

LINK's Response to the PSR's Review of Specific Direction 8

Introduction

On 19th October 2018 the Payments Systems Regulator (PSR) gave a Specific Direction (SD8) to LINK aimed at ensuring that LINK could fulfil the public commitments it made at the beginning of 2018 regarding the ongoing access to free-to-use ATMs. It was primarily concerned with "protected ATMs", broadly speaking those free-to-use ATMs at least one kilometre away from the next nearest free-to-use ATM. The Direction provides for an annual review at the end of one year and, if still in place, after 24 months. On 11th October 2019 the PSR invited stakeholders to input into this review.

As the Specific Direction applies to LINK naturally LINK wishes to participate fully in this review.

Market Developments Relevant to the Review

SD8 was a direct consequence of the announcement by LINK in January 2018 that it would reduce the basic interchange rate by 20% in four 5% moves. This announcement followed a consultation which commenced 1st November 2017, that is two years ago. The Specific Direction reflected the public debate at that time, on the effect that this might have on the size and geographical spread of the ATM network. However, the market has changed significantly since that time such that attention is now on the wider issues of access to cash and removing barriers to the use of digital payments.

A significant catalyst for this change has been the independent Access to Cash Review, commissioned by LINK in early 2018 and which reported in March 2019. The Review was evidence based, authoritative and overseen by a panel comprising consumer representatives and industry experts. It has become accepted as the source of relevant analysis, and its conclusions have been broadly welcomed by all stakeholders and have been taken on board by policy makers and decision takers.

The report was commissioned by LINK in recognition of the fact that transactions through ATMs were declining as a result of increased use of electronic means of payment, particularly contactless cards the use of which has increased massively over the last few years. When LINK announced the reduction in the interchange it estimated the impact based on a decline in transactions through ATMs of 6% a year, the prevailing rate at that time. That percentage has in less than two years nearly doubled to 11% and that rate of reduction seems likely to continue for the foreseeable future. It is this reduction in transactions and the expectation that it will continue that is now the main driver of changes in the ATM network, rather than decisions taken by LINK on the interchange.

There have been a number of other market initiatives relevant to the use of cash and which have potential implications for access to cash:

- The high street banks continue to be under pressure as a result of having a cost base that is now excessive in relation to the services that customers are willing to pay for and are facing strong competition from new market entrants such as Revolut and Monzo, which operate without any physical infrastructure.
- Generally, the switch from high-street retailing to internet retailing continues, with a number of household names closing down in the high streets. Consumers need electronic means of payment to buy on the internet and are severely and increasingly

disadvantaged if they are unable to do so. This has further accelerated the move away from cash.

- A continuation of the successful Banking Framework agreement has been signed by the retail banks and building societies with the Post Office through which access to cash and deposit facilities will continue to be provided at all 11,500 post offices in the country.
- It is known that the major banks are considering their own initiatives on access to cash which may, or indeed possibly may not, involve being a Member of LINK in the longer term.
- Barclays has recently announced an initiative, which includes the installation of new ATMs, and cash withdrawals from a number of merchants.
- Mastercard has announced an initiative which will facilitate people taking out cash from retailers by reversing the current arrangement whereby the retailer pays the card operator to one in which the card operator pays the retailer. Should VISA take a similar step this could be transformational in retailers becoming a primary source of access to cash. LINK itself has also been working on such an initiative, but like VISA and Mastercard, it faces a regulatory obstacle in that cashback currently is unlawful unless a physical purchase is made.
- Some independent ATM deployers have changed their business models resulting in large numbers of ATMs, although not protected ATMs, being switched from free-to-use to charging. This is an understandable business decision given that their business is ATMs and they need to compensate for the reduced turnover as a result of reduced transactions and the 10% reduction in interchange.

In announcing its measures to protect access to cash in January 2018 it was never the intention of LINK this would be a one-off operation, to be reviewed at a specific date sometime in the future. Rather, it was always the plan continually to take account of current and likely future market developments, to liaise with all relevant stakeholders and to learn from the experience in handling protected ATMs, then using all of this information to design and implement additional measures or amend existing policies and practices to help continue to preserve access to cash. Among the learning points during 2018 and 2019 have been:

- The increasing understanding (primarily by others rather than LINK) of the role played by post offices in providing access to cash. They provide the same service as ATMs in respect of access to cash, and a better service in respect of accepting deposits, and do so in places where consumers want these services. Moreover, post offices are a vital part of local communities, particularly smaller and more remote communities, where typically they are sited inside a convenience store.
- Access to cash cannot be viewed as a subject in isolation but is part of two wider issues. That is giving people the widest possible choice of means of payment, and for smaller communities how access to cash fits in with other priorities. In respect of the first point the public policy priority must be to help remove barriers to people using digital means of payment as otherwise that group of people, often already disadvantaged, will be even more disadvantaged. Preserving access to cash is important for this group but should not be seen as an alternative. On the second point, access to cash is not the main priority for people living in remote areas. In general, this is broadband. In some places, other factors, including continuity of the electricity supply and transport links, are also important. In this context, LINK has taken the advice of, and commissioned a specific report from, Professor Russel Griggs, the recognised expert in this area. His report for LINK, "*Access to Cash in*

Rural Communities”, has become widely accepted as a significant contribution to the quality of public debate in this area.

- LINK has always known that there is a rapid turnover in the ATM estate, in response to other factors such as significant changes in the nature of shopping centres, the establishment of new transport links and new commercial developments. So, a net reduction of 2,000 in the number of ATMs in a year might reflect 2,000 opening and 4,000 closing. SD8 rather implies a more static position, and was almost based on the premise the ATMs would close as a result of the announced reduction in interchange. LINK carefully analysed as best it could the reasons why ATMs were closed, so as to understand better the business model of ATM deployers, which is not easy as these are not publicly disclosed. ATMs are not closed because they have become marginally unprofitable in relation to average running costs. If they are closed for economic reasons this is because they have become massively unprofitable. Broadly speaking, the average cost of running a remote ATM is £20,000 a year (note that the variations in practice are large). However, the marginal cost of running an older ATM could be as little as a tenth of this, say £2,000 a year. It follows that there might be no economic sense in closing an ATM that is generating £10,000 a year as it is more than covering marginal costs and making a significant contribution to overheads. However, operators may prefer to convert the ATM to charging if they believe it will increase overall income. However, it also follows from this that if an ATM is closed, whether for economic or more likely for other reasons, even a substantial increase in the interchange payment is unlikely to be sufficient to provide an economic justification for opening a new ATM. Accordingly, if it is wished to replace closed ATMs then often this has to be through direct commissioning by LINK.
- Many ATMs, including protected ATMs, are closed for reasons that have nothing to do with economic viability. Reasons include the retailer closing down or changing hands, the retailer simply deciding that the hassle involved in maintaining an ATM is not worth the cost and in some extreme cases security concerns. It follows that where an ATM is closed for these reasons it will generally not be possible for another ATM to be opened in the same place. So far, 75 locations which lost a protected ATM and which met the criteria for a replacement have been targeted with higher premiums. However, only five have been resolved in this way. There are now over 34 sites where premiums have not resulted in a replacement for a closed protected ATM and which are therefore in the Direct Commissioning Programme. In other locations, following comprehensive site visits, it has been concluded that ATMs cannot be installed because there are no suitable premises or no willing site owners in the area.
- The market mechanism still operates effectively. ATMs, like other goods and services, are supplied where there is a demand for them and where that demand can be met in a viable way. Of the 75 lost protected ATMs targeted with higher premiums, the normal market mechanism has resulted in 11 new ATMs being installed without any intervention by LINK.
- People rapidly adapt to the opening or closing of ATMs as they do with other goods and services. When a bus timetable changes people adapt by going to the bus stop at the new time for example, or when a retailer changes opening hours people take account of this when deciding when to shop. When an ATM is closed people react in one or more of a number of different ways:
 - Obtaining cash from an alternative source, which might be a nearby post office or an ATM that they pass when shopping or travelling.
 - Taking out larger sums less frequently.

- Using electronic means of payment more frequently.

It follows that if an ATM closes and a new one opens on the same site say six months later, it is very unlikely that it will have anything like the same volume of business as the closed ATM had. People have moved on. Their concerns are the means of payment, not access to cash from an ATM in a specific location.

LINK has responded to these factors by several initiatives introduced as quickly as possible when the necessary analysis and preparatory work had been done. These include:

- As a result of larger than forecast reduction in transactions through ATMs the third planned 5% reduction in interchange, scheduled for January 2020, was cancelled.
- A strong relationship with the Post Office. LINK's ATM locator App has been modified to include all post offices including details of their opening hours. LINK has also had a number of high-level meetings with the Post Office Chairman, invited the Post Office to join the LINK Consumer Council and has regular meetings at an operational level with relevant Post Office executives.
- LINK has increased the maximum interchange rate for low volume ATMs from 30p to £2.75. 2,194 ATMs benefit from enhanced premiums, 54 obtaining the highest possible premium. This was intended to help keep open some ATMs that might otherwise have closed. Analysis shows that ATMs in receipt of low volume premiums are only half as likely to close or convert to charging than those that are not.
- LINK has made a commitment to ensure that all retail centres with at least five relevant shops have an ATM and has taken steps to install ATMs in the small number of such centres that do not currently have ATMs.
- Most recently, LINK has introduced a new Community Access to Cash Delivery Fund so that consumers and their representatives can request a free ATM from LINK when one is needed.
- LINK has raised funds from its Members to commission ATMs directly, either to replace protected ATMs that have closed or as part of the new initiatives. Recognising the lack of expertise among ATM deployers, it has also taken on a role of identifying potential sites and liaison with the site owners.

LINK's Compliance with SD8

SD8 is unusual in regulatory terms in that it imposed on LINK significant documentary and reporting requirements in respect of a commitment made by LINK to protect certain ATMs which might be at a risk of closing following the reduction in interchange. Had LINK not made the commitment there would have been no SD8. The Direction gave specific dates by which much of the initial documentation had to be published and specified the nature and frequency of reporting requirements to the PSR. LINK has fully complied with SD8, employing significant additional resources to be able to do so. LINK estimates that the total cost of complying with SD8 has been up to £150k per year. However, what LINK has actually done in respect of protected ATMs, for all practical purposes, has not been influenced by SD8. The new initiatives covered in the previous section are outside the scope of SD8.

Given the developments outlined in the previous section, the requirements specified in SD8 have had become significantly less relevant to the issue of protecting and enhancing access to cash. Most of the data supplied by the PSR is not used by LINK, which instead relies on

its extensive access to market information from its participants and from relevant stakeholders such as MPs, local councils and consumer bodies, together with a limited amount of hard data on the number and location of ATMs and information about specific protected ATMs.

The Future

It was appropriate to build in a one-year review of SD8 given that it was clear at the time the Direction was made that the market was rapidly changing. Much of the Direction is now irrelevant as it specified dates by which policies and reporting mechanisms had to be put in place, all of which has duly occurred. More specifically:

- Section 1 comprises recitals.
- Section 2 sets out the powers exercised and purpose of the Direction.
- Section 3 comprises definitions.
- Section 4 required the identification of protected ATMs by 31st October 2018 and is now therefore redundant.
- Section 5 required certain policies to be developed and published. This has duly occurred so the section is redundant.
- Section 6 sets out minimum requirements in respect of commitment to protect certain ATMs and is still applicable.
- Section 7 sets out a timeline for policies to be in place. This was achieved so section 7.1 is redundant. Section 7.2 requires weekly reporting on progress in implementing the Direction and is still in place.
- Section 8.1 set out a timeline for policies and processes for the ATM replacement procedure. This was achieved so the section is redundant. Section 8.2 required reporting to the PSR on progress in replacing lost ATMs and is still in operation.
- Section 9 required LINK to give the PSR two weeks' notice of changes in policies and procedures in respect of its commitments.
- Sections 10.1 set out detailed monthly reporting requirements on any changes in protected ATMs and actions in respect of lost ATMs.
- Section 10.2 required LINK to give notice to the PSR of changes to its Financial Inclusion Programme and what has happened to the free-to-use estate compared with its expectations at the time of the commitment. This is still in operation, although for reasons already explained the free-to-use estate is now changing for reasons that have nothing to do with LINK's commitment. The remainder of section 10 has other reporting requirements.

However, SD8 has now fulfilled its original purpose. It has enabled LINK to demonstrate and the PSR to be satisfied that it has met the commitments in respect of protected ATMs in accordance with its announcement in January 2018. The Specific Direction could continue in place even though much of it is now not relevant because the time limits are in the past. This would give LINK no great problems.

The regulated reporting of protected ATMs can continue if the PSR desires. However, LINK expects that its use in practice will be superseded by voluntary reporting by LINK on its recent high street and community ATM initiatives outside of SD8. We do not recommend a separate Specific Direction to cover these new initiatives as the cost in both monetary terms

and in the loss of ability to respond quickly to the rapidly changing competitive marketplace is high.

In addition, a more strategic mechanism for the PSR to review developments in access to cash could usefully be introduced that is based on regular (say monthly) reviews with LINK on the overall marketplace. Rather than focusing on detailed and extensive batches of data for ATMs, which we doubt are actually useful to the PSR, this could focus on the overall development of the marketplace. Attempting to define and manage this through a Specific Direction is unhelpful as the marketplace is changing too quickly. There are also a number of important and complex matters that need addressing to ensure the sustainability of the overall infrastructure. As Natalie Ceeney's Access to Cash Report points out, this infrastructure (including ATM distribution) is fragile and faces a number of immediate and severe threats. LINK would prefer to be working with the PSR on these pressing strategic systemic matters rather than focusing on detailed data relating to market circumstances from two years ago.