

## [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 McDonald's, Marriott, Subway and Compass.

*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 for 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 POS 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.

### 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.

**Callum Godwin**

**Chief Economist, CMSPI**