Link Scheme Holdings Ltd

Interchange Consultation Member Response Summary

Summary

Seventeen LINK Network Members responded. These are the card issuers (such as banks and building societies), and the ATM deployers (both banks and Independent ATM deployers or IADs) who make up LINK.

All member responses are supportive of maintenance of broad access to cash through an extensive free network. On the Board's detailed proposals, a range of views was expressed from stating that the proposed changes went too far, to that they did not go far enough. The larger Network Members had set up a Working Group to resolve interchange that had met a number of times over the previous months but that had been unable to reach an agreement. In general, the responses replicated the position with the Working Group, with the large IADs stating that the proposals went too far, and some large banks proposing faster and more extensive changes.

Calls to strengthen the Financial Inclusion Programme were well supported.

No member provided detailed marginal cost analysis on how the proposals would lead to changes in the size or distribution of the network. In particular, there was no input on how individual machine profitability and hence viability would be affected.

As well as the responses from members, a number of consumer organisations and politicians have provided input. All are very supportive of the policy objective of a sustaining an extensive free network as now. There were strong concerns raised by some that the impact should be well understood as it relates to changes in overall free access, and that the risk of consumer detriment must be low.

There are a few procedural points relating to the consultation process that are not covered here and are subject to separate legal advice that will be considered by the Board to ensure that the consultation process is robust.

Themes

Members have been grouped into three broad categories for this summary and the detail of various responses generally fall into these groups:

- Large card issuers.
- Large IADs.
- Smaller Network Members and Supermarket Banks.

Large Card Issuers

These members were largely supportive of the process and direction of travel and their views generally echoed those they had expressed in the Working Group with several members broadly supporting the Board's proposals as is, with others proposing significantly more radical changes.

The more radical proposals were generally around an accelerated introduction, or an even a greater reduction. The split between cash and non-cash was also a recurring theme with the view that balance enquires were over-promoted being pretty much universal and that their interchange should be reduced, with a corresponding rebalancing to the cash rate, so as to have a neutral overall effect. Note that the Consumer Council is concerned that any change should protect consumer access to balance enquiries. The split between branch and non-branch was less of an issue, with most happy to see reductions apply equally to both although some were interested to see further work here. Financial inclusion (FI) was very important to these members (and all others) with an expanded and developed FI programme providing ATMs in deprived and rural areas being well supported. All issuers mentioned the competitive threat from other schemes and, whilst none mentioned moving themselves, all presented it as a real risk and something the Board must address urgently. Dealing with Common Ownership was a theme, with most suggesting it should either be reviewed or abolished immediately.

Theme	**Members**	**Summary**
The threat from other schemes is real	Majority of large banks	The cost of switching is low, others may go. LINK must adjust to the market.
Increased reduction necessary	Majority of large banks	The 20% proposal would still leave LINK 10% above other schemes. It should be 30% (large issuer).
Accelerated introduction	Majority of large banks	Other schemes offer lower rates so move more quickly so a two-year timetable would be best. Early phasing reduces the risk of moving to other schemes. Phasing should be quicker with six monthly changes. Example given: Should be two years, front loaded 15% in 2018 and 7.5% in Jan 2019 and Jan 2020.

		Another issuer proposed 10% 3.4% 3.3% and 3.3%.
Phasing	Majority of large banks	Should be front loaded
Branch-Non/branch	Majority of large banks	These should be the same or aligned. One would like more focus on non-branch.
Balance Enquiry interchange should be reduced/compared to cash	Majority of large banks	The current rates drive over promotion and the wrong customer behaviour. Lowering it would reduce these incentives. One wanted it phased out completely applying greater changes to balance enquiries to achieve this.
Common Ownership	Majority of large banks	Should be part of the review and abolished. One thought they should receive branch rates.
Financial Inclusion	Majority of large banks	Increased FI budget needed. FI should be at the core. Reductions should only be where there is over-supply of ATMs. Enhanced FI should make sure ATMs are removed from the right areas. Banks have a social responsibility to protect vulnerable consumer through the programme.

Large IADS

The IADs were generally against the Board's proposals and, whilst all seemed to accept some change was necessary (or at least inevitable), there was a wide range of proposed solutions based on varying principles. One said the proposal would neither secure ATM access or the future of the Scheme and while it did not agree with any move away from average costs it did propose a solution in the form of a lesser cost reduction with small 10-60p top-up fees. Several favoured a more market-led or reactive approach. One saw the network reacting naturally with small reductions in line with demand. Back-loading any changes to allow contracts to adjust was mentioned frequently as was the threat of external cost pressures such as interest rates, hardware and security upgrades.

Several questioned the Board's approach strongly and the basis of "over recovery" of costs. It was felt that the Scheme's wider social remit should have precedence over the threat from other schemes, which they did not in any case believe credible. All IADs generally seemed to think the threat of other schemes was artificial or exaggerated and some mentioned in detail how the benefits to banks might prove short term as the other schemes moved markets to their own favour.

A theme from all the IADs was that banks had effectively outsourced their ATM networks to the IADs who were operating them at lower cost but having done so the banks were now reluctant to pay the cost of their customers using them. Similar comments were made about branch closures and how IAD ATMs supported cash access in those areas. A major related theme was that unlike bank ATMs they were effective in their choice of locations and had a wide geographical distribution, the west of Hull being given as an example.

Subsidiary themes involved merging branch and non-branch rates. Several IADs favoured the status quo with the clustering of bank branch ATMs being commented on.

Theme	Members	Summary
Negative Impact	Large IADs	Some foresaw closure of many ATMs in remote or rural areas with other machines being moved to charging and should the full 20% reduction take effect claimed they would not be able to operate any free-to-use (FTU) ATMs. In more specific terms one said 4,000 ATMs which were under review because of volume reductions would now be removed by end 2018. One predicted 20% of FTU machines (10,000) closing.
Did not accept over-recovery of costs as basis of review	Large IADs	Did not accept that there was over-recovery and that they were effective in their choice of locations and had a wide geographical distribution. Volume of *cash payments* as a basis for the reduction was not appropriate, should be looking at *volume* of LINK transactions or consumer need.

		One large IAD said that rates should be driven solely by wider social remit. Banks are responsible for clustering of ATMs not IADs.
IADs already efficient	Large IADs	Banks had sold sites to more efficient IADs.
Phasing should be back loaded	All	A typical example is - 11% over 5 years starting with 3% then 2% per-year or at least gradual reduction.
Top-up fees	One IAD	Operators should be able to charge consumers small fees such as 10-50p in addition to getting interchange. Banks could come to bi-lateral agreements to give their customers free access.
External cost pressures	Two IADs	External cost pressures were also frequently mentioned with fixed costs, crime prevention, compliance and business rates all being referenced.
Falling demand	All	Falling demand would put pressure on IADs to reduce costs and indeed this should reduce costs over time. Some accepted that the current system could lead to rates rising as volumes fell and therefore the total payable, or even total number of ATMs, should be the target, not the interchange rate.
Costs needed capping	Two IADs	The weakness of the current mechanism was that would allow rates to rise in response to falling demand and that there might be some incentives to increase network size.
Cash/non-cash	All	IAD members were in favour of treating non-cash and cash the same, although one did acknowledge that over-promotion was a risk which should be addressed although they also emphasized the benefits of balance enquires for some customer segments. One was strongly in favour of retaining the split and as with others, the fact that a common cost pool was used and that any changes would have a reciprocal effect elsewhere was mentioned.
FI programme ineffective	Large IADs	Narrow focus and small number of machines getting the premium. Felt current programme unable to deal with the pressure on FI ATMs.

Smaller Network Members and Supermarket Banks

The smaller members who responded were broadly supportive with many having no strong opinions on the detailed interchange issues. One said that it accepted that a reduction was necessary and that control of ATMs numbers was needed and referenced 5% in years one and two but would want a review after that point, its main area of interest appearing to be the removal of Common Ownership. Another also supported the Board although it wanted to see external costs considered and phasing rear-loaded; it also suggested surveys to assess the impact on consumers' access to cash.

Specific Consultation Question Response Summaries

A	Do you agree with the principles set out in paragraph 19 above that the Board has adopted in setting interchange rates? If not, what changes should be made to those principles? What other principles do you think the Board should take into account?	Several members were generally in favour with additional comments that acquirers should be able to "make a fair return". Issuers generally favoured faster implementation and in some cases larger cuts. It was also a very consistent theme that maintaining cash access for consumers who rely on it is very important and a strong FI programme is needed. Some ATM operators expressed views that LINK should not move away from the actual average cost and should focus on consumer access without regard for the competitive landscape while one suggested moving away from costs altogether. Some IADs felt that reductions would occur naturally, or perhaps with the use of caps or similar and some noted that a rate cut on top of natural volume reductions and possible external cost increases would combine to be a real threat to ATM networks. One IAD gave detailed analysis of each principle and while they broadly accepted some such as changes in consumer behavior, they felt that average costs, as used at present should remain the driving principle.
B	Is a reduction in the interchange rate needed in order to ensure the long-term viability of the LINK Scheme?	Issuers were universal in considering other schemes a real threat and therefore a reduction was essential. Some members also commented that interchange is not the only tool and other areas of the LINK proposition (such as FI) should be developed. ATM operators, while mostly accepting that some change was necessary, did not accept that interchange should drive permanent change and did not accept the threat of competitive schemes; some were however prepared to accept minimal reductions in small changes.
C	If you consider that no reduction is needed, please explain your reasons	Only one IAD felt no reduction was necessary although they did concede to pressures on the Board.

D	If you consider that a reduction is needed, how much do you consider to be necessary, and over what period?	While some felt the Board's view seems reasonable, including some large issuers, others thought the Board's proposal too far and too fast, preferring lower reductions or in one case, the solution presented to the Working Group of an 11% reduction over 5 years. The more radical issuers however wanted changes introduced earlier, over a shorter time period and in the case of one a greater 30% reduction. A number of members wanted external costs such as interest rates and regulatory costs to be considered.
E	If a reduction in interchange rates is considered necessary, what should be the phasing of implementing the reduction? For example, should the phasing be frontloaded, back-loaded, or in even steps	This was an area with significant variance with several members supported back-loading changes as this would allow supplier contracts to be adjusted, others mentioned gradual to allow for contracts to expire and ATMs withdrawn, this was the opposite of the more radical issuers and indeed one wanted to see the changes front loaded with greater changes in early years or complete introduction over two years.
F	If a reduction in interchange rates is considered necessary, should the reduction be applied at the same percentage for cash withdrawal rates and balance enquiry rates? Or should the total reduction be delivered though a higher cut in balance enquiry rates on the basis that they have a very low marginal cost?	The perceived over-promotion of balance enquiries to generate income was a theme for issuers, pushing customers towards transaction they didn't really need. Some members advocated that the balance should be moved towards cash and away from non-cash as customers have alternatives for getting account information. This was not a universal view though and others strongly favoured the status-quo noting that it was the total cost pool which mattered rather than its distribution between different transaction types and others commented on the benefits of people checking their balances and that the volume of balances was evidence that they saw this of value.
G	Should branch and non-branch ATMs be treated the same, or should any reduction only be required on remote machines on the basis that this is where previous studies have found evidence of cost over-recovery?	In most cases members thought that these should be treated the same. Some suggested more evidence was needed before making any major changes and other said the Board should focus on other areas where the problems were greater. A few suggested moving to a blended single rate although views were not split on issuer/acquirer grounds with some issuers saying they should be blended, and some IADs agreeing.

H	Should the Board consider reforming Common Ownership rates at the same time as reducing interchange, drawing on some of the thinking from the Network Member Representative meeting on 5th September where this was considered?	While a significant number of members were indifferent the views of those expressed where that either this should be considered or more commonly removed altogether, the exception was One large IAD felt that its removal would encourage the proliferation of ATMs in locations which already had good ATM access.
I	In reaching your view, what do you consider is the evidence that consumers will be well served by the provision of ATMs in the resulting network?	Some members particularly those who advocated rate reductions believed the resulting network, especially with FI support would leave customers well served. Others commented that a wide range of factors should be assessed there, not just ATM numbers, including FI, media response and the ratio of FTU to PTU. Some commenting that getting interchange right should lead to ATMs being where people want them for cash access. Other members, notably acquirers, were more negative and thought that significant numbers of ATMs would either be removed or converted to charging. These members also the compounding effect of falling volumes and increased external costs on top of any interchange reduction. Wider consumer issues around access to cash, lower investment, and knock-on effects on consumer indebtedness and increased cost friction from the move to card payments were also mentioned.