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Date: 9th July 2019

Response to PSR CP19/5: Review of the structure of LINK interchange fees - Call for views

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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 as 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 and 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.

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July 2019