposit cash. It would also help reduce their costs further as the input fee would be set at a fairer price than banks' current fees.

29. A far greater real-time analysis of data from cash input and output within the system means AI can optimise the delivery and collection of cash on a real, just-in-time basis. This would dramatically reduce the amount of physical cash needed to operate the system, lower costs and increase access for all.

30. NoteMachine's proposal (see appendix 3) aims to halve some existing infrastructure costs, namely by reducing the need for cash centres and depots, with improved ability to respond quickly to changes in consumer demand in localities. More detail on the technology and innovations available to reduce the physical infrastructure while maintaining a more reliable and cost-effective cash infrastructure is set out in more detail in appendix 3, and NoteMachine's white paper, *The future of the UK's cash infrastructure*.

31. Fundamentally, we believe a more streamlined and cost-efficient infrastructure which, principally, would be driven by AI and data to identify where cash is most needed in certain localities, is necessary. This would create a level playing field for players of all sizes, not just the large banks, and ensure cash is recycled more quickly in localities.

Reduction in cash centres

32. We believe it necessary to dramatically reduce the number of large cash centres from 30+ to 15, as well as their individual sizes. Similarly, the depots to which cash currently flows should also be reduced from 70+ to 35.

33. After passing through consumers and retailers, often, the banknotes that businesses and banks receive in payment are returned to one of the Note Circulation Scheme (NCS) members, either directly or through a bank. This is because banknotes need to be stored securely or because banknotes don't earn interest, so retailers pay them into a bank where they can earn interest.

34. However, some retailers and businesses use banknotes received from customers to fill their own ATMs, for example. This is known as local recycling, whereby notes are not returned to an NCS member and authenticated. Instead, they are put straight back into the local cash ecosystem. Hence, we argue there isn't the need for the current number of large cash centres and depots. Through more local recycling, and an increase in input cash devices (see below), the cash ecosystem can be localised, streamlined and made more cost-efficient, ensuring cash is located where it is most needed.

Input cash devices

35. As above, for local cash recycling to be increased, it is essential the number of input cash devices or ATMs that have deposit-taking capability is increased. Allowing businesses to pay in or deposit cash more easily and cost-efficiently means generating real-time credit is much easier. However, these machines need to be rolled out on a much larger scale across every major retail centre in Britain. Only then can they start to replace the need for having costly cash centres that store cash ineffectually. If recycling technology was used this would promote local recycling and reduce cash processing costs.

36. NoteMachine would place these devices as demand warranted. In effect, the AI is like that used for projecting and deciding the requirements for ATM filling. However, we need an interchange fee set as for ATM fees – aimed at small businesses paying in cash. At present, expensive and gives ample scope for a lower cost alternative, as well as creating more competition in SME banking. Competition would be driven by location attractions for SMEs to easily access.

37. 'Domestic' cash would be accommodated through ATMs with deposit taking functionality. These could be rolled out – subject to adequate 'free' MIF on both 'cash out' and 'cash in'.

Better use of data / artificial intelligence

38. To further enhance any future emphasis on local cash recycling, AI needs to be the key driver of this. And so, any reform to the current cash infrastructure must commit to continuously looking at device level activity, to enable precise timing of deliveries and collections 'Just in Time'.

39. External data inputs from history and changing footfall, as well as local input (e.g. major sporting events, school holidays etc.), would add invaluable data to the overall AI engine which, ultimately,

can help to better determine the movement of cash. Just-in-time delivery and real time credit input, though things like input cash devices, would dramatically improve cashflow and lower economic friction.

40. NoteMachine ATMs currently take over 19 external feeds to inform their decision making and anticipate demand as well as continually monitor actual demand. Nationally, our machines already do this as part of or cash processing

An economic model driven by fair fee structures

41. Underpinning these three features, however, must be a sustainable economic and regulatory environment in which all market players can operate. For this level playing field, some cash devices should have an input mechanism and be funded on an interchange basis. This interchange fee should be a universal multilateral one (MIF) on a free to the consumer basis where card issuers pay.

42. This would apply to all UK issued debit cards including those outside of LINK like VISA and MasterCard. This would prevent issuers or acquirers gaming the system and using a scheme which does not pay its way on the acquiring system.

43. In common with other regulated activities, the PSR would be informed by the old (or similar) cost study audited by KPMG for LINK expanded for other scheme transactions. There would then be consultation between regulators and industry participants to consider variance.

44. This MIF would still be applied to ATMs that charge that enable such machines to have lower transaction costs. The overall charges should be capped by the regulator where it exists to avoid misuse. This route is so that the market can compete for transactions, creating either greater free coverage through competition or retailers paying a contribution to enable it to be free, or a very small charge for low volume ATMs.

Appendix 1: Case study: Impact of interchange fee and pay to use ATM conversion on retailer

Anonymous

I am writing to you as I need to highlight the effect of the ATM charge being added on to the ATM machine transactions at one of my stores. The ATM machine was free to use for customers and now it's been changed to 95p per transaction. When this was free to use it attracted more customers to the business but also helped to increase the number of people using the ATM machine.

It's very disappointing that it has come to a point where every customer is being affected by this charge. I understand it may not mean a lot to yourself, but a couple of pounds is a lot of money for customers in this area, especially when they use the cash machine three to four times a day.

Not only has this caused a dramatic dip in shop sales, but from when this has been auctioned it has got worse as days have went on. The store has dropped over £4000 turnover in just one week. From doing over £22,000 in sales per week to hitting just over £16,000 now.

You can also see from your system the transaction has dropped to less than half since the change came into place as the customers have so many options available.

It is really worrying that staff members of this store are worried as they feel the way the sales are dropping their jobs will be at risk because of this charge being added to the ATM machine. Over time this may cause great inconvenience and have an effect on the community.

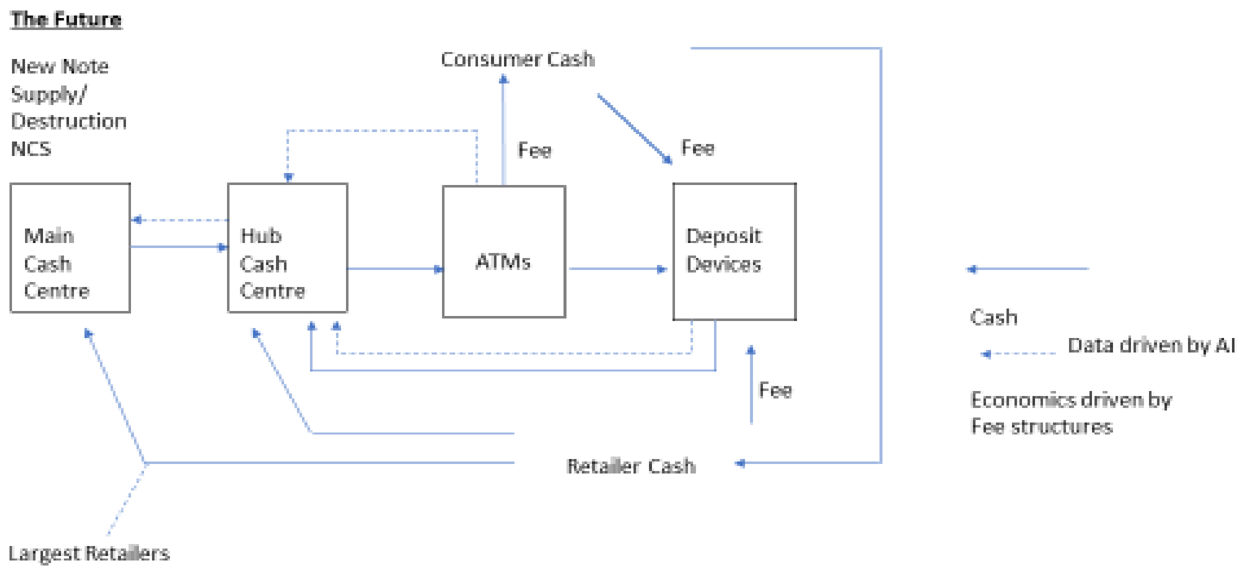
Appendix 2: NoteMachine Sites receiving enhanced interchange

Eligible Premium	No of ATMs
£0.10	67
£0.20	103
£0.30	84
£0.43	11
£0.81	13
£2.75	2
Total	**280**

Link has applied a scatter gun approach to this and in doing so has failed to address the underlying issue. For example, it has subsidised sites for NoteMachine including the McLaren manufacturing plant – a workplace ATM allowing no access to the public.

Appendix 3: NoteMachine's vision for a future cash cycle

Free to Use cash access and inbound cash model *



Fee – ‘MIF’ - Multi-Lateral Interchange Fee

*Extract from NoteMachine White Paper, *The future of the UK’s cash infrastructure*

NoteMachine has set out its vision for a new cash infrastructure based on increased use of AI and real-time data to allow for a more efficient, and more cost-effective, distribution system for free cash. This is outlined in the diagram above, and in more detail in NoteMachine’s White Paper, *The future of the UK’s cash infrastructure.*

Specifically, NoteMachine is calling on the JACS Group to consider the following three features as part of the future cash infrastructure:

1. Reduction in cash centres

Unlike with the current cash infrastructure, NoteMachine proposes dramatically reducing the number of large cash centres from 30+ to 15, as well as their individual sizes. Similarly, the depots to which cash currently flows, should also be reduced from 70+ to 35.

After passing through consumers and retailers, often, the banknotes that businesses and banks receive in payment are returned to one of the Note Circulation Scheme (NCS) members, either directly or through a bank. This is because banknotes need to be stored securely or because banknotes don’t earn interest, so retailers pay them into a bank where they can earn interest.

However, some retailers and businesses use banknotes received from customers to fill their own ATMs, for example. This is known as local recycling, whereby notes are not returned to an NCS member and authenticated, they are put straight back into the local cash ecosystem.

Hence, NoteMachine argues there isn't the need for the current number of large cash centres and depots. Through more local recycling, and an increase in input cash devices (see below), the cash ecosystem can be localised, streamlined and made more cost-efficient, ensuring cash is located where it is most needed.

2. Input cash devices

As above, for local cash recycling to be increased, it is essential the number of input cash devices or ATMs that have deposit-taking capability is increased. Allowing businesses to pay in or deposit cash more easily and cost-efficiently means generating real-time credit is much easier.

However, these machines need to be rolled out on a much larger scale across every major retail centre in Britain. Only then can they start to replace the need for having costly cash centres that store cash ineffectually.

3. Better use of data / artificial intelligence

To further enhance any future emphasis on local cash recycling, AI needs to be the key driver of this. And so, any reform to the current cash infrastructure must commit to continuously looking at device level activity, in turn, allowing things like rescheduling of deliveries and collections.

External data inputs from history and changing footfall, as well as local input (e.g. major sporting events, school holidays etc.), would add invaluable data to the overall AI engine which, ultimately, can help to better determine the movement of cash. Just-in-time delivery and real time credit input, though things like input cash devices, would dramatically improve cashflow and lower economic friction.

The future of the UK's cash infrastructure, June 2019

NoteMachine white paper

Introduction

Recent Which? research has highlighted the scale of the problem facing free access to cash in the UK: 2.2 million people depend entirely on cash, and as many as 25 million people rely in some way on free access to cash. Access to cash, especially free access, is under major threat. Cash usage dropped by 16 per cent in 2018 and ATMs closed and/or switched to pay-to-use models at an alarming rate.

To safeguard the future of free access to cash, large scale reform to the cash distribution infrastructure and reimbursement system is needed. A universal system should be implemented which does not discriminate against smaller market players whilst unfairly protecting the interests of large banks.

This paper puts forward a set of features that must be considered as part of the future of the cash infrastructure. Specifically, it is aimed at informing the work of the newly formed Joint Authorities Cash Strategy Group.

It outlines how government, regulators and industry can ensure the long-term future of free access to cash. These features include:

1. A reduction in large infrastructure costs i.e. the number of cash centres;
2. More accessible input cash devices rolled out across every major UK retail centre; and
3. An increase in the use of AI to help better identify local demand.

Together, these features would ensure a smoother, more efficient and, ultimately, more economically viable cash infrastructure system. The cost of infrastructure would be radically reduced, given the more efficient use of AI to determine local cash demand via a constant feedback loop.

Underpinning these changes, however, must also be an economic and regulatory environment in which all market players can operate. In the first instance, this should involve the immediate return to LINK's previous cost-study mechanism that determined the interchange fee, audited by KPMG. In the longer-term, all cash devices should have a cash input mechanism on an interchange basis. This interchange fee should be a universal multilateral one (MIF) on a free basis where card issuers pay. This should be regulated and independent of LINK.

Context

While a great number of recent reports have looked at cash and its importance for certain groups or geographies, such as the Access to Cash Review and Treasury Committee inquiry into access to financial services – both of which NoteMachine welcomed - they have failed to identify the real issues at play and provide genuine solutions.

The UK public has enjoyed free access to cash for the last decade. Almost all withdrawals in the UK are free at the point of use and the spread of cash machines outside of banks has increased consumer choice and accessibility. There are currently 50,000 free-to-use ATMs in the UK, and many of these are clustered in the same areas, such as towns, busy high streets, and retail centres.

Whilst the number of transactions has declined slightly, the number of withdrawals has gone up. With over 2.9 billion cash withdrawals across the UK in 2018, cash is still widespread and the primary payment method for large numbers of people. Many people still see an important role for cash in their lives, particularly when making smaller transactions, and over 50 per cent of consumers in the UK use their card at a cash machine every week.

Cash usage across the UK has been falling for the past ten years, with the percentage of payments by cash dropping from 63 per cent of all payments to 34 per cent. However, throughout this period the number of ATMs has risen substantially. In order to reduce the number of ATMs, particularly in urban areas, LINK made a decision to reduce the interchange fee by 15 per cent in three instalments from July 2018. The interchange fee is the cost paid to independent ATM operators by banks for each transaction.

The reduction in the interchange fee has affected the economic viability of free-to-use ATMs, particularly those in rural and isolated areas which experience less footfall. The first two reductions in the interchange fee, in July 2018 and January 2019 respectively, have placed unprecedented strain on ATM operators, causing many to convert their machines to a pay-to-use model.

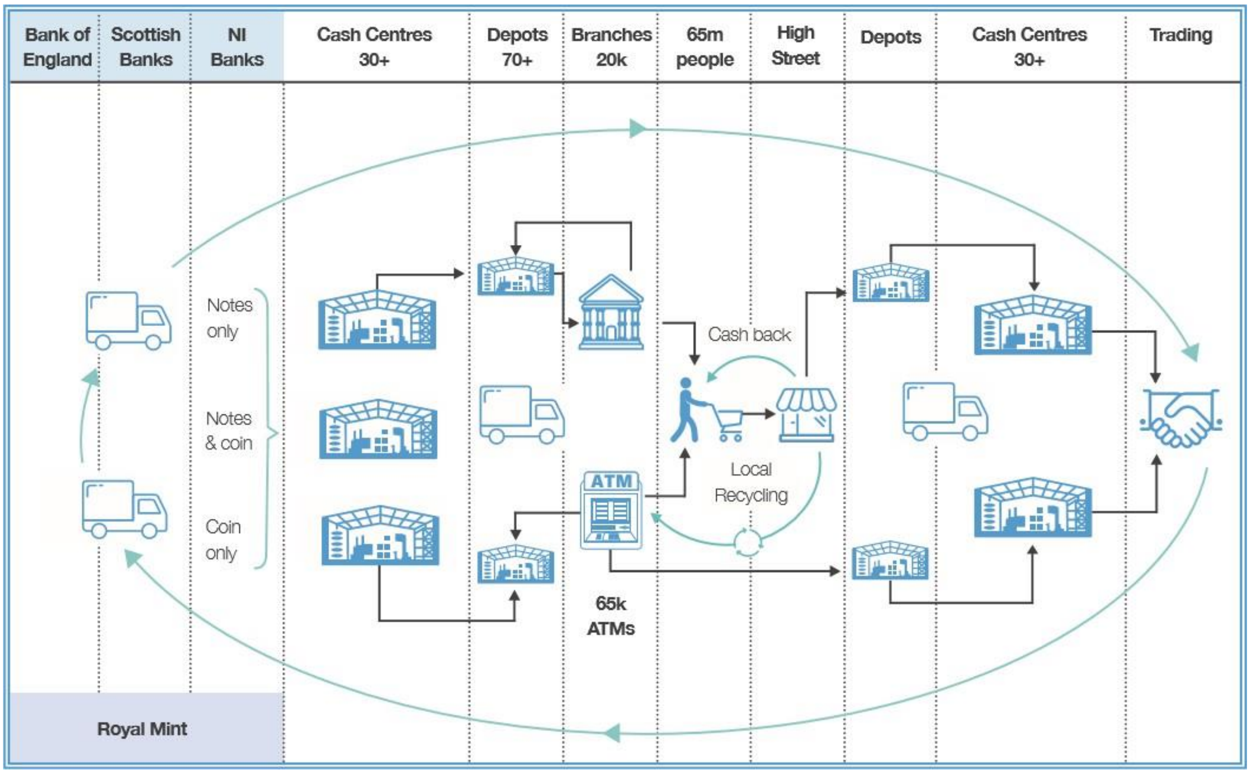
Since the reductions, there has also been a significant reduction in ATM numbers. From July 2018, there were circa 3,500 fewer ATMs in total (5.3 per cent) and circa 2,100 fewer free-to-use ATMs (4 per cent), an annual reduction of around ten per cent which positively corresponds with the 10 per cent reduction in the interchange fee.

As a result, the inefficiencies in the cash infrastructure system have become increasingly apparent as the cost of tracking and moving cash has become clear. This is why it is essential there is a wholesale reconfiguration of the UK's cash infrastructure.

The existing cash cycle

The current cash infrastructure involves 30 cash centres which receive their notes directly from central banks. Cash is then distributed via lorry to 70+ depots, and from there to 20,000 branches and the 65,000 ATMs. This cash is then used in the local economy, from where it is eventually deposited into banks and makes its way back to depots, and cash centres, before going back to central banks.

See the below diagram of how the existing cash cycle works:



This process is currently extremely costly and inefficient. Cash is often moved to areas where it is not needed, left in places where it needs to be removed, and moved piecemeal to areas which make it extremely expensive.

This is in part due to a lack of real-life data used throughout the process, meaning there is insufficient information informing the movement of cash across the UK.

The case for a more "utility approach" to cash

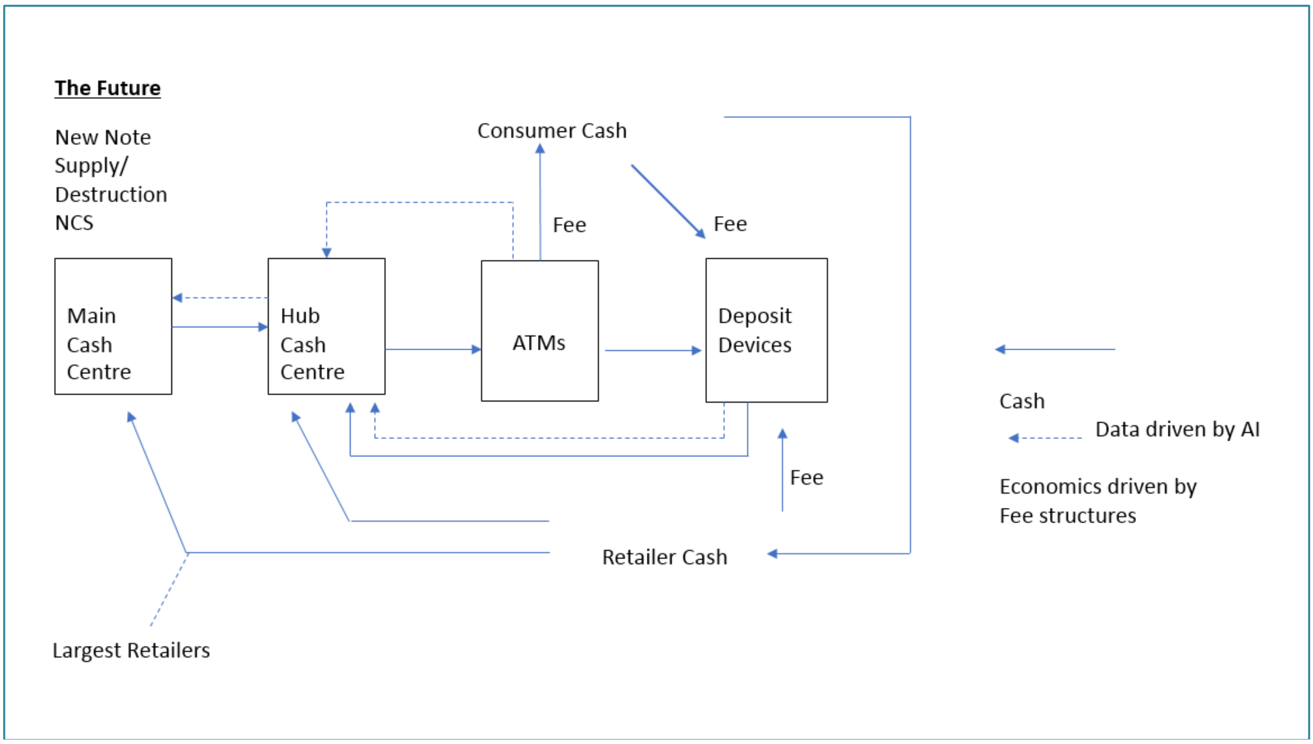
The current cash infrastructure does not account for demographic need and is too heavily weighted towards those areas where there is significant demand for cash. This does not reflect the needs of the population to have free access to cash, rather than those areas with the largest population.

Reform of this system is particularly urgent as large banks continue to close their local branches, which the current system heavily depends upon. A radical overhaul is needed to reduce large cash centre operations and introduce a cash input mechanism across the UK. This would be implemented via devices that enable retailers and businesses to deposit cash in real time into their accounts and receive same day value. This would help avoid retailers having to travel long distances to their local bank branch to deposit cash. It would also help reduce their costs further as the input fee would be set at a fairer price than bank's current fee for doing this.

A far greater real-time analysis of data from cash input and output within the system means AI can optimise the delivery and collection of cash on a real just-in-time basis. This would dramatically reduce the amount of physical cash needed to operate the system, lower costs and increase access for all.

NoteMachine's proposal aims to halve existing infrastructure costs, namely by reducing the need for cash centres and depots, with improved ability to respond quickly to changes in consumer demand in localities.

The below diagram illustrates NoteMachine's vision for a changed model of UK cash utility:



Fundamentally, NoteMachine proposes a more streamlined and cost-efficient infrastructure which, principally, would be driven by AI and data to identify where cash is most needed in certain localities. This would allow a level playing field for players of all sizes, not just the large banks, and ensure cash is recycled more quickly in localities.

Specifically, NoteMachine is calling on the JACS Group to consider the following three features as part of the future cash infrastructure:

1. *Reduction in cashcentres*

Unlike with the current cash infrastructure, NoteMachine proposes dramatically reducing the number of large cash centres from 30+ to 15, as well as their individual sizes. Similarly, the depots to which cash currently flows, should also be reduced from 70+ to 35.

After passing through consumers and retailers, often, the banknotes that businesses and banks receive in payment are returned to one of the Note Circulation Scheme (NCS) members, either directly or through a bank. This is because banknotes need to be stored securely or because banknotes don't earn interest, so retailers pay them into a bank where they can earn interest.

However, some retailers and businesses use banknotes received from customers to fill their own ATMs, for example. This is known as local recycling, whereby notes are not returned to an NCS member and authenticated, they are put straight back into the local cash ecosystem.

Hence, NoteMachine argues there isn't the need for the current number of large cash centres and depots. Through more local recycling, and an increase in input cash devices (see below), the cash ecosystem can be localised, streamlined and made more cost-efficient, ensuring cash is located where it is most needed.

2. *Input cashdevices*

As above, for local cash recycling to be increased, it is essential the number of input cash devices or ATMs that have deposit-taking capability is increased. Allowing businesses to pay in or deposit cash more easily and cost-efficiently means generating real-time credit is much easier.

However, these machines need to be rolled out on a much larger scale across every major retail centre in Britain. Only then can they start to replace the need for having costly cash centres that store cash ineffectually.

*3. **Better use of data / artificial intelligence***

To further enhance any future emphasis on local cash recycling, AI needs to be the key driver of this. And so, any reform to the current cash infrastructure must commit to continuously looking at device level activity, in turn, allowing things like rescheduling of deliveries and collections.

External data inputs from history and changing footfall, as well as local input (e.g. major sporting events, school holidays etc.), would add invaluable data to the overall AI engine which, ultimately, can help to better determine the movement of cash. Just-in-time delivery and real time credit input, though things like input cash devices, would dramatically improve cashflow and lower economic friction.

An economics driven by fair fee structures

Underpinning these three features, however, must be a sustainable economic and regulatory environment in which all market players can operate.

For this level playing field, all cash devices should have an input mechanism on an interchange basis. This interchange fee should be a universal multilateral one (MIF) on a free basis where card issuers pay.

This would still be applied to ATM surcharges that enable such machines to have lower transaction costs. This is so that the market can compete for transactions, creating greater free coverage through competition or retailers paying a contribution.

Next steps

In light of the above, NoteMachine is calling on the JACS Group to:

1. Consider its proposal for a utility approach to cash, including incorporating a reduction in large cash centres, an increase in input devices, better use of data and artificial intelligence, and an economics driven by fair fee structures.
2. Commission an independent economic study from a regulatory point of view looking at how value is distributed throughout the supply chain and addressing monopolistic behaviour from the banks and card providers.
3. Urgently reinstate the original KPMG cost-study mechanism that determined the LINK interchange fee to stabilise the market whilst a longer-term solution can be found.
4. Ensure the JACS Group has protecting the role of ATMs as the primary means of accessing cash as a core objective of its work programme.

NoteMachine is looking forward to continuing its work with government and the regulators to ensure fee access to cash for the UK's most vulnerable can be maintained.

NOTEMACHINE GROUP

ATMIA Industry Seminar, London
June 2019

[redacted]

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Interchange and Interoperability: Introduction

- UK Interchange
- Direct Charging
- NFC at the ATM: Keeping the channel relevant
- Intelligent Deposit
- Pooling or Utility?

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Interchange and Interoperability: UK Interchange

- Price cuts imposed on Acquirers by Issuers; notionally 10%
- NoteMachine regards these cuts as arbitrary and anti-competitive
- When does it stop?
- Established mechanism since 2001 OFT ruling
- However the formal Cost Study still takes place – linkage is broken
- Industry has changed!
- Efficiencies have been realised but cupboard now bare
- Inflationary pressures, regulatory burden, obsolescence costs etc
- Every action has a reaction....

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Interchange and Interoperability: Direct Charging

- Percentage of PTU transactions had fallen for years
- NM and others built infrastructures to deliver efficient FTU deployment
- PTU increasing sharply as machines are being switched
- Choice of uplift or charging
- Clearly not what the Access to Cash review envisaged
- Stark choices must be made absent a robust interchange methodology
- Why is a small top-up plus Interchange not an option?
- Visa about-turn on Direct Charging inexplicable
- Regulators must level the playing field across Schemes in UK

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Interchange and Interoperability: NFC at ATMs – keeping the channel relevant

- LINK initiative failed because Mastercard and Visa wouldn't permit use of their chip applications
- Introducing a new LINK application to the issued card base expensive and largely impracticable
- So only possible on an on-us basis
- Unaware of any international Scheme rules in existence or planning to enable interoperability
- Not in their interests?
- Another matter that regulators should be interested in

Interchange and Interoperability: Intelligent Deposit

- Technology well established
- Defined LINK transaction and mandatory on Issuers to accept
- So why is this not happening considering branch closures?
- No substantive agreement on interchange
- Deployment and operating costs substantial and must provide ROI
- Seems like an obvious area for FIs and the independents to collaborate
- Could aid closure programmes without consumer detriment
- “Bank in a Box” could easily be a reality

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Interchange and Interoperability: Pooling or Utility?

- Pooling initiatives in Northern Europe
- UK would be better served by a utility approach
- Independent operators provide the off-branch ATM network
- Regulator-based pricing, costs + ROI element
- Would give certainty to the industry
- Cross-scheme interchange critical to prevent gaming

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5 July 2019

Dear Sirs,

Response to Consultation – Call for views LINK Interchange Fee structure – June 2019

ABOUT PAYPOINT

PayPoint is a LINK IAD managing c 4000 ATMs. We operate both free-to-use and surcharge machines. Our specialism is in convenience stores, and as a consequence our machines tend to be lower volume than the large IADs and banks, with many placed where other operators would be reluctant to operate.

PayPoint has a pivotal role in the cash economy, working through 28,000 outlets in every part of the UK to provide convenient bill payments every day of the year, from early-to-late. I am a founder of PayPoint and a member representative on the LINK Consumer Council.

The views that follow consist of a combination of PayPoint's and my personal observations having been in the ATM industry for 31 years. I have opted for an informal structure rather than to answer your questions directly and would welcome the opportunity to engage with the PSR as you move from research into action.

PayPoint Plc No 3581541
PayPoint Network Limited No 2973115
PayPoint Collections Limited No 3581551
PayPoint Retail Solutions Limited No 4476269
PayPoint Payment Services Limited No 08633289

All registered in England office as above

PayPoint

PayPoint welcomes the PSR's interest in LINK ATM interchange, which has become a problem since January 2018 and in the run up to this time, when the previous cost based study, which had been so successful for so long, was unfairly amended to benefit big card issuers and penalise acquirers.

It is unfortunate that the PSR was not given the opportunity to consider LINK interchange before the damaging cuts were made. Whilst the structure is important, the damage caused by fee levels which are too low is self-evident. We believe the current problems have been caused primarily by reducing interchange below cost study rates. Inevitably, the unwarranted 10% reduction in interchange fees (and threat of more to come), combined with falling volumes, devastates the business plans of acquirers and requires action that has the unfortunate consequence of reducing supply to the detriment of consumers.

Under the old cost study, which we acknowledge had its imperfections, as all potential structures will inevitably have, LINK had enjoyed unprecedented success delivering the extraordinarily positive results as specified in your paragraph 1.16. After the intervention to arbitrarily reduce fees by 10%, the unwanted results in paragraph 1.18 have inevitably followed.

PayPoint sympathises with the LINK Board's predicament in deciding to cut interchange, as its survival was being threatened by some big issuers threatening to defect to Visa. There is a parallel to the debit card industry in which the Switch/Mastercard scheme was effectively wiped out by Visa debit interchange rates that favoured big issuers over merchants. As the power in any scheme sits with the issuers, and the other parties are effectively recipients of scheme decisions, the threat to LINK was real and the collapse of LINK would have had far worse consequences for consumers and ATM acquirers, than cutting interchange. We regard this as an emergency response on the part of LINK, but that does not make the decision fair or economically reasonable. Ironically, the strength of LINK and efficiency of IADs has allowed big issuers to reduce their own ATM networks and close branches to make massive savings, but whilst taking these, some large issuers still moved to attack the costs of ATM provision.

The reality is that ATM growth had naturally tracked consumer activity. Volumes in LINK had continued to grow as consumers enjoyed its convenience, and especially as banks discontinued high volume machines as they closed branches, displacing volume into the off branch IAD served sectors. Fair fee levels and the lack of customer appetite to pay for cash withdrawals contributed to free-to-use machines all but eclipsing the surcharge machines. There was no need to move from the fairly determined cost study rates, other than the threat of issuer defection.

Inevitably, as in any market, there was a short lag between action and consequences. Just as increasing ATM numbers had served growing demand, when volumes started to fall and the trend started to look consistent, it was inevitable that the supply side of the industry would need to respond to falling demand. This could have been a much steadier adjustment in line with small changes in demand, without the double impact of interchange cuts which increased a c10% volume fall-off into a 20% revenue drop in just one year. The reinstatement of the original cost-based model is urgently needed, together with issuer commitment to LINK, to help to rebalance some of the more recent damage, and we strongly recommend this does not wait for the conclusion of a lengthy consultation.

In terms of structure, the PSR's assessment is broadly accurate but there are practical implications that have not been highlighted. The best measure of value is usage. Consumers adapt behaviour according to their available options. There must be some volume test of the viability of a machine to avoid absurdity. In extremis, an ATM may be exceptionally valued by the one person using it, but does this outweigh the benefit of thousands of users choosing a machine because it is marginally more convenient than others nearby?

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A good analogy here is food. A person in a city environment will have a myriad of lunch choices and those living or working away from an urbanisation or city centre far fewer, or none at all, unless they have planned ahead and bought provisions in to make their own. Why should cash be different? There is a risk that simplistic coverage rules set hurdles for ATM coverage that exceed those generally available for life's essentials.

It must also be the case that perceptions of value vary dramatically depending on urgency. A rural ATM user may have been nearly as happy to pick up cash when next in town. On the other hand, a distressed person in town needing cash for a taxi home late at night, or a rural user without transport, may be extremely grateful for a machine a few yards away.

Consumer adaptation to circumstances also explains why paid-for withdrawals always account for such a small proportion of overall withdrawals. People generally adjust their behaviour to avoid paying fees.

It follows that what is needed is a safety-net to provide sensible free-to-use coverage where needed and possible. In this respect, subject to a fair underlying interchange rate, LINK's premiums for low volumes, financial inclusion and protected ATMs are sensible and helpful, but they are not always sufficient. Politicians, regulators and/or trusted organisations, such as LINK, should determine what the safety-net should be and how it is funded. It may alternatively be a consumer safety-net that is needed to look after those who cannot cope with adapting behaviour, so that vulnerable consumers get a free service at otherwise paid-for machines.

At the other end of the spectrum, there is no real problem if busy areas attract more free machines. The market will determine whether this is sustainable and theoretically, if volumes are pushed by perfect competition towards averages and break-even, then a fall in volume will lead to an equivalent fall in ATM numbers in these well served areas, with minimal consumer impact. This has contributed to some of the ATM closures that have been seen recently, particularly where a renewal gives a supplier a break opportunity. In contrast, the conversion of free-to-use to fee-paying is being caused by the interchange cuts which leave operators with unviable machines mid-term and the need to take urgent action.

This structural element of sunk cost (not just fixed cost) is not mentioned in the call for views. Once a machine has been purchased and installed it is costly to move, and the availability of alternative sites is limited, given saturation and falling demand. The supplier may be stuck with a dead asset unless an alternative business model can be put in place (such as introducing a surcharge).

The suggestion that interchange could be restructured to include fixed fees and (lower) variable fees is logical in that it mirrors the machine's cost structure, but has the effect of creating new winners and losers. It could be severely damaging to suppliers with high average volumes and threaten their viability even more than an average transaction cost approach.

The PSR starts this call for views expressing concern for cash access and follows this by stating an objective to broadly maintain free-to-use ATM coverage. This appears to make ATMs synonymous with cash, rather than identifying their real status as an important, but only one of several, means of delivering cash to consumers. In practice, ATMs are expensive to locate and operate, and other methods, such as retailers paying cash out over-the-counter from the money in their tills, could be far more sustainable as volumes fall and to allow coverage where an ATM cannot be cost-justified.

LINK and PayPoint have been working to advocate such an over-the-counter capability since the interchange crisis developed but it has been slow-going. A trial has been ready for 12 months, but is unable to start, owing to delays

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gaining clearance from the FCA. It is unclear to PayPoint why this approach is not being given more regulatory urgency. Given that most high street merchants and corner stores handle cash, it is an obvious solution and indeed, it is a service already provided by the Post Office. The PSR states a further objective of promoting investment and innovation. The LINK counter service would be an exemplar of this and PayPoint is frustrated at the continual delays, not least because it is consumers who will suffer if alternatives to ATMs are not supported.

We hope that this commentary is helpful to you. In summary;

1. The long-standing LINK cost study approach was particularly successful and is as good a structural approach to interchange as any. The mistake was to move away from this. We believe it should be reinstated.

2. Machine numbers will fall as volumes reduce and in busier urban environments, where there will still be machines, this is natural and does not cause undue consumer distress.

3. Lower volume rural areas will be at risk of machines becoming unviable and a safety-net approach is needed. This should cover exceptions rather than the general ATM interchange policy.

4. ATMs themselves can be expensive and this is part of the problem. There is an urgent need to innovate to establish lower cost and more sustainable over-the-counter retail alternatives and to create a regulatory environment where these are encouraged. This would maximise the opportunity for all areas to have continuing free access to cash.

[redacted]

RBS

PSR Review of the Structure of LINK Interchange Fees: Call for Views

The Royal Bank of Scotland (RBS) welcomes the opportunity to respond to this Call for Views. Within this response you will find the RBS position in relation to ensuring continued payment choice and access to cash for consumers. The response also includes RBS's views in relation to the specific LINK interchange questions posed by the PSR but in so doing, RBS wish to emphasise that ATMs are only one means by which customers access cash in the UK. RBS would caution against looking at LINK interchange fees in isolation from such other channels given the wider debate on Access to Cash.

1. We agree with the PSR review's policy objectives, but think its considerations should be broader than LINK interchange

RBS strongly supports the PSR's objective to ensure continued payment choice for UK consumers, including their sustained access to cash in an increasingly digital market.

We believe all banks have a societal responsibility to provide appropriate free cash-access (herein referred to as 'access') to consumers who both need or want to use it. We also believe that ATMs, though an important consumer channel, cannot be solely relied upon to provide this access.

Consequently, we do not believe that a review of the LINK interchange structure and ATM deployer incentivisation alone can ensure well distributed, geographic and socioeconomic access to cash in the long term.

Instead, we believe that free access needs to be considered and reviewed more broadly. We think the objective of this broader review should be to ensure that fair, sustainable and multichannel[1] cash-access can be provided to consumers at the most efficient cost. We do not think a review which looks only to sustain the current level of ATM coverage, through iterations of the interchange structure or its incentives, will meet the overall policy objectives the PSR have set out.

Achieving this broader cash coverage objective requires close collaboration between independent bodies, cash supply chain members, banks and regulators. RBS already plays an active role in this work and maintains a close dialogue with LINK, the Post Office and regulators on the topic of access to cash issues. We also chair the recently established UK Finance 'Access to Cash' (A2C) Steering Group[2].

2. We agree there is a growing imbalance in ATM coverage as location strategy becomes more commercially driven

Compared to similar countries, the UK has a high number of cash access points provided by ATMs, the Post Office and bank branches[3]. In fact, from 2008 up until 2017, the number of free-to-use ATMs steadily grew, peaking at ~53k despite a drop in cash usage of 50% over the same period. Despite this growth, there is a problem with the geographic and socioeconomic coverage of these devices, which is becoming increasingly inconsistent and unevenly distributed.

Currently, ATM deployers drive the location strategy and can choose where they install free-to-use devices – a factor we believe is contributing to the growing coverage problem.

1. Includes diverse cash access points, ranging from ATMs and Post Offices, to bank branches and retailers.
2. The A2C Steering Group's members include key industry players and major banks. The group is chaired by RBS Chief of Staff, Helen Grimshaw.
3. The UK has a comparatively high number of ATMs per person compared to other developed economies. Currently, 99.7% of homes are within 3 miles of a Post Office.

As observed by the PSR, deployers are generally concentrating ATMs in urban centres and we agree that the reason for this oversupply is predominantly a commercial one; deployers receive more economic benefit from installing additional ATMs here (where usage is high and costs are proportionately lower), than consumers receive in improved access.

Conversely, rural areas tend to have fewer ATMs; their comparatively low usage and high service costs make them commercially less attractive to deployers than their urban counterparts. Despite their consumer and societal value, deployers are increasingly exiting or converting these low usage ATMs to pay-to-use without recourse, leading to an undersupply of free access.

As a result of this deployer-driven, commercially-led location strategy, consumers in both over and undersupplied areas are not receiving a level of ATM coverage, or free access, aligned to their cash needs.

Levels of this current imbalance are negligible, but we recognise that – unless changes are made to the ATM coverage model – the issue could worsen and negatively impact more members of society.

3. We also agree that there are growing coverage ‘gaps’ across the UK

There are currently a small number of areas where there is both an undersupply of ATMs and few/no other access points (such as Post Offices and bank branches). Consumers here are either unable to use cash, or must increase their reliance on a neighbouring areas’ access points. The former threatens consumers’ payment choice and the latter places additional strain on remaining cash channels, leading to a coverage dependency risk.

These coverage gaps can exist where access points have been removed (for example, where deployers have exited low usage ATMs or banks have closed branches in response to changing consumer demand), or where there has never been any cash access provided.

If the undersupply issue outlined in section 2 worsens, there is a chance that the number of coverage gaps will also increase.

4. There are three root causes behind these growing coverage issues:

4.1. Deployer driven location strategy:
Currently, the ATM location strategy is not owned/guaranteed by a single body – there is no defined blueprint or set of agreed parameters defining what efficient and appropriate ATM coverage looks like in the UK. Even if there was, there is no enforceable legislation or guarantee (against either banks or IAD deployers) to ensure this coverage is provided.

As explained in section 2, location strategy and coverage are instead being driven by the commercial objectives of individual deployers, rather than by the access needs of consumers.

4.2. Different levels of consumer obligation:
It is important to note that the three key players involved in ATM provision (i.e. LINK, banks and IADs) all have different stakeholders and obligations:

- LINK's primary obligation is to provide society with both appropriate and efficient access to cash.
- Banks willingly share this societal obligation, which they meet and fund as *both* ATM deployers and card issuers; last year, in their capacity as card issuers, banks collectively paid ~£900m in interchange to cover the cost of access. It is important to remember that banks also have a duty to their own customers, shareholders and regulators. To meet all four obligations[5], banks aim to provide appropriate, cost-efficient ATM coverage, as well as free current accounts to consumers.
- Finally IADs (who play a crucial role in the provision of free access, as they own the majority of Britain's ATMs) carry comparatively less societal obligation and regulation to that of banks. As non card issuers, IADs do not pay interchange – further allowing them to focus on maximising value from their devices and protecting their shareholders' commercial interests.

We therefore have a situation where the obligations of those providing the majority of ATMs (i.e. the IADs) are at odds with the obligations of those a) funding free access (i.e. the card issuing banks) and b) setting interchange and trying to protect coverage (i.e. LINK) – effectively, deployers' commitment to providing free access to cash are unequal.

4.3. Interchange incentivisation alone is not the optimum mechanism through which to address coverage:
Much like a public tax is intended to pay for the NHS and public access to healthcare, interchange fees were intended as a bank 'tax' to cover the cost of another fundamental societal need i.e. access to cash and financial inclusion. Interchange was not originally meant to influence ATM supply or location strategy.

When deployer coverage met consumer needs, this interchange 'tax' served its purpose effectively – in economic terms, ATM deployer supply matched ATM consumer demand and the unit cost of cash access (i.e. interchange) sustained this equilibrium.

However, as deployers have become more commercially driven (and the abovementioned coverage issues have arisen), LINK has begun using interchange as a way of indirectly influencing ATM supply and coverage. They have implemented incentivisation measures, including Financial Inclusion premiums and interchange reductions, to leverage market forces and make certain areas more/less commercially appealing to deployers. In spite of these measures, deployers are continuing to serve areas of (profitable) oversupply and exit areas of (unprofitable) undersupply.

Whilst this move away from interchange as a 'tax', towards interchange as an incentive has the right intentions, we believe it will remain an inefficient means of addressing coverage issues, as long as ATM location strategy remains uncontrolled/commercially driven.

5. Our recommendations of how we think the LINK scheme could further influence and improve ATM coverage

As outlined in section 1, we think that sustained and appropriate access to cash requires a more holistic review of coverage, across multiple channels and access points.

As discussed in section 4.3, we also think that interchange incentivisation alone is not the optimum means of addressing the current ATM coverage issues.

That said, until a solution to issue 4.1 is agreed, we agree with the PSR that the current interchange scheme *'could deliver better (ATM) coverage at the same overall cost, or at a lower cost.'*

We believe the following improvements to the interchange structure would support this objective:

5.1. Introduce a general set of design principles to LINK interchange:
We think the following principles would support LINK's coverage objectives and improve the effectiveness of incentivisation on deployer location strategy

5.1.1. Interchange fees and incentivisation should be simple and transparent:

Removing unnecessary complexity from interchange would make its incentivisations less convoluted and allow LINK to address coverage imbalances more directly. A simpler structure would also be easier for LINK to administer and implement.

Improved transparency around interchange (and so LINK's desired location strategy) would de-risk coverage from a deployer perspective; it would reduce the uncertainty in an ATMs' business case and could make deployers more willing to install devices in undersupplied areas.

We think these principles should be consistently applied *across* cash (e.g. to the Post Office Banking Framework fees), to ensure channel coverage is consumer driven and demand-led, rather than commercially decided.

5.1.2. Interchange fees should directly align to consumer cash needs:

As ancillary, non-cash ATM services tend to have many established alternatives (e.g. account transfers, balance enquiries etc.) they add limited access value to consumers.

Entirely removing the cost of these services from interchange – or at least significantly decreasing them and being transparent about how they are charged – would mean card issuers are only funding cash access (as originally intended by interchange). This would improve the cost efficiency of the LINK scheme, and in turn improve the sustainability of ATM coverage.

5.1.3. Interchange incentivisation must contribute towards flexible coverage:

As cash usage continues to decline in the UK, it is important that the end-to-end cash system (including its access, acceptance and handling) downscales accordingly, allowing it to remain cost-efficient and able to sustainably serve residual demand.

Part of this downscale should include a right-sizing of the ATM footprint. As such, it is important that interchange incentivises deployers to adopt a flexible, medium-term coverage model, rather than a rigid, long-term one.

5.2. Continue to set interchange to address oversupply, but manage narrative:

We believe oversupply is as problematic as undersupply, as it detracts from the service of the latter. We think this oversupply can effectively be addressed by interchange. For example, a further reduction of fees on non-protected ATMs could promote a market driven rationalisation of oversupplied areas: 'excess' ATMs (i.e. those devices over the sufficient number required to meet falling customer demand) would be gradually exited/converted to pay-to-use in these localities, as their commercial attractiveness continues to decrease.

5. i.e. cash-access, customer service, shareholder value and regulatory compliance.

However, we think the narrative around this type of market driven, incentivised rationalisation needs to be better articulated – the public need to be made aware that oversupplied areas exist, and that they detract from the coverage and commissioning of ATMs in underserved areas/gaps.

5.3. Continue to review protected ATM interchange to address undersupply, but set parameters:

We believe the current Financial Inclusion programme and its incentives should be built upon, but include reasonable commercial parameters going forward. I.e. there should continue to be tiered – but not infinite – premiums placed on protected ATMs.

We feel this will ensure competitive deployer coverage in undersupplied areas continues, but not at an unreasonable cost.

We also think that premiums should be reviewed to account for increased deployment costs in certain areas, but not at the expense of the structure becoming overly complex/zone-specific (see design principle 5.1.1 Re. simplicity).

5.4. Regularly monitor area coverage and adjust interchange/protection accordingly:

If interchange and market forces are to continue being used as mechanisms for influencing deployer location strategy and improving coverage, it is important that their potentially counterproductive impacts are mitigated going forward.

I.e. LINK must ensure that interchange premiums do not lead to a swapping of under/over supply in the long term, as certain areas become more/less profitable to deployers respectively.

To protect against this perpetuation of coverage imbalance, we believe it is necessary to regularly review an area's access points against consumers' changing needs, adjusting its level of protection and interchange where necessary and accordingly (see design principle 5.1.3 Re. flexibility).

Non-interchange/market intervention recommendations

5.5. Enhance the process for requesting cash access:

Interchange incentivisation only directly affects existing ATMs and so would only improve existing coverage/the issues outlined in section 2.

To address the coverage gaps (outlined in section 3), UK Finance are working in partnership with LINK to explore the feasibility of a new commissioning mechanism. Through it, members of the public could submit a request to an independent body, who would then assess the current level of access against a set of parameters[6] and determine what access point (be it provision of an ATM or alternative channel at a shared and reasonable industry cost) should be commissioned..

5.6. Guarantee protected ATMs:

We believe there should be additional ways of underpinning and guaranteeing protected ATMs in the event that interchange incentivisation and market measures fail. For example, we feel it would be a real community benefit if there were a minimum notice period during which other deployers have the option to bid for an exited site i.e. a pre-emptive version of Direct Commissioning (which currently intervenes 2 months after market incentivisation has failed to re-establish protected access).

Failing this, we think impacted stakeholders should be encouraged (including by regulators) to collaboratively look at creative ways to sustain the protected ATM – or replace it with a suitable alternative channel – to the extent it can be done at a reasonable shared cost (see recommendation 5.3 Re. commercial parameters).

5.7. Explore additional ways of rationalising areas of oversupply:

We believe there is real merit, for both consumers and regulators, in encouraging banks to develop a way of collaborating to review any oversupply in their estates. One way to rationalise any oversupply and manage

6. Parameter questions might include asking: Where are retailers most concentrated in the area? Where is the nearest free access point? What are the consumer demographics? What are the business cases for each type of access point? Etc.

the costs of operating their remote ATMs, would be to set up a shared, white-label service (as per the Netherlands model). This bank collaboration could incentivise more competitive coverage with IADs, especially in undersupplied/protected areas.

5.7. Better align deployers' consumer obligations:

We think consideration should be given as to how the consumer obligations of all deployers – namely those who commercially benefit from the LINK scheme – are better aligned to ensure there is shared accountability (financial or otherwise) in addressing underserved areas for consumers.

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Our response to the four specific PSR Review questions posed in the Call for Views:

Please note that the following responses make reference to our views already outlined on pages 1-6.

1. Do you agree with the description and framework (including the objectives) for considering the costs of providing ATMs and the value they provide? If not, please explain why and set out your view of the alternative way these issues should be analysed.

Please see section 1 of our response for detail:

- We strongly agree with the PSR's objective and its alignment to the broader A2C agenda set out by UK Finance and the A2C Steering group i.e. we agree that there should be continued choice for UK consumers about how they make payments, including through their geographically and socio-economically widespread access to cash.
- We agree with the customer value framework outlined in this section, but feel it is too narrowly focused on ATMs as a channel for free cash-access. Other access points and channels (such as Post Offices, bank branches and local retailers with cash-back) should also be considered, as their use influences how much reliance and value an individual/area may place on an ATM.
- We agree with the cost framework set out in section 2 of the PSR's call, but think that ATM deployer margins earned over and above these costs should also be explicitly considered.
- We agree with the PSR observations that there is good, but imbalanced free access to cash coverage, evidenced by growing areas of over and under ATM supply, as well as total coverage gaps.
- We also agree that this ATM coverage issue has resulted from a predominantly deployer-driven, commercially-led ATM location strategy. However, we think there three root courses that sit behind this which should be considered (please see section 4 for detail), namely:
    - Deployer-driven location strategy
    - Differing levels of consumer obligation amongst ATM market players/deployers
    - Interchange incentivisation not being the optimum mechanism through which to directly address ATM coverage

2. Are there any other factors we should take into account when analysing the incentives to provide ATMs?

- When deciding which areas require incentivisation/additional ATM coverage, the availability of alternative free cash-access points (e.g. Post Offices) should also be considered.
- Similarly, when identifying areas for incentivisation/additional ATM coverage, changing local consumer preference and payment profiles should be examined. For example, does the area prefer face-to-face cash transactions or self-service devices?
- When considering more effective incentivisation going forward, we believe that the existing Financial Inclusion and Direct Commissioning programmes should enhanced and their impacts considered in detail.

3. What incentives and impacts do the existing LINK interchange fee arrangements as described in the PSR paper (including in Annex 2) have?

Please see sections 2-4 of our response for detail:

- In part, the existing interchange arrangements – and more specifically the deployer location strategy that they look to incentivise – have begun to have a negative impact on ATM coverage and its sustainability.
- As cash use has fallen, the commercial viability of ATMs is no longer evenly spread across the UK. Consequently, deployers have created (and may continue to create if the root causes in section 4 are not addressed) an oversupply of ATMs in profitable/urban centres, and an undersupply of ATMs in comparatively more costly/rural areas.
- The existing Financial Inclusion and Direct Commissioning programmes are trying to address these coverage issues and are having some success (the proportion of free-to-use ATMs increased in 2018).
- Similarly, the recent interchange reductions applying to non-protected ATMs have gradually begun to rationalise areas of oversupply.
- That said, we believe these interchange incentivisation measures will remain an inefficient means of addressing coverage issues, as long as location strategy remains uncontrolled/commercially-driven.
- Additionally, a potentially counterproductive impact of the Financial Inclusion programme in particular, is that its interchange premiums could lead to a long term ‘swapping’ of ATM under/over supply, as certain areas become more/less profitable to deployers depending on their associated levels of protection.

4. What structure of interchange fees would have appropriate incentive effects going forward?

For our views on suggested changes to the interchange fee structure, please see section 5 or our response.

Scottish Grocers' Federation (SGF)

[redacted]

Sent by e-mail

03 July 2019

Dear sir/ madam

REVIEW OF THE STRUCTURE OF THE LINK INTERCHANGE FEES: CALL FOR VIEWS

The Scottish Grocers' Federation (SGF) is a trade association for the Scottish Convenience store sector. There are 4,962 convenience stores in Scotland, which includes all the major symbol groups, co-ops and convenience multiples in Scotland. SGF promotes responsible community retailing and works with key stakeholders to encourage a greater understanding of the contribution convenience retailers make to Scotland's communities. In total, convenience stores provide over 40,000 jobs in Scotland.[1]

Over the last year, the UK convenience sector contributed over £8.8bn in GVA and over £3.6bn in taxes. The sector is more relevant than ever to every type of customer and has key social benefits and is of key economic value to the economy.

Convenience stores trade across all locations in Scotland, providing a core grocery offer and expanding range of services in response to changing consumer demands close to where people live. The valued services provided by local shops include mobile phone top-up (83%), bill payment services (63%), cashback (59%), and branches of the Post Office network (25%)[2].

The provision of ATMs is a key service provided by local shops for consumers to access their cash to spend on local high streets and shopping parades. Consumers have an expectation that they will be able to access their cash free of charge apart from in very isolated or inconvenient locations.

Our Scottish Local Shop Report 2018 highlighted that 62%of local shops provide ATMs for local people, with 50% hosting a free-to-use (FTU) ATM and 12% having a fee charging ATM. In addition it indicates that 76% of convenience store customers pay by cash as the total value of cash spending has remained relatively stable.

[1] Scottish Local Shop Report 2018
[2] Scottish Local Shop Report 2018

SGF welcomes the opportunity to contribute to the consultation exercise and have responded to questions 1, 2 and 3 below:

Question 1 – Do you agree with the description and framework (including the objectives we set out) for considering the costs of providing ATMs and the value they provide that are set out in this paper? If not, please explain why and set out your view of the alternative way these issues should be analysed.

SGF recognise the importance and significance of supporting cash access and protecting the current spread of free-to-use ATMs, while also improving the access to cash more generally. We are happy to engage with PSR in this process.

We believe that ATMs should be viewed as 'high street enablers' by providing consumers access to their cash and facilitating economic spend on local high streets and shopping parades. They are a valued and essential part of the cash architecture and are offered as part of a range of financial services provided by Scottish convenience stores.

Question 2 – Are there any other factors we should take into account when analysing the incentives to provide ATMs?

In the Scottish convenience sector 76% of customers pay by cash and we expect this will remain the primary payment method. The average spend is £6.50 per customer visit[3] and so using cash is a convenient way to pay for shopper missions. If c-stores are forced to relinquish their ATMs due to them not being financially viable this will present a problem for local communities particularly those in rural areas. This also raises the issue as to whether mobile banking services would be a sufficient replacement.

Modern local convenience stores are community assets, from providing busy families with a top up shop facility on the one hand, to allowing patrons (particularly the elderly) with an alternative to larger or out of town supermarkets. Many people rely on their local convenience store with the average shopper visiting their local store 3.4 times per week[4] and with 56%[5] of customers choosing to walk as a mode of travel to stores. Therefore a convenience store being able to provide customers with access to an ATM is an important part of the range of services and benefits which they offer customers and the communities they serve.

Question 3 – What incentives and impacts do the existing LINK interchange fee arrangements as described in this paper (including in Annex 2) have?

The LINK interchange fees reductions in both July 2018 and January 2019 have led to retailers being approached by their ATM providers to renegotiate their ATM contracts. This can result in reduced or no

[3] Scottish Local Shop Report 2018
[4] The Scottish Local Shop Report 2017
[5] The Scottish Local Shop Report 2017

commission for retailers. This situation is not helped by there being in effect a duopoly ATM provider market. Hosting an ATM can also incur opportunity costs for the retailer and the money received for doing so could be viewed in certain cases as inadequate in return for what the retailer has to put out. Some of our members are of the view that ATM costs and the implications of ATM interchange fee cuts requires everyone needs to share the loss e.g. ATM providers were seen by some as protecting their own bottom lines with the costs being passed down the line.

ATMs in local shops have become increasingly valuable due to the bank branch closures, but convenience retailers must consider the commercial viability of the service. In coming to any decision however convenience stores will have to take into account that having an ATM on site is a footfall driver, increases customer spend and provides an essential service for customers.

The Financial Inclusion Programme has failed to guarantee nationwide free access to cash for consumers. LINK has identified 2,651 deprived areas in the UK that are eligible for a free-to-use ATM subsidy, but 824 (31%) of these do not have free access to cash within a kilometre radius, 10 years after the introduction of the Programme[6]. Extending the Inclusion Programme will therefore not guarantee free access to cash for all UK consumers.

Also the Access to Cash Final Report[7] highlighted the trend of 'cash deserts'. It stated that ATM usage is falling by 6% a year and that FTU ATMs that do not see much use – for example in rural and remote areas – could be closed by commercial operators (e.g. the per transaction fees don't cover their marginal cost). There is also concern amongst some of our members that if an ATM provider decides there is an overprovision of ATMs in a location that this might result in retailers losing their ATM altogether with no right of reply.

We trust that you will find our comments helpful and are happy to engage further with you on this important matter.

Yours sincerely

[redacted]

[6] LINK Financial Inclusion Programme: 10 Year Anniversary p.4
[7] Access to Cash Final Report – March 2019

TSB

TSB Ltd Public Response to:

PSR Review of the structure of LINK interchange fees: Call for views (June 2019 – CP 19/5)

July 2019

TSB Response

- TSB recognises the important role that ATMs and cash play in meeting customer needs and providing choice over other payment types in communities across Britain. TSB has a network of over 770 free-to-use ATMS, all of which are attached to branches and are open 24 hours per day, seven days a week. TSB's network represents 1.6% of the estimated 50,000 free to use ATMS in the UK. TSB does not currently operate a remote estate (non-branch locations).
- When TSB launched as a standalone bank in 2013 we adopted a number of ATMs already attached to the branch network within England, Scotland and Wales. TSB made a significant investment In 2014 where we installed a further 80 ATMs into former Cheltenham & Gloucester branches which previously did not have any ATM devices.
  Since 2013, TSB has only ever removed an ATM where it was no longer economically viable to sustain the branch.

- ***[TSB CONFIDENTIAL FINANCIAL DETAILS REDACTED]*** Providing TSB customers access to the ATM network across the whole of Britain is a significant cost to TSB, but we recognise its importance and value to our customers. ***[TSB CONFIDENTIAL FINANCIAL DETAILS REDACTED]***
- It is however important that the structure of interchange fees is not considered in isolation, and is considered alongside other factors, for example the cost of wholesale cash distribution, where significant cost savings could be made through common relationships, or business rates, where reductions or exemptions would create different incentives. TSB would also like to see the industry seek to collaboratively identify ideas & suggestions to keep ATMs sustainable and available for customers long term ***[TSB CONFIDENTIAL DETAILS REDACTED]***

UK Finance

PSR CP19/5: Considering the Incentives to Deploy Free-To-Use ATMs in the LINK Network

UK Finance Response

Date: 05 July 2019

[redacted]

[redacted]

UK Finance is the collective voice for the banking and finance industry. Representing more than 250 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

We welcome the opportunity to input on the structuring of the LINK ATM interchange fees and appreciate the consideration that the Payment Systems Regulator (PSR) is paying, through this consultation, to the current concern regarding the wider public desire to maintain low-cost and effective access to cash to consumers.

This consultation takes place at a time when there is wider consideration of what reforms may be necessary in order to secure reasonable access to cash for those who continue to use it in a cost-effective way. We are supporting several pieces of work designed to help address this concern and, in our statement of 12 June 2019,[1] committed to working with the recently established Joint Authorities Cash Strategy Group (JACS).[2] We said more detailed work is required to understand the future cash needs of local communities, in particular remote rural and urban deprived communities, and to design a system which addresses how their needs can best be served quickly and efficiently should an access problem emerge. We are also working with the Bank of England's Wholesale Distribution Steering Group (WDSG) on how to develop a new end state model for wholesale cash distribution.[3]

Over the summer we will engage with consumer and local authority representatives alongside market participants, including LINK and its members, to:

- map the range of channels through which consumers can access cash (e.g. bank and building society networks, Post Offices, ATMs, merchant cashback);
- consider the potential of a number of industry pilots already underway to deliver new options for cash provision;
- develop an approach for how industry could work with local authorities to help communities to identify and report gaps in cash provision;

[1] https://www.ukfinance.org.uk/press/press-releases/uk-banking-and-finance-industry-commits-support-local-communities-free-access-cash
[2] https://www.gov.uk/government/news/cash-here-to-stay-as-government-commits-to-protecting-access.
[3] https://www.bankofengland.co.uk/news/2019/march/boe-welcomes-access-to-cash-review.

[redacted]

- develop a definition of industry's commitment to customers and communities in terms of the "appropriate provision for free access to cash";
- consider how this new approach could involve the creation of an independent body with responsibility for responding to access to cash representations and coordinating and facilitating appropriate industry action; and
- work with LINK, the Post Office and the Payment Systems Regulator (PSR) to identify ways in which the existing commitments and delivery against them, can be developed and improved.

The PSR's examination of the interchange fee structure is another part of the wider investigation into how to support access to cash in the future, relating to the principal way in which customers access cash. We are supportive of this work, but it is difficult to analyse the structure of interchange in isolation and we recommend that the PSR take into consideration other programmes looking at the future access to cash. In addition, UK Finance consider that an economic assessment of any changes to the interchange fee should be undertaken during the investigation period.

While we do not hold any data that gives us an insight into the best way to structure the interchange fee, we look forward to continuing to work with the PSR on future access to cash.

[redacted]

[redacted]

Visa Europe

VISA

VISA Europe response to the PSR's call for views on the structure of LINK interchange fees

1 Overarching comments

Visa Europe ("Visa" in this document) welcomes the opportunity to respond to the PSR's call for views on the structure of LINK interchange fees, and to help inform the PSR's ongoing work on access to cash more generally.

Our vision as a business is to be the best way to pay and be paid for everyone, everywhere. Visa has been dedicated to transforming the payments experience for customers and merchants around the world, for almost 60 years. We are primarily a payments technology business, working in partnership with merchants and financial institutions to provide more and more ways for customers to pay however and whenever is convenient for them.

We are fully committed to playing our part in ensuring the payments industry continues to deliver benefits to all consumers. Our view is that the UK's dynamic and competitive payments market is working well to meet the rapidly changing needs of consumers (and will continue to evolve rapidly, especially given the relatively recent arrival of new regulations such as PSD2).

As the PSR will be aware, Visa also operates a UK ATM network scheme, which uses broadly the same network of ATM machines as the LINK scheme. This scheme is operative where the customer has a Visa card issued by a bank that is not a member of the LINK scheme or a type of card that is not part of the LINK agreement (e.g. UK Visa credit and commercial cards and non-UK issued cards). Visa estimates that its share of domestic UK transactions represents around 1% of all ATM transactions in the UK.

In this section of our response, we outline three aspects that we urge the PSR to consider further before proceeding with any review into LINK fee structures.

- Addressing digital exclusion will lead to benefits across the UK economy. At this critical juncture, where decisions need to be made now on the way forward for cash in the UK economy, there is an opportunity to address the current levels of financial and digital exclusion.
- A bigger conversation is needed on what the appropriate level of cash access is, and the best way to deliver this. The *Access to Cash Review*[1] has challenged UK authorities to work together (and with industry) to develop joined-up solutions on how overall UK cash infrastructure could be configured to meet the needs of those who still prefer or rely on cash. There needs to be a clearer view on this before the appropriateness of any incentives can be fully understood.

1 See https://www.accesstocash.org.uk/. References to the Access to Cash Review in this response are from the Final Report of March 2019 unless specified otherwise.

- The PSR should develop a better and more detailed understanding of cash provision in the UK (including ATMs) before it can form a view on which incentive structures may work best We know the PSR is investigating some of these issues in more detail as part of its wider access to cash programme
- The PSR's work should be informed by relevant precedents from other sectors. The ATM industry shares some characteristics with other 'network' sectors subject to economic regulation We suggest that the PSR also engages with other regulators in those sectors to understand their experiences of the effectiveness of different kinds of tariff structures, as well as their responses to broader issues

Below, we expand on these points, and then in Section 2 we provide comments on the PSR's specific questions

1.1 Addressing digital exclusion will lead to benefits across the UK economy

Consumers are increasingly choosing to use digital payments, due to their significant advantages compared with more traditional forms of payment, in terms of security (against personal theft), efficiency and speed of sales and transactions From a consumer perspective, one of the biggest drivers of growth is retailers offering customers greater convenience and/or choice of payment experiences For services such as Uber, Airbnb, Netflix, and Amazon, the transaction/payment is embedded in the experience and is either billed on a subscription or recurring basis or can occur in a single click, as the payment credentials are stored on file

As digital payments grow, they are increasingly delivering a broader set of economic benefits For example, enabling new payment experiences allows merchants of all sizes to access global markets and engage in seamless, simple and secure digital commerce, which can increase the dynamism of the economy, and provides UK consumers with global access to goods and services

Whilst the potential opportunities are great, Visa continues to recognise the importance of ensuring that digital payments can work for everyone Visa works with our partners on both the issuance and acceptance side of the payments system to make digital payments increasingly accessible and inclusive

- On the issuance side, as an example, we collaborated with issuer banks to implement Visa Transaction Controls for cardholders With Visa Transaction Controls, issuers can offer their cardholders the ability to set blocks and alerts on their cards and/or digital accounts via the issuer's mobile banking app or online website This means there is an easy way for consumers who are using digital payments already to budget – this is particularly helpful for those on low or irregular incomes
- On the acceptance side, we have increasingly been working closely with a range of merchants and stakeholders across various campaigns and initiatives in the UK to ensure that the smallest merchants can easily use digital payments As an example, we would highlight the work that Visa, and our partner Square, have done in the town of Holywell, North Wales Square offers an affordable and easy-to-use card-reader for merchants It does this with an app, which allows merchants of all sizes to process and manage card transactions through a device linked to a smartphone or a tablet Square partnered with the town of Holywell to enable Holywell's 'Digital Town' initiative, whereby 50 local merchants were equipped with Square readers so that they could accept credit and debit cards – many for the first time

We continue working with the Government as proud partner for the second year running of the Great British High Street Awards - a nationwide campaign to support and recognise the important role of high streets in driving local economies and bringing together communities

Visa has also sponsored the Love Your Local Market campaign in May Run by the National Association of British Market Authorities (NABMA), the campaign encourages everyone to rediscover their local market and celebrate small businesses at the heart of our communities This year's theme was "Markets – Close to your Heart" and hundreds of markets across the UK took part This campaign is part of Visa's commitment to helping local markets and high streets find ways to adapt and innovate, thus ensuring that they can continue to thrive both now and into the future

As digital payments become increasingly accessible and inclusive, through the kinds of initiatives shown above, their reach is growing However, as the PSR identifies, there are many UK consumers who will need or want to use cash as a payment method for some time Whilst we agree that ATM provision and access to cash is an important consideration for those consumers, there is now a wider opportunity to address the current levels of financial and digital exclusion.

We support the Government's strong stance on a digital transformation in which no one is excluded, and we are committed to tackling the causes of exclusion - financial, digital or otherwise Our reach makes Visa's network and services a powerful platform to drive financial inclusion (and associated educations), and we would welcome further engagement with the PSR, alongside the industry and other UK authorities to progress these issues

1.2 A bigger conversation is needed on what the appropriate level of cash access is, and the best way to deliver this

The recent *Access to Cash Review* stated that around 2 2 million people continue to use cash for all their day-to-day transactions[2] and that even where digital payments are available, some people prefer to use cash because of its physicality (and perceived 'security'), ease of use for budgeting, and ease of use for informal transactions [3]

Whilst ATMs are currently the primary way for consumers to obtain cash, there is increasingly a wide range of alternatives Today, consumers are able to withdraw cash through cashback facilities at retailers and over the counter facilities at bank branches or at the Post Office There are also industry initiatives under way to expand cash provision further – for example, in partnership with Lloyd's Banking Group, Visa has recently announced a new pilot scheme designed to boost access to cash, which will see local retailers paid to offer cashback to customers in their stores This new approach will offer more support to retailers and offer customers more availability in areas where access to cash has been identified as more challenging [4]

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2 UK Finance, UK Payment Markets 2018, as quoted in Access to Cash Review, page 12.

3 UK Finance, UK Payment Markets 2018, as quoted in Access to Cash Review, page 12.

4 https://www.lloydsbankinggroup.com/media/press-releases/2019-press-releases/lloyds-banking-group/lloyds-announces-new-cashback-incentive-scheme

Irrespective of the particular method consumers use to access cash, there are significant costs in the maintenance of current levels of "free" access to cash, which go far beyond the ATM estate itself Whilst the ATM estate reportedly costs £1 billion per year to maintain, the overall UK cash infrastructure reportedly costs £5 billion per year, and includes costs such as the printing of notes, minting of coins, wholesale and retail distribution, and merchant and consumer handling [5,6]

Clearly, as the use of cash declines, there is a need to balance these costs (which are not likely to fall as fast as the use of cash, because of the influence of fixed costs) against those most financially vulnerable incurring the majority of those costs We therefore urge the PSR to 'think bigger' than just the ATM industry and consider how the overall UK cash infrastructure could be configured to meet the needs of those who still prefer or rely on cash In particular, we note the challenge from the *Access to Cash Review* for the UK authorities to work together (and with industry) to develop joined-up solutions

1.3 The PSR should develop a better and more detailed understanding of cash provision in the UK (including ATMs)

Notwithstanding the concerns expressed above, the PSR is considering multiple ambitious objectives in respect of ATM provision These include setting appropriate incentives to maintain a suitable geographic distribution of ATMs, and developing a practical and stable system where individual parties can understand and react appropriately to the incentives

However, the PSR should develop a better and more detailed understanding of cash provision in the UK, and ATMs specifically, before it can form a view on which incentive structures may work best The following issues in particular will need to be understood first

- Who uses cash, where, and why? The PSR should develop a more detailed understanding of who uses cash and why, with a focus on geographical and generational patterns For example, the *Access to Cash Review* highlighted that consumer groups are increasingly concerned that remote or rural communities are being excluded from cash access [7] Similarly, a study that Visa commissioned in 2017[8] identified some of the key reasons why some individuals or businesses continue to use cash Some of these relate to structural or knowledge barriers that are likely to change over time, such as access to adequate digital infrastructure or financial and digital literacy Therefore, before any charging methodology can be evaluated, there needs to be more granular data on consumers' preferences for cash, which could inform the social objectives of a revised fee structure
- How has the ATM estate evolved? The number of ATMs alone is not a sufficient proxy for levels of cash access The PSR should therefore collect data on how the geographic distribution and ownership of ATMs has changed over time, including, for example, the change from bank-owned/operated to independent operators

5 UK Finance, UK Payment Markets 2018. as quoted in Access to Cash Review, page 7.

6 The costs incurred by merchants and consumers to 'handle' cash is especially difficult to estimate, and is one reason why some estimates of the overall 'cost of cash' are even higher – one source cited in the *Access to Cash Review* puts the overall cost at £9 billion (Access to Cash Review, page 64).

7 Access to Cash Review, page 67.

8 Roubini Thoughtlab study into the benefits of digital payments (2017): https://usa.visa.com/dam/VCOM/global/visa-everywhere/documents/visa-cashless-cities-report.pdf

- What services do ATMs provide? ATMs provide an increasingly wide range of services, beyond the traditional service of cash withdrawal The PSR should examine the range of services, how this has changed over time (and in response to different charging structures), and what other potential services could be provided by ATMs
- What is the cost structure of the ATM estate? Whilst the call for views asks about individual ATM cost structures, there would be significant value in a systematic data set collected on a consistent basis from ATM deployers The PSR should establish a robust and detailed dataset on ATM costs, before pursuing further analysis on fee structures
- What other ways could people access cash? As the *Access to Cash Review* makes clear, and as noted above, there is considerable scope for consumers to access cash outside of the ATM network – for example, through convenience stores and branches of the Post Office [9] These other options, as well as potential future developments providing alternative cash delivery methods, need to be mapped out in detail and form part of the picture of cash provision

As a broader point, the PSR should also consider what unintended consequences a new fee structure could introduce. The payments market is changing at an unprecedented speed, which means the PSR should look to the future when considering regulatory interventions Regulatory change that is not well targeted risks introducing further sunk costs, which future consumers may have to pay for

Given the complexity of the issues above, we would recommend that the PSR dedicates time and resources to understanding these issues first, before undertaking a review of future fee structures for ATM provision We urge the PSR to work closely with industry stakeholders in doing so

1.4 The PSR's work should be informed by relevant precedents from other sectors

In response to Question 4 (in Section 2, below), we set out some pricing themes that the PSR may wish to consider later in the process when considering an appropriate fee structure – drawing on insights from sectors such as water, post, energy and healthcare We urge the PSR to engage with regulators in those sectors to understand their experiences of the effectiveness of different kinds of tariff structures

However, we would also urge the PSR to engage with other regulators to understand their responses to broader issues (beyond tariff structures) This could include issues such as

- What are the merits of different regulatory approaches to achieving the desired outcomes? The intent of a charging regime is to set the right incentives so that an 'optimal' outcome is achieved over time by a market However, there is regulatory precedent for a regulator (or other authority) to specify the outcome, with individual parties then tendering to supply At its most basic, this is known as a 'franchise' approach, such as that used in the rail sector There are other models with more flexibility for example, in energy, Ofgem has introduced a regime for offshore electricity transmission involving a competitive tendering process This has the potential to leverage innovative thinking from the industry, as well as competition between bidders, to deliver the required investment at lower costs and provide higher standard of service

[9] Access to Cash Review, page 74.

- What competitive constraints do other source of cash have on the ATM network, now or in the future? As the PSR is aware, the services that ATMs provide can, to some extent, be replicated by other networks (such as the Post Office, or through cashback). This means that the question of whether other services are substitutes is potentially very relevant to the overall form of any regulation / oversight. As an example, in telecoms, the current dominant provider of fibre networks across most of the UK is Openreach. However, assessment of Openreach's market power (and therefore the imposition of remedies) depends on local market conditions, and these may in fact change significantly if various competitor providers (e.g. Virgin and CityFibre) roll out their own networks in future. Similarly, in post, price regulation on First Class stamps was relaxed when Ofcom determined that Second Class stamps (which remained price-regulated) imposed a sufficiently strong constraint on First Class stamps.[10]

[10] See, for example, Ofcom's Review of the Second Class Safeguard Caps 2019.

2 Comments on specific questions posed by the PSR

In this section, we set out our responses to the specific questions stated by the PSR As noted in Section 1 above, Visa urges the PSR to consider a more holistic set of analyses and issues before proceeding further with its review of the specific structure of LINK ATM fees The answers given below are based on our understanding and experience of the current UK market, and we look forward to engaging with you further on them as the PSR's work programme develops and more in-depth research is conducted

2.1 Framework for considering cost and value of ATMs

Do you agree with the description of the framework (including the objectives we set out) for considering the costs of providing ATMs and the value they provide that are set out in this paper? If not, please explain why and set out your view of the alternative way these issues should be analysed

As discussed above, the PSR should consider the wider context and alternatives to ATMs before pursuing the development of a future fee structure

Notwithstanding this, we broadly agree with the PSR's characterisation of the cost drivers and differences between 'more remote' rural ATMs[11] and urban ATMs We expect that the PSR will test its hypotheses against actual data provided by ATM operators on ATM costs (including a full account of fixed, semi-variable, and variable costs and how they have changed over time)

In addition to the factors listed in the PSR's paper, we recommend the PSR also works to understand occupancy costs – for example, the 'rental' cost an ATM operator might pay to a shop in order to place its ATM in its premises Our understanding is that these costs can be very high in urban areas, and not including them fully in any cost assessment could distort the results materially Indeed, it may even be the case that ATMs in urban areas cannot in general be considered 'lower-cost' as the PSR suggests

In terms of the value that ATMs provide to consumers, Visa considers that the PSR should be looking at a wider range of factors For example, the PSR rightly identifies that reliability, proximity to other free ways to withdraw cash, and geographical convenience are relevant factors affecting the 'value' of a given ATM However, another important factor is the extent to which customers who use a given ATM prefer to use (or are reliant on) cash [12] This is one reason why we recommend that more work should be done on understanding the geographical patterns of cash usage and dependency before proceeding further with reviewing LINK's fee structures

11 We suggest a terminology clarification point: the PSR uses "remote" in the sense of "rural" in some contexts. As the PSR acknowledges, "remote" is also used to refer to ATMs in non-branch locations (e.g. a supermarket) and we suggest the PSR uses the word 'remote' only in this context.

12 Notwithstanding this, we would also note that the PSR's *Observation 2* and *Observation 3* are not meaningful on their own. For example, *Observation 2* by itself implies that the most valuable ATM is the most isolated in the country irrespective of whether cash is needed at that location.

In terms of the interaction between cost and value, the PSR's logic appears to us reasonable, including the implication that there are likely to be locations where the consumer need for access to cash is high, but an ATM would not be commercially viable (because of low revenues, or high costs, or both)

2.2 Additional factors to take into account when analysing incentives

Are there any other factors we should take into account when analysing the incentives to provide ATMs?

We set out in Section 1 the issues that we urge the PSR to look at in more detail before proceeding further with analysis on the incentives that ATM deployers have through the LINK fee structure At this stage, we have one other specific comment, which is that **the interaction with site owners is important and should not be minimised.** The PSR says its focus is on the interactions between ATM deployers and LINK through interchange fees, but that views are also invited on how this "*flows through*" to ATM site owners As noted above, occupancy costs (i e , rental paid to site owners) can be significant Further, there may be many ATM deployers with multi-year contracts, and/or contracts that cover multiple ATMs at multiple sites In principle, these could affect the ability or willingness of an ATM deployer to make site-by-site decisions based on changes in the fee structure

2.3 Impact of the existing LINK fee structure

What incentives and impacts do the existing LINK interchange fee arrangements as described in this paper (including in Annex 2) have?

We are not commenting in detail on the current structure of LINK's interchange fees or on the impact of the recent changes However, at this stage, we have two general comments on the existing arrangements

First, we note that, until recently, LINK's interbank fees were based on the principle of **full cost recovery.** This methodology uses total costs, as reported by operators, and calculates the fee per transaction that would recover these costs in full However, this means that there were limited incentives to minimise the overall quantum of costs

This has historically had the potential to lead to an upward spiral in costs, since operators were (in the round) assured that any further costs incurred as a result of installing additional ATMs would be recovered (in aggregate) through an increase in fees across their network In addition, because of slowing growth or even reduction in transaction volumes, the cost per transaction (and hence the fees) appeared to increase over time even if the overall cost base did not increase [redacted]

Second, as the PSR is aware, there are also fees for services other than cash withdrawal, such as balance enquiries, which are mentioned in the PSR's *call for views* The PSR should consider the cost drivers (if any) of these additional services

2.4 Appropriate structure of fees going forwards

What structure of interchange fees would have appropriate incentive effects going forward?

We have set out above some required precursor analysis that we expect will be needed before the PSR will be able to form an initial view on an appropriate fee structure that best meets the needs of customers However, even with that analysis in hand, an 'appropriate' set of incentives can only be developed in view of some criteria for what the intended outcome is We recommend the PSR engage with stakeholders (including consumer groups) to develop a set of criteria

One potential (non-exhaustive) starting point is the following criteria [redacted]

- Financially vulnerable consumers should continue to have free access to cash. It is important that charging methodologies ensure that financially vulnerable consumers are protected
- Costs, which are ultimately borne by consumers, should be constrained The free banking model currently prevalent in the UK makes the impact opaque, but the overall costs should be reduced (or at least not be allowed to spiral upwards)

Given this, and the challenges set out in Section 1, we consider it premature to suggest what the most appropriate fee structure would be going forwards However, given the multiple objectives the PSR is looking to meet, for the purposes of this response we simply set out some pricing themes that the PSR may wish to consider later in the process These themes are

- Charges that reflect economically efficient costs
- Charges that reflect the marginal costs of provision
- Charges that reflect the value of ATMs in locations where cash is needed and where there are few alternatives to cash access

2.4.1 *Economically efficient costs – approach to overall level of cost recovery*

In many regulated sectors, there is precedent for not reimbursing all of an average operator's fully absorbed costs, but instead encouraging efficiency by determining the 'efficient' costs of provision that operators should be allowed to recover through fees.[13] This can be done in numerous ways. For example:

- Revenues for the different regional water supply operators are set by the regulator based on benchmark performance against the upper quartile of the most efficient operators, which are then used to set fees for all of the operators.[14]
- Prices for hospital services are set based on historic costs, but after application of an 'efficiency factor' designed to replicate the year-on-year efficiency gains that could be expected in a competitive market.[15]

The choice of which approach to take depends on the structure of the industry and the form of regulation applied – however, in each case, the ultimate aim is to make sure that only reasonably efficient costs are reimbursed.

[redacted]

2.4.2 *Marginal cost pricing*

Economic efficiency is achieved where firms continue to produce to the point where the marginal cost of output is equal to its marginal revenue (i.e., price). In theory, this optimises the level of output, mimicking the outcome of a competitive market. However, the marginal cost alone would not be sustainable since firms need to recover fixed costs in the long run.

In some regulated sectors in the UK, marginal costs have been used to set prices (e.g. wholesale call termination and track access for freight services), with operators recovering fixed costs either through other services or through an 'adder' (which lifts the charge by an equal amount for each unit of output, preserving the price signal).

In the ATM industry, such an approach might work in tandem with geographic or 'zonal' pricing. The use of geographic or zonal pricing can address distortions resulting from the use of average pricing in markets with differing levels of cost. Geographically de-averaged fees have been introduced by regulators in markets where competition brings in risks of 'cherry-picking' – such as in electricity transmission[16], post[17] and NHS healthcare[18].

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13 This followed concerns that full cost recovery including an allowed rate of return (or "cost pass through" as it was known) incentivised companies to increase costs (known as "gold plating". See for example, Averch, Harvey; Johnson, Leland L. (1962). "Behavior of the Firm Under Regulatory Constraint".

14 See, for example, Ofwat 2014 price review.

15 See, for example, 2016/17 National Tariff Payment System: A consultation notice Annex B5: Evidence on efficiency for the 2016/17 national tariff, Monitor, 11 February 2016.

16 Electricity transmission networks use zonal pricing to incentivise efficient connection to the network.

17 Royal Mail delivery fee is used in a four zonal structure to disincentivise 'cherry-picking' of the delivery market.

18 National prices for healthcare services are adjusted to reflect regional cost differences, to ensure hospitals in high-cost areas (such as London and the South-East) are able to provide similar quality of care as those elsewhere.

Of course, for any such approach, a balance would need to be struck between complexity (to reflect different 'zones' at a sufficiently granular level) and practicality.

2.4.3 *ATM-specific pricing*

Geographic de-averaging, potentially in combination with marginal cost pricing, may help to ensure *even* coverage of a given service, regardless of location. This is a desirable solution when the value' of the service is assumed to be the same for all consumers.

However, it is not clear this is the optimal outcome for ATM coverage, since the *value* of the service may also differ between ATMs at different locations. Some factors that could be relevant include:

- Population size or deprivation level.[19]
- Travel times to other alternative provision.[20] As per our comment above, this should include all other types of alternative provision.
- Accessibility (as the PSR notes, this could relate to both the site of the ATM itself but also the features of a particular ATM).
- Reliability. As the PSR notes, consumers value ATMs which are actually able to dispense cash when needed.

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[19] Access to Cash Review, page 82.

[20] Access to Cash Review, page 82.

Vocalink

[redacted]

Dear Sir/Madam

Access to Cash Review

In your recent call for views on the review of the structure of LINK interchange fees you welcome short contributions, observations and other ideas for reform. In that spirit, we would like to set out an alternative to the current model for ATM provision. This alternative model is more akin to the Faster Payments model, where financial institution pay, on a per transaction basis, for their customers' use of ATMs. The LINK scheme could centrally procure and deploy ATMs, and centrally procure ATM maintenance, cash management and switching and settlement services.

The benefit of his approach is that LINK scheme could directly control the location of ATMs. Compared to the current obligations on LINK to protect the current geographic spread, this model would enable LINK to extend the geographic spread and deploy ATMs to areas where they current do not exist. This would improve access to cash. The pricing would be on a cost recovery basis, similar to the concept which underpinned the original interchange model and consistent with the OfT's approval of the scheme when it was initially set up.

We would welcome the opportunity to discuss our thoughts with you.

[redacted]

VOCALINK
mastercard

Which?

Which?, 2 Marylebone Road, London, NW1 4DF
Date: 9th July 2019
Response to PSR *CP19/5: Review of the structure of LINK interchange fees - Call for views*

PSR Access to Cash project team
Payment Systems Regulator
12 Endeavour Square
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Which?'s response to the PSR CP19/5: Review of the structure of LINK interchange fees - Call for views

Introduction

- Which? welcomes the opportunity to respond to the PSR's *call for views* on the review of the structure of LINK interchange fees.

- Which? strongly agrees with the PSR that everyone should have a good choice of payments and that there should be widespread geographic access to cash, including protecting the current spread of free-to-use (FTU) ATMs. This is particularly important in remote or low income areas where individuals' needs for cash may be great, but where overall demand may not be sufficient to support FTU ATMs under the current LINK interchange model. LINK's change to the interchange fee in January 2018 failed to protect consumers' access to cash via FTU ATMs. There has been a net loss of approximately 5,500 FTU ATMs since January 2018, including the loss of 151 ATMs that had been designated protected.

- The loss of FTU ATMs is also accelerating with recent LINK figures showing month on month reductions of 400 to 500 ATMs - some closing and some converting to charging. The PSR needs to act as quickly as possible to protect free access to cash for all who need it. The PSR cannot just look at the LINK network in isolation. It must, as a minimum next step, commit to regulating both the structure and level of ATM interchange fees for all major UK ATM networks, not just LINK. Failing this we believe it will be necessary for the PSR, industry and other members of the JACS group to make a decision on whether a Universal Service Obligation (USO) will be necessary to protect consumers' access to cash.

- Given the pace of change, it is also important that the PSR starts exploring how it can better support access to cash via other means, including ATM cash deposits, cashback at retailers' tills, and other shared means of access to cash, such as the Post Office, new shared banking hubs, existing bank branches, or potential third party locations.

- Which? continues to believe that the government should make protecting access to cash a priority and put in place legislation to ensure consumers can access cash free of charge for as long as they need it. Which? will continue to engage with the PSR on this important issues for consumers and are happy for this response to be published.

Response to Questions

Q1: Do you agree with the description and framework (including the objectives we set out) for considering the costs of providing ATMs and the value they provide that are set out in this paper? If not, please explain why and set out your view of the alternative way these issues should be analysed.

1. Which? agrees with most of the description, framework, and objectives set out in the PSR's *Call for views*.

2. In particular, we agree that everyone should have a good choice of payments and that there should be widespread geographic access to cash, including protecting the current spread of free-to-use ATMs. It is essential that consumers' freedom to pay for goods and services as they choose is protected as we move to an ever more digital society. Moreover, we strongly agree with the conclusions of the independent *Access to Cash Review*.[1] The evidence shows that many consumers are not ready to go cashless and that diminution of the UK's cash infrastructure will cause substantial harm. Given this, we believe that consumers need a guarantee that they can access and use cash for as long as they need it.

3. Since LINK's decision to change the interchange fee in January 2018 there has been a loss of approximately 5,500 FTU ATMs which have closed or switched to pay-to-use (PTU). The loss of FTU ATMs is also accelerating with recent LINK figures showing recent month on month reductions of 400 to 500 ATMs - some closing and some converting to charging. While we recognise that in some areas there may have been scope for some ATMs to close without limiting consumers' access to cash, a number of stakeholders have raised concerns that these closures are resulting in remote or low income areas - where there may be a greater need for cash - losing their primary means of accessing cash.

4. The loss of FTU ATMs since January 2018 includes the closure of 151 ATMs that have been designated protected.[2] The closure of protected ATMs reflects a failure of the PSR to meet its objective to ensure that payment systems, in particular those that facilitate access to cash, are operated and developed in a way that considers and promotes the interests of all the businesses and consumers that use them. It also

[1] Access to Cash Review, Final Report, March 2019, https://www.accesstocash.org.uk/
[2] LINK, *Monthly Footprint Report*, April 2019 https://www.link.co.uk/initiatives/financial-inclusion-monthly-report/

reflects a failure of LINK to meet its commitment made in January 2018 'to defend the free ATM network and the consumers who rely on it.'[3]

The PSR needs to act quickly

5. Which? remains concerned with the speed at which things are changing, and the lack of clear and rapid action from the regulator. In addition to LINK's data showing an acceleration in the loss of FTU ATMs, the data has also shown that cash withdrawals are continuing to decline at a rapid rate. LINK ATM transactions have been falling at rates as high a 13.9% year-on-year, based on data for w/e 28th April 2019. Which? remains concerned that this reduction is not fully being driven by the needs of consumers.

6. While we recognise demand for cash is falling, we are aware that consumers are facing increasing barriers when accessing cash following a rise in ATM closures, the introduction of ATM surcharges and the loss of bank branches. We are concerned that the loss of many of the FTU ATMs, including those that have been protected, have happened as a result of the LINK 2018 interchange fee change and that these losses are unnecessarily pushing consumers away from cash - exacerbating the concerns around the sustainability of the current FTU ATM network.

7. It is essential that the PSR acts as soon as possible and while we agree with the *call for views* that the LINK interchange fee is central to addressing the concerns around the loss of FTU ATMs, changes to the LINK interchange fee by themselves would only constitute a short term fix and are too narrow a focus for this review.

The PSR must commit to regulating all major UK ATM network interchange fees

8. Which? believes that the failure of the market to protect FTU ATMs for consumers who need it now requires the PSR to step in a regulate interchange fees to support their aim of protecting cash access for UK consumers who need or want to use it as a payment method. Given the state of the market we are confident regulating the ATM withdrawal interchange fee level and structure would be consistent with all three of the PSR's objectives:

    a. to ensure that payment systems are operated and developed in a way that considers and promotes the interests of all the businesses and consumers that use them
    b. to promote effective competition in the markets for payment systems and services - between operators, PSPs and infrastructure providers

[3] LINK, *Board announces changes to the operation of its ATM network*, January 2018, https://www.link.co.uk/media/1355/h-documents-uploads-link-interchange-consultation-announcement-31-january-2018.pdf

c. to promote the development of and innovation in payment systems, in particular the infrastructure used to operate those systems.

9. In order to protect the current spread of free-to-use ATMs in the interest of consumers, it is necessary to address not just LINK's interchange fees but also the interchange fees for other UK ATM networks, in particular those with widespread coverage such as Mastercard and Visa. This is essential to prevent UK banks, and other major card issuers, opting to use an ATM network with interchange fees that do not support the PSR's objectives of widespread free-to-use ATM access - for example a network that sets fees at a level at which more protected FTU ATMs become economically unviable. This is already happening, with numerous UK card issuers already opting for Mastercard or Visa rather than LINK to provide ATM access for their customers, for example, Monese, Monzo Bank, N26 Bank, Revolut, Starling Bank, and Virgin Money (which had reportedly started the process of withdrawing from the LINK network in early 2017).

10. It is clear from our engagement with industry stakeholders that the threat of further banks leaving LINK as a result of Mastercard's and Visa's lower interchange fees was the main driver of LINK's decision to reduce its interchange fees in January 2018. As such, and to ensure there is a consistent approach to protecting access to cash, the interchange fees for non-LINK ATM networks that could compete with LINK must be taken into account.[4]

11. In order to capture all major ATM schemes, the PSR should define a minimum threshold, such as minimum share of UK ATMs connected to a given ATM scheme or minimum share of ATM transaction volumes provided by a given scheme. The PSR must also address ATM scheme rules and practices that may limit competition between ATM schemes or may represent other anti-competitive practices, as described in our response to question 2.

12. The PSR must therefore step in to regulate ATM interchange fees for all major UK ATM networks. The PSR is the economic regulator for payment systems and was set up with the express purpose and powers of regulating wholesale access fees in payment systems, such as ATM and other interchange fees.

13. If the PSR does not commit immediately to regulating interchange fees for all major UK networks, we believe it will be necessary for the PSR, industry and other members of the JACS group to review and make a decision within the next 6 months as to whether a Universal Service Obligation (USO) is necessary to protect consumers' access to cash.

Alternatives to ATM withdrawals

[4] We discuss this issue further in response to question 2.

14. Which? recognises the need for the PSR to focus now on the funding for FTU ATM withdrawals as this is the primary method by which consumers access cash. However, it will be necessary in the future for the PSR, working with other members of the JACS group, to explore if there are other complementary ways via which consumers and businesses would be willing to access and deposit cash, and to enable and promote these so as to support the continued sustainability of cash.

15. In order to protect access to cash for consumers it is important that the PSR starts to consider the need to set and regulate interchange fees for *cash deposits* at ATMs. This would enable personal and business customers of any UK bank or building society to deposit cash at any ATM that offers cash deposit services (also known as “smart ATMs” or “recycling” ATMs). In particular, ATM scheme cardholders should be able to use existing smart ATMs in bank branches, which are currently available only to banks’ own customers.

16. Such a cash deposit interchange fee should be set at a level that promotes the wider deployment of such deposit-taking/cash-recycling ATMs, for example, in potential new shared banking hubs. Much greater prevalence of such ATMs would itself greatly support continued access to cash. It could enable smaller businesses to continue paying in cash easily providing some replacement for lost bank branches. It would also greatly increase the efficiency of providing cash, by reducing unnecessary cash transportation and ATM refilling.

17. Second, it is necessary to consider other means of withdrawing (and depositing) cash beyond ATMs, in particular:

    a. *cashback* at retail tills/terminals
    b. cash withdrawals/deposits at Post Offices
    c. cash withdrawals/deposits at other shared locations, such as new shared banking hubs, existing bank branches, or other third party locations, such as supermarkets.

18. While cashback is not a substitute for ATMs in all locations, cashback nevertheless offers the opportunity for a significant low cost expansion of access to cash, especially where few or any ATMs are present, for example, in pubs or shops in rural or suburban areas. According to UK Finance data, cashback has been in decline as a share of cash access during the last two to three years and many retailers no longer offer or promote cashback. Following the EU payment card interchange fee regulation, debit card interchange fees are now a percentage of transaction values, rather than pence per transaction. This therefore creates a disincentive for retailers to offer cashback, which previously had no incremental cost to the retailer, but now could have an appreciable cost.

19. As with ATM interchange fees, interchange fees for cashback transactions should be considered a regulatory issue for the PSR. Indeed, like ATM interchange fees, the interchange fee for cashback could be paid by card issuers to retailers, not the reverse, in order to promote access to cash, albeit not necessarily at the same level as the ATM interchange fee.

20. Likewise, it is also necessary to consider wholesale interchange fees and rules for other means of withdrawing (and depositing) including cash withdrawals/deposits at Post Offices, and cash withdrawals/deposits at other shared locations, such as new shared banking hubs, existing bank branches, or other third party locations.

21. For example, banks pay the Post Office a wholesale fee for cash withdrawals and cash deposits at Post Office branches. However, this scheme is not available to customers of all banks and is limited only to the Post Office, which appears to unduly favour the largest banks and the Post Office. This scheme could be opened to include all card issuers and other prospective outlets, such as bank branches, new shared banking hubs, and other third party locations, for example, supermarkets, on an open and non-discriminatory basis. This would provide a further complement to ATMs and cashback as a means of access to cash. In particular, this could address the adverse impact of bank branch closures, by ensuring that customers of any bank can still deposit cash at the "last bank branch in town", and provide an additional revenue stream to support such banks.

Q2: Are there any other factors we should take into account when analysing the incentives to provide ATMs?

22. Which? welcomes that when looking at the factors to take into account the PSR has started from a point of finding a solution that supports access to cash in a way which meets the needs of users, including widespread geographic access for UK consumers who need or want to use cash as a payment method.

23. Which? believes the PSR has broadly identified the balance of factors to take into account when analysing the incentives needed to provide FTU ATMs. While the PSR must prioritise actions to address the rapid reduction in free-to-use ATMs resulting from LINK's 2018 interchange fee changes, it is also essential that the PSR takes into account factors that LINK cannot reasonably be able to protect against.

24. Which? is concerned that some of the Mastercard and Visa ATM network scheme rules may be anti-competitive in nature. While a decision by the PSR to regulate interchange fees for all major UK ATM networks may address competition concerns, we believe it is still necessary for the PSR to thoroughly investigate the operation of Mastercard and Visa's ATM network scheme business rules.

25. Mastercard and Visa are offering a lower interchange fee than LINK for their ATM networks - these lower fees would reduce costs for individual banks when customers withdraw cash from an ATM not operated by their bank and equally decrease income for ATM operators.

26. At the same time both Mastercard's and Visa's scheme rules prevent ATM operators introducing a surcharge for consumers using Mastercard's or Visa's ATM network at an ATM where consumers using LINK (or any other ATM network) can make a 'free withdrawal'.

27. While Mastercard and Visa currently process a very low proportion of ATM withdrawals, the fact that almost all ATMs are connected to their networks means that both are credible competitors to LINK.

28. If a significant number of consumers started to withdraw via non-LINK networks - for example if one major bank chose to leave LINK - then LINK's commitment on FTU ATMs would become unsustainable as it could no longer set interchange fees at a reasonable level to promote the necessary geographical spread of FTU ATMs. Mastercard's and Visa's rules - that prevent ATM operators from surcharging consumers using their networks to withdraw from ATMs that are free-to-use for LINK members - have enabled the banks to pressure LINK into making interchange fee reductions such as those implemented in 2018, without properly taking into account the needs of consumers. In fact, we have now seen that the decision taken in January 2018 has led to FTU ATMs that should have been protected closing or switching to PTU.

29. The PSR has specific duties to enforce the EU Interchange Fee Regulation, which specifically prohibits card-based payment scheme "steering rules" in ATM card schemes, hence we believe PSR action on this is needed.[5] As stated above, we also believe the PSR should commit to regulating interchange fees for all major UK ATM networks, doing so should ensure that all major networks have interchange fees that promote widespread geographic access to cash via FTU ATMs

Q3: What incentives and impacts do the existing LINK interchange fee arrangements as described in this paper (including in Annex 2) have?

30. Which? strongly agrees with the PSR's statement that predictability of future charges is likely to be important in designing incentives to appropriately promote future investment and innovation from both the LINK ATM network and for other networks that allow consumers to access cash free of charge.

[5] Article 11 ("Steering rules") of REGULATION (EU) 2015/751 (the EU "Interchange Fee Regulation"), which applies to all "card-based payment transactions" within the EU, including cash withdrawals at ATMs.

31. LINK's pre-2018 approach to setting interchange fees was successful in providing transparency, predictability, and objectivity of the interchange fee setting process. The 2000 Cruickshank Review and 2001 OFT Decision on LINK's interchange fee specifically recommended and approved LINK's interchange fee approach on the basis that such a mechanism would promote investment and innovation.

32. In contrast, LINK's hasty interchange fee consultation and changes in 2018 moved away from transparent, objective, and predictable interchange fees, thereby undermining any future investment and innovation. Conversations with various industry stakeholders have increased our concerns about the likelihood of new investment in the UK's cash infrastructure, as they understandably fear the prospect of future interchange fee cuts - absent regulatory or policy intervention - which could undermine any investments made by firms in the next few years.

33. While we recognise that LINK's previous interchange fee setting approach was not perfect and is likely to have led to over-promotion of ATMs in certain locations and under-promotion in others, the new approach has led to the widespread closure of many FTU ATMs in a short space of time. This has made more urgent the need for the PSR make sure that LINK and other major UK ATM networks have the appropriate incentives to protect FTU ATMs in a manner that ensures consumers maintain access to a good choice of payments.

Q4: What structure of interchange fees would have appropriate incentive effects going forward?

34. This will need to be subject to full analysis and evidence, but at minimum must comprise transparency, objectivity, and associated predictability, in order to re-establish incentives for future investment and innovations. The structure must, as stated above, apply to all major ATM networks operating in the UK market.

35. It is vital that the PSR recognises that there are significant economies of density in the distribution of ATMs, owing to costs associated with cash delivery and ATM maintenance costs, hence the overall distribution of ATMs will inevitably depend on the overall structure and level of interchange fees, rather than just the interchange fee for any specific ATM. This is why the changes in interchange fees for specific locations, such as LINK's various recent initiatives to protect certain ATMs, have had little effect.

36. The structure of such interchange fees should depend on independent objective criteria necessary for supporting widespread geographic access to cash, including among other things:

   a. *Geographic characteristics*, such as urban/suburban/rural/remote designation, population density, or socio-economic measures, in order to create incentives for access to cash in certain types of location over others, especially in remote or low income areas where a much greater incentive is needed to ensure sufficient access to free-to-use ATMs.

b. *Availability of cash access*, for example, as a percentage of time available (i.e. non-down time) or by time of day, in order to create incentives for maximum access to cash availability, thereby reducing the likelihood of ATMs from running out of cash, of encouraging prompt repair of faults, and of supporting locations that offer longer opening times (e.g. through-the-wall ATMs). This is consistent with the PSR's observation that consumers care not just about the existence of an ATM but the existence of an ATM which is able to dispense cash for the vast majority of the time.

37. The structure of interchange fees should not depend on endogenous, discretionary, or other non-transparent factors, such as the proximity of the nearest other ATM or bank branch. Using such criteria will result in an ATM funding structure that lacks the predictability necessary for sustained investment and innovation.

About Which?

Which? is the largest consumer organisation in the UK with more than 1.3 million members and supporters. We operate as an independent, apolitical, social enterprise working for all consumers. We are funded solely by our commercial ventures and receive no government money, public donations, or other fundraising income. Which?'s mission is to make individuals as powerful as the organisations they have to deal with in their daily lives, by empowering them to make informed decisions and by campaigning to make people's lives fairer, simpler and safer.

[redacted]

July 2019