

CONSULTATION BY THE BOARD OF LINK SCHEME HOLDINGS LTD

LINK'S INTERCHANGE RATE

Final Decision and Impact Assessment

For issue at 7am on Wednesday 31st January 2018

Introduction

Following careful consideration of the responses received to LINK's consultation about its interchange rate, the Board of Link Scheme Holdings Ltd has reached a decision on the changes that it intends to make. This announcement sets out the decision.

In reaching its decision, the Board has also considered:

- An assessment of the impact in line with LINK's obligations as a payment system Operator regulated by the Payment Systems Regulator.
- An assessment of the systemic risks to the LINK payment system in line with LINK's obligations as an Operator of a systemically important payment system regulated by The Bank of England.
- An analysis of the competition law issues surrounding interchange to confirm that it meets all legal obligations.

LINK's objective is to maintain free access to cash for many years to come through an extensive footprint of ATMs with the same geographic coverage as now. It is not intended to change this public policy position. An Impact Assessment gives LINK's analysis of why the changes being made will leave the public's position unchanged. The full Impact Assessment is appended to this announcement.

Current interchange rates are too high as evidenced by the continuing growth in the free ATM network despite declining consumer usage of cash for payments and ATMs for cash withdrawals.

There is an accelerating reduction in the demand for cash by consumers for payments and this should be leading to a reduction in the use of free ATMs and the number of free ATMs. UK Payments (now UK Finance) has reported that cash payments have fallen by 33% in the last ten years to 2016 and are forecast to fall by a further 43% in the next decade. However, free ATM numbers have grown by about 18,000 (50%) in the same ten-year period. In the last year (2017), cash withdrawals over the LINK network fell by 2.25%. However, there was a growth in the number of free ATMs from 53,872 to 54,995 in the same period. This is not sustainable and needs addressing now otherwise the future of LINK is in jeopardy.

This includes the risk that free ATMs will continue unnecessarily to be concentrated in busy urban centres but become less viable in less busy communities, hence reducing geographic access to cash. It also includes the risk of LINK breaking up because some organisations choose to move to competing ATM networks such as VISA and Mastercard that have cheaper interchange regimes. LINK needs to address these risks now.

Whilst individual consultation responses are confidential, LINK's detailed analysis and the responses themselves have been provided to the Payment Systems Regulator. A summary of the responses and of the response to them is also included with this announcement.

Summary of the Changes to be Made to Interchange Now

The Board of Link Scheme Holding Ltd is determined to defend the free ATM network and the consumers who rely on it. LINK will use its new powers as a regulated not-for-profit company with a clear public interest objective to reform interchange which is currently at unsustainably high levels. This will include implementing a strengthened Financial Inclusion Programme to protect every community across the UK from losing free ATM access. Consumers can be reassured that LINK will maintain their access to free ATMs for years to come.

The changes that LINK will make are as follows:

- A phased reduction of 20% in the main interchange rates over the next four years. This will allow the network to develop in size and location to better meet consumer demand and stabilise the competitive position of LINK against other ATM schemes such as VISA and Mastercard. This will start on 1st July 2018. It will mean for the 2018 calendar year an overall 2.5% interchange reduction equivalent to an 0.7p reduction in interchange per non-branch cash withdrawal worth approximately £30 per month in lost revenue for an average non-branch ATM. However, the position will be reviewed annually taking into account unavoidable increases in costs caused by interest rate increases and regulatory requirements, and other trends in the marketplace.
- An increase in some interchange payments through a strengthened Financial Inclusion Programme to ensure that free ATMs are maintained across the country, including in areas where consumer demand is insufficient to justify a free ATM under normal rates. This will be achieved by paying a premium of up to 30p on top of the underlying interchange rates to maintain free ATM access within a kilometre distance. The kilometre distance will be interpreted flexibly to reflect actual travel conditions on the ground, rather than a rigid "as the crow flies" approach. In addition to this, there will be no reduction in the interchange for all current free ATMs that are one kilometre or more from the next free ATM. This will ensure that no ATM that comes into this category will close as a result of the reduction in interchange rates generally.
- A transparent annual review process supported by new publicly available information on changes to ATM numbers that will allow LINK to modify interchange if there is a need to make changes to maintain consumers' free access to cash position.

There is a sustained reduction in the demand for cash by consumers for payments. It is therefore likely that we have entered a long period of steadily reducing demand for ATM services in the UK. The reforms to LINK's interchange announced here will not protect the LINK network in its current form for more than a few years. Yet consumer demand for cash, whilst declining, is likely to remain an essential need for decades to come.

In order to address this longer-term problem and avoid a disorderly reduction in free ATM access, LINK intends to conduct a public Review into Long-Term Access to Cash via an independently chaired committee. This will consider how to maintain free access to cash for as long as needed, how it will be paid for, and the role of ATMs alongside increasing other cash distribution mechanisms such as cash from retailers' tills. It is intended that this Review into Long-Term Access to Cash will start within a few weeks and be concluded by the end of the year. Further details will be announced as soon as possible.

Impact Assessment

LINK's Impact Assessment is attached. KPMG was asked to model the possible impacts of the reduction in interchange on the number of free remote ATMs. KPMG's analysis is appended. Its key conclusion was that the full 20% reduction in the interchange, once the strengthened Financial Inclusion Programme has been applied, would in the long-term lead to a reduction in free remote ATMs equal to 8 to 18% of the current estate of free remote ATMs. This analysis does not take into account some mitigating factors which may reduce the impact of the change in interchange such as ability of deployers to renegotiate contracts, reduce costs, and earn additional revenues. In LINK's assessment, this figure can be considered to be an upper limit, and the actual number will be lower and in the 1 to 11% range.

The PSR has also commissioned Europe Economics to conduct a study to look at how potential changes in interchange might affect the future estate of free ATMs. This has an impact of a reduction of between 0.3 to 6.2% in free remote ATM numbers over time which is similar to LINK's own assessment. This work is also attached.

Summary of Consultation Responses

A detailed summary of the consultation responses received is appended. The Member responses are confidential and the detailed summary anonymises individual inputs.

Member Responses

Seventeen LINK Members responded. All Member responses were 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.

In the year before the consultation, the eight largest Members of LINK had formed a Working Group to try to agree a new interchange settlement. It had not succeeded in reaching agreement. In general, the responses replicated the position with the Working Group, with the large Independent ATM Deployers stating that the proposals went too far, and a number of the large banks proposing faster and more extensive changes.

Calls to strengthen the Financial Inclusion Programme were well supported.

No Member provided detailed analysis on how the proposals would lead to changes in the size or distribution of the network. There was no input on how individual machine profitability and hence viability would be affected.

Consumer and Other Responses

As well as the responses from Members, a number of consumer organisations and politicians provided input, including the LINK Consumer Council. These were all very supportive of the policy objective of a sustaining an extensive free network as now. There were also strong concerns raised by some that the impact should be well understood, and that the risk of consumer detriment must be low.

There was also a range of suggestions relating to the consultation process and to competition law.

Key Findings

The key findings from the consultation responses are as follows:

- All agree with the policy objective of maintaining a sustainable and extensive free network.
- The polarised position of the Working Group is reflected in the responses. This includes several large banks wanting a larger and faster reduction and the large Independent ATM Deployers wanting less and slower.
- Most Members' responses wish the Board to resolve the situation and will support a proposal along the lines of what was set out in the consultation.
- There is strong support for a strengthened Financial Inclusion Programme.
- The two large Independent ATM Deployers suggest that the Board's proposals will lead to a major reduction in the network and severe impact on consumers. The financial evidence for this is based largely on average costs. There is no detailed cost analysis of the impact on individual machines.
- There are some specific concerns relating to the impact of costs outside the Independent ATM Deployers' control including interest rates, regulatory costs, and changes in consumer demand.
- There is a balance in favour of changes to the interchange rates applying equally to branch and non-branch ATMs.
- There is support to abolish Common Ownership (a feature of interchange that applies mainly to ATMs in supermarkets).
- There is debate on the merits of balance enquiry interchange but a concern not to make any changes that limit consumer access to what is considered an important service.

Detail of Changes to be Made

Based on its analysis of the consultation responses, the Board has modified its original proposals. The changes to interchange that will now be made are set out below.

Strengthening of the Financial Inclusion Programme

The Board has already decided to leave unchanged interchange for all existing free ATMs one kilometre or more from another free ATM.

There is also broad support for increasing the premium to up to 30p, and mandating the Board to use this across the country to deal with specific problems with financial inclusion caused by loss of a free ATM. This will therefore be implemented from 1st July 2018.

The one kilometre criterion will be maintained but the Board will exercise its discretion to assist communities of less than one kilometre where practical challenges on the ground warrant action. This will include consideration of shorter distances where geographic obstacles such as roads and rivers exist, and problems with specific vulnerable communities where the one kilometre distance is too far. This will specifically include where closure of a bank branch is leading to a financial inclusion problem.

The LINK Consumer Council will be asked to review and refine the criteria as the strengthened Financial Inclusion Programme develops in use. There will be no financial cap on the Financial Inclusion Programme's cost.

Reduction of Interchange

The 20% reduction over four years proposal has, as expected, proven controversial, with some arguing for less and longer, and others for more and quicker. There have been statements from some deployers suggesting that large numbers of machines will close but very little financial data has been provided to substantiate this.

The Board's Impact Analysis is included with this announcement. It concludes that there will be modest reductions in free ATM numbers as a result of the proposed changes to interchange (see the paragraph 23 of the Impact Assessment).

Therefore, the Board's proposal of 20% over four years will be implemented and in even 5% steps.

However, the Board will review the impact of this on an annual basis, and adjust as necessary to maintain a broad free network. The first two reductions of 5% in 2018 and 5% in 2019 are firm. The total of 20% over four years is a direction of travel rather than a firm target. The annual Cost Study will be maintained to support this annual review. There is no need for this Cost Study to continue to cover all Members and it will be simplified to cover those Members that contribute approximately 80% of the costs. This will reduce the administrative burden for smaller organisations. This simplification will apply from 2019 and the 2018 Cost Study will run as normal, given that it is well underway.

The consultation has confirmed that the costs of interest rates and regulatory costs are potentially significant and outside of deployer control. The Board should therefore take these two areas of cost into account for when future rates are set and if necessary change the 5% reductions to offset cost increases.

The Board will also carefully monitor the effect of reductions in consumer usage of ATMs and review in 2019 whether further mitigation of the 20% direction of travel is required, informed by the results of the proposed public Review into Long Term Access to Cash described below.

To assist in this, a monthly reporting of the number and change in number of ATMs both free and paid by parliamentary constituency will be provided on LINK's public website.

Timing

The Board had proposed implementing changes from April 2018. Given the time taken for the market to adjust, it is proposed to change this to 1st July 2018. This is then over six months from the start of the consultation, and two and a half years from the start of the original Independent Economic Review of interchange commissioned by the now abolished Network Members Council. It is equivalent to a 2.5% reduction in the 2018 calendar year. Subsequent changes will continue to be on 1st January each year as now, starting in 2019.

Branch and Non-Branch

There is a balance in favour of treating branch and non-branch the same through any changes that are made to interchange. This will therefore be implemented.

Common Ownership Adjustment to Interchange

There is some support to review and abolish Common Ownership, although most Members are indifferent, and one argues that it will encourage proliferation.

The Board considers that the Common Ownership adjustment is no longer possible to justify given market changes since its introduction. The Board will therefore abolish it from 1st July 2018.

Some deployers have argued that the existence of supermarket ATMs in large numbers drains away business from otherwise viable remote sites. However, as this is a matter of consumer preference, it does not support continuation of the adjustment given the lack of logic that lies behind the methodology.

Cash Withdrawals Versus Balance Enquiry Interchange

There is wide debate on the merits or otherwise of balance enquiry interchange but also strong concern not to make any changes that limit consumer access to what is considered an important service. The Board considers that the immediate priority is protection of the free network. It should therefore treat both rates the same in relation to the immediate introduction of change.

However, the future treatment of balance enquiry interchange will be reviewed. In particular, the Board is concerned with possible distortions to the way that consumers are offered balance enquiries as a consequence of the current pricing mechanism, including the use of multiple unnecessary prompts to consumers to take balance enquires by some deployers.

Review into Long Term Access to Cash

Consumer usage of cash for payments, whilst still important, is dropping rapidly. However, some consumers will need access to cash for many years to come. This will be particularly so for more vulnerable consumers as they rely on cash more heavily:

- Cash payments make up 40% of all consumer payments.
- Usage of cash for payments has dropped 33% over the last 10 years and is forecast to drop a further 43% over the next decade.
- 2.7 million consumers rely on cash for all of their payments and this group includes a higher number of lower income households than the average.

There is general acceptance of the need to maintain a single nationwide system such as LINK for accessing cash. Whilst the planned changes to the LINK interchange mechanism will stabilised the position for up to four years, longer term reform is required to maintain an effective and inclusive cash access service for as long as needed by consumers.

This is an important public policy matter as many consumers rely on cash and this is expected to continue long into the future.

LINK intends to establish an Access to Cash Committee to consider this matter, taking evidence from all interested parties including the public, consumer groups, politicians, and the industry, and then recommend a way forward. This Access to Cash Committee will work from its launch (intended for the second quarter of 2018) to the end of 2018 and will aim to announce its findings by January 2019.

It will include consumer groups, independent experts, and industry issuers and deployers.

It will be chaired independently and have appropriate funding and support from the LINK Scheme. Its work will be transparent and available on the LINK public website.

The Access to Cash Committee will consider how to maintain free access to cash for as long as needed, how it will be paid for, and the role of ATMs alongside increasing other cash distribution mechanisms such as cash from retailers' tills.

These all raise important matters of public policy and therefore LINK intends to conduct a wide review exercise to assess the best way forward.

The main objective is to maintain an effective and inclusive cash access service that meets the needs of all consumers, regardless of their personal circumstances. The approach will be to:

- Understand consumer needs and implications for cash access requirements over the next twenty years.
- Review the evidence on future trends in cash usage and ATM coverage.
- Identify and analyse options for retaining nationwide access to cash.
- Develop a recommended way forward and high-level implementation plan and economic impact.

Further details will be announced as soon as possible.

Systemic Risk Management Assessment

The Board has assessed the major systemic risks presented by these changes to confirm that they are understood and mitigated. This is in line with LINK's responsibilities as a systemically important payment system regulated by The Bank of England. The systemic risks that have been considered include:

- Some issuers leave LINK.
- Volumes of consumer cash withdrawals drop at an accelerating rate.
- Large numbers of free machines are closed or turned surcharging.

The Board has concluded that it has plans in place to adequately mitigate these systemic risks as follows:

Some Issuers Leave LINK

Whilst this cannot be prevented as it is a matter of competitive choice, the Board considers that the changes that it will make to interchange will restore the competitive attractiveness of LINK over other available ATM schemes. In the unlikely event that LINK does break up because a critical number of its members leave, then an orderly transition to alternative ATM schemes can and will be managed by LINK. This is discussed in the Scheme's Wind Down Plan as part of its risk management obligations.

Volumes of Consumer Cash Withdrawals Drop at an Accelerating Rate

Should consumer demand for cash decline at a faster than expected rate, then this will also reduce interchange income faster than expected. LINK will review interchange rates annually and aim to address this risk through that review by adjusting rates if necessary to maintain an adequate network. However, declining use of cash is expected to be a long-term issue that will require further assessment of how to manage the network in the long run. The Long-Term Access to Cash Review set out earlier will address this risk.

Large Numbers of Free Machines are Closed or Turned Surcharging

Whilst LINK cannot prevent any operator turning any of the ATMs that it operates surcharging, the Board believes that its ability to target locations with interchange premiums through the strengthened Financial Inclusion Programme will be adequate to prevent this happening on a widespread basis.

Competition Law Assessment

The Board has taken extensive legal advice from its lawyers Allen & Overy LLP. Based on the advice received, the Board is satisfied that its proposals meet all competition law requirements.

LINK INTERCHANGE FEE – IMPACT ASSESSMENT

Introduction

1. The UK has a network of 69,800 cash dispensers (ATMs). 55,000 of these are free, but they account for 98% of cash withdrawal transactions. 27,750 machines are owned and run by card issuers – banks and building societies. Many of these are part of branches, some “through the wall” and others inside the branches. Independent ATM Deployers (IADs) own and run most of the free remote ATMs (68%) and also operate all 14,800 pay ATMs. IADs in total account for 60% of all ATMs, but a lower proportion (46%) of transactions. Card issuers pay a fee, known as the interchange, to free ATM owners for every transaction.
2. The interchange fee has been based on a cost study such that it is equal to the average cost of a transaction – separated into four main categories, branch and non-branch, cash and non-cash. A number of banks have considered that the fee is unreasonably high and that this has led to a steady increase in the number of ATMs notwithstanding declining use of cash to finance transactions. Attempts were made between the card issuers and the IADs, over a lengthy period, to secure agreement on changes to the methodology, but ultimately no agreement was possible. With effect from the beginning of 2018 the LINK Board has become responsible for setting the interchange.
3. The Board published proposals for consultation on 1st November 2017. The final decision takes account of responses to the consultation. The Board in reaching its decision has carefully considered its impact through the consultation exercise, its own analysis, analysis by independent consultants (KPMG), and direct meetings with a number of banks and IADs. This final Impact Assessment sets out the Board’s analysis of the impact of its decision.

Summary

4. One counterfactual is “no change’, that is continuing to use the existing cost recovery methodology. The existing approach will lead to reduction in free ATM numbers as consumer demand for cash withdrawals falls, and a concentration of free ATMs in busier centres.
5. A second counterfactual is that some card issuers leave LINK now for schemes such as VISA and Mastercard. VISA is apparently offering interchange rates 30% below those of

LINK. This would result in a considerable and immediate reduction in the number of ATMs.

6. Much, if not most, of the impact of the reduction intended by LINK in the interchange will feed through to lower rental payments to site owners; secondary effects will be a reduction in IAD profitability and a reduction in the number of ATMs.
7. The LINK Board's decision not to reduce the interchange for ATMs one kilometre or more away from the next free ATM together with a much-strengthened Financial Inclusion Programme will ensure that there will be no reduction in the geographical coverage of ATMs as a result of the general reduction.
8. KPMG has estimated the long-term impact of the interchange fee proposals. Its key conclusion was that the full 20% reduction in the interchange, once the strengthened Financial Inclusion Programme has been applied, would in the long-term lead to a reduction in free remote ATMs equal to 8 to 18% of the current estate of free remote ATMs. This analysis does not take into account some mitigating factors which may reduce the impact of the change in interchange such as ability of deployers to renegotiate contracts, reduce costs, and earn additional revenues. In LINK's assessment, this figure can be considered to be an upper limit, and the actual number will be lower and in the 1 to 11% range.
9. The Impact Assessment is confined to the effect of the policy decision to change the interchange methodology. General market trends, particularly the decline in the use of cash to finance transactions, will in any case reduce the number and location of ATMs.

The Proposal

10. The key components of the decision by the LINK Board are:
 - 10.1. A 5% reduction in the interchange rates from 1st July 2018, with a further 5% from 1st January 2019.
 - 10.2. A "direction of travel" for further cuts of 5% in 2020 and 2021 but final decisions to be taken after a "hard review" in 2019.
 - 10.3. The reductions to be mitigated by compensating for any increase in interest rates and regulatory costs, which are outside the control of the deployers. This will be informed by a continuing Cost Study.

- 10.4. No reduction in the interchange for existing free ATMs which are one kilometre or more away from the next nearest free machine.
- 10.5. An enhanced Financial Inclusion Programme, which will enable machines that do close in areas where a free ATM is needed to be replaced and more additional free ATMs to be installed in areas where they cannot be justified through standard interchange rates but where a community needs one. The one kilometre criterion from the existing Programme will be maintained but will be interpreted flexibly, ie distance to travel as opposed to how the crow flies. The maximum premium will be increased from 10p to up to 30p.
- 10.6. Monthly monitoring of the number and location of free ATMs in the network and a commitment to review the interchange if trends are markedly different from those anticipated in this impact assessment.
- 10.7. A longer-term review of access to cash in the face of declining use of cash.

Impact Methodology

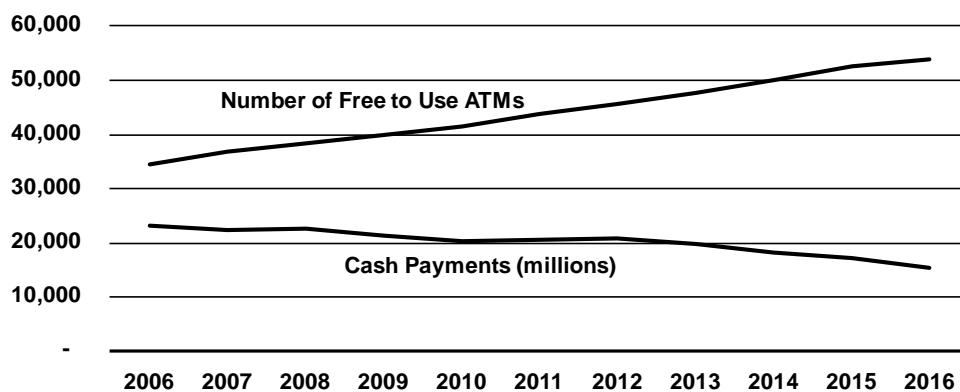
11. There is an established methodology for impact assessments, but equally it is well established that they can never be an exact science. Impact assessments are more reliable the more accurate and precise information that is available and the more that the effects of a policy change can be isolated from other influences. The methodology needs to set out a “counterfactual”, that is what would happen if the policy change was not introduced, and then analyse as precisely as possible the impact of the change.
12. In the case of the decision by LINK three factors have made the impact assessment more challenging:
 - 12.1. The counterfactual is not clear – and could be the break-up of the LINK Scheme.
 - 12.2. LINK has only limited information on the cost structure of IADs and their business models and little beyond average costs was made available during the consultation.
 - 12.3. The marketplace for transactions is changing rapidly, in particular as a result of the declining use of cash for consumer payments. UK Payments (now UK Finance) has reported that cash payments have fallen by 33% in the last ten years and are forecast to fall by a further 43% in the next decade. This factor in itself should lead to a reduction in the demand for ATMs regardless of whether

the interchange methodology is altered. The number and location of ATMs is in any case in constant flux in response to demand and in any year several thousand ATMs are closed and opened.

The Counterfactual

13. There are two counterfactuals that need to be considered. The first is simply “no change”, that is the interchange continues to be set on the basis of a cost study. The current interchange rates, which came into effect on 1st January 2018, are the figures that emerged from the 2017 Cost Study, which was based on costs in 2016. The existing approach will lead to reduction in free ATM numbers as consumer demand for cash withdrawals falls. This is because the declining volume of ATM transactions will generate a declining interchange revenue stream and encourage the closure of less profitable ATMs. Higher volume busy locations will continue to be well served by ATMs. ATMs are more likely to close in less busy locations.
14. There is a second counterfactual that needs to be considered. A number of card issuers consider that the rate they are paying through the interchange is too high. This view is based on:
- 14.1. The counterintuitive trend of a rapid increase in the number of ATMs notwithstanding an already adequate supply of ATMs and declining use of cash. Currently, the number of free ATMs is increasing despite declining consumer demand for cash for making payments (see Exhibit 1 comparing consumers’ use of cash for payments with the total number of free ATMs over time).

Exhibit 1: Number of Free ATMs versus Consumer Cash Payments



Total Cash Payments: Payments UK, UK Payments Markets 2017.
Number of ATMs: LINK Data.

- 14.2. The banks' own calculations of what they consider to be reasonable fees to pay for the service.
 - 14.3. The existence of alternative providers to LINK including VISA and Mastercard. For example, VISA already is capable of providing a similar service to that offered by LINK. Almost all cards and ATMs are already connected to the VISA network and issuers can fairly easily switch between LINK and VISA. LINK understands that VISA is currently offering interchange rates some 30% below those offered by LINK. Card issuers generally prefer to stay with LINK, of which they are Members rather than customers, and which provides an extensive Financial Inclusion Programme that they regard as being essential to provide a comprehensive service to their customers. However, given the amounts of money involved there is clearly a trade-off between the benefits offered by LINK and the cheaper service provided by VISA, particularly as VISA has we understand announced its intention to establish a financial inclusion programme.
15. So, a possible counterfactual is that one or more card issuers decide to leave LINK, which they can do without cost in 2021 at the end of the current contract period with Vocalink – LINK's infrastructure provider. It can also be done in phases from now, with removal in stages of the total card base and no "big bang" exit to focus attention on. If one large card issuer leaves then almost certainly others would follow and the LINK Scheme would end (for the avoidance of doubt LINK and the card issuers would ensure that this was done in an orderly way).
16. Whilst there are many variables involved and is difficult to be precise about what impact that would have on the ATM network, the overall position can be set out with certainty:
- 16.1. The reduction in the number of ATMs with a move to another scheme such as VISA would be much greater than that resulting from the LINK Board's proposal, as the interchange rates currently available are 30% below the current LINK rates and 10% below the LINK rates after a 20% reduction over four years.
 - 16.2. While others such as VISA could develop a financial inclusion programme, modelled on the current LINK programme, it is unlikely to be as effective, at least immediately.

Impact of the Changes

17. It is helpful to start with the base data that supports the analysis. The table below summarises for the last ten years:

17.1. The number of ATMs connected to the LINK network, including the growth in free ATM numbers.

17.2. The total number of cash withdrawals over the LINK network, including the current decline in withdrawals per machine.

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Free ATMs	38,565	39,991	41,581	43,889	45,634	47,715	50,154	52,763	53,923	54,995
Pay ATMs	25,335	23,111	21,687	21,179	20,395	19,782	18,844	17,825	16,097	14,821
Total ATMs	63,900	63,102	63,268	65,068	66,029	67,497	68,998	70,588	70,020	69,816
Free Cash Withdrawals (millions)	1,707.40	1,608.82	1,803.60	1,848.97	1,899.30	1,956.19	1,984.41	2,004.93	2,017.35	1,976.34
Cash Withdrawals Per Free ATM	44,273	40,229	43,376	42,128	41,620	40,997	39,566	37,999	37,412	35,937

18. The UK has a high number and density of ATMs when compared to other European countries, with only Germany having more ATMs and only Spain having a higher density. In particular, the UK has a high number of ATMs per head of population, especially when one considers that the UK is a fairly densely populated country with a single ATM network (compared to Germany and Spain with multiple networks and in the case of Spain a more dispersed population). Most European countries have seen declines in ATM numbers (in some case significant ones) and only the UK, Ireland, and to a lesser extent Germany, have seen growth.

Number of ATMs	2012	2013	2014	2015	2016	Change 2012 - 2016	Pop (millions)	ATMs /million
Germany	82,610	82,761	86,767	86,702	85,352	3%	82.5	1,035
France	58,536	58,638	71,741	60,756	58,480	0%	66.9	875
Italy	50,746	50,042	49,653	50,532	49,286	-3%	60.6	813
Spain	56,258	52,221	50,445	49,569	49,963	-11%	46.5	1,075
Netherlands	7,569	7,383	7,165	7,005	6,750	-11%	17.0	396
Sweden	3,416	3,237	3,231	3,285	2,850	-17%	9.9	287
Finland	2,265	2,241	2,210	2,040	1,923	-15%	5.5	350
Ireland	3,061	3,075	3,628	3,414	3,400	11%	4.8	704
UK	66,134	67,963	69,382	70,280	70,020	6%	65.6	1,068

Source ECB

19. Clearly, the initial impact of a reduction in interchange will be to reduce revenue per ATM by the amount of the reduction. Other things being equal this would lead to some ATMs not meeting profitability criteria set by deployers. It might be assumed that this would lead to those machines being closed. However, this does not necessarily follow. Decisions to close a machine by deployer, whether a bank or an IAD, depend on a number of factors:

- 19.1. Whether the ATM is yielding marginal revenue in excess of marginal costs in line with the required profit margin.
- 19.2. Income from free ATM sources that are not LINK interchange (and are not considered by the Cost Model). This includes International Card Scheme interchange, advertising on ATMs, and foreign currency dispense.
- 19.3. Contracts that allow for costs such as rent to be reduced if interchange income falls.
- 19.4. The cost of removing ATMs.
- 19.5. Some contracts will be for ATMs at all of a client's locations, not just the marginally profitable ones and therefore "unprofitable" sites are supported by other, busier ones.
- 19.6. Other "non-commercial interests" such as a bank's or a remote site host's desire to have an ATM for competitive, brand or convenience purposes even if not directly profitable.

20. The reduction in the interchange will have the following effects:

- 20.1. Reduced profitability for the IADs.
- 20.2. Closure of some machines but in most cases not until the end of the contract period with the site owner. IADs will assume the full 20% reduction in making this calculation.
- 20.3. Some of the contracts IADs have with site owners are believed to have provisions that reduce rent if revenue falls so part of the reduced income will feed through to site owners.

- 20.4. Most site rental agreements run for three to five years and as existing agreements expire IADs will adjust the rents they are willing to bid for sites to reflect the lower interchange fees.
- 20.5. Some ATMs may be switched from free to charging where local market conditions make that possible.
21. The rental issue is key and merits examination in more detail. The rent paid to site owners is in effect a residual and reflects anticipated income in relation to other costs. (A useful analogy is the housebuilding industry: The price a developer will pay for a site is the residual - the difference between the expected sale price and the cost of construction and required profit margin.) The increase in the number of ATMs in the face of declining use of cash must reflect a price more than adequate to cover costs and hence non-price competition between IADs, in practice this can only mean proliferation in the numbers. The scarce resource here is suitable sites so a natural consequence is the bidding up of what IADs are prepared to pay for a site. Between the 2013 and 2016 the Cost Study's occupancy costs for non-branch transactions increased by 33% and now accounts for nearly 8p of the 25p total interchange fee for non-branch cash transactions as opposed to less than 2p for branch transactions.
22. It is not possible to estimate with any degree of precision how the impact of the decline in the interchange will be split between the five effects described in paragraph 20. To enable a more precise estimate to be done would require detailed marginal cost and revenue figures from the IADs and details of their rental agreements, which are not available to LINK. It can be said with some certainty that the whole of the effect will not be felt by the IADs; a significant proportion of it, quite possibly over half, will be fed through to site owners, some immediately and the rest as rental agreements expire. It is reasonable to ask what if site owners no longer find it worthwhile to rent space? In practice, this seems unlikely for those ATMs in retail establishments because ATMs help to attract business (it may be noted that "A boards" outside convenience stores and advertising at entrances to petrol stations often are for "free cash" rather than for petrol or groceries). This suggests that that there will be a low effect on the willingness of site owners to rent space to ATM deployers; they will still benefit substantially even with a reduced rental payment.
23. The best estimate is that over a four-year period the 20% reduction in the interchange will have only a modest impact on the total number of ATMs, largely because much of

the impact will be on occupancy costs. Indeed, the point was made in one of the consultation responses that the reduction in the interchange would have a significant effect on retailers “*who earn a share of the interchange fees and logically will earn less, both through lower commission rates and the expectations of lower volumes*”. There will be a secondary impact on the profitability of ATMs and the number on ATMs.

24. To the extent that ATMs are removed there will probably be some reduction in use of ATMs generally. People may take out larger amounts less frequently, switch more of their transactions to contactless, or use alternative sources of cash such as Post Offices or retailers’ cashback. However, the main effect is simply to switch demand to nearby ATMs of which in most areas there are many. This will increase the profitability of those machines.

25. The rather more important issue is not the number of ATMs but rather the geographical distribution of ATMs. It is helpful to note the starting point:

25.1. ATMs are heavily clustered. More than 80% of all free ATMs are within 300 metres of another free ATM.

Distance to next nearest free-to-use ATM	<100m	100-200m	200-300m	300-400m	400-500m	500-600m	600-700m	700-800m	800-900m	900m-1km	>1km
Number of ATMs	37,747	5,080	2,967	2,125	1,646	1,269	943	696	475	325	2,373
%	68%	9%	5%	4%	3%	2%	2%	1%	1%	1%	4%

25.2. Urban centres now have huge clusters of ATMs in small areas. For example, following is a list of streets each with 55 or more free ATMs within a five-minute walk:

- Gallowtree Gate, Leicester 68
- Long Row, Nottingham 67
- New Street, Birmingham 65
- Market Street, Manchester 62
- Lands Lane, Leeds 61
- St Peters Street, Derby 60
- Knowsley Street, Bolton 56
- Queen Street, Cardiff 56
- King Street, Huddersfield 55
- Waterloo Place, Sunderland 55
- Fargate, Sheffield 55

26. So what impact will the reduction in the interchange have on the geographical spread of ATMs? A number of responses to the consultation expressed concern at the possible creation of “*ATM deserts*”. LINK has a well-established Financial Inclusion Programme that ensures that there are ATMs in deprived areas that could not justify an ATM on economic grounds. LINK has always been clear that it would take steps to prevent “*ATM deserts*” being created. On 14th December, it announced that there would be no reduction in the interchange for all existing ATMs that are one kilometre or more away from the next free ATM. In addition, LINK will now strengthen its existing Financial Inclusion Programme. Previously, the Programme provided an additional premium of 10p on the interchange for ATMs in deprived areas that could not otherwise sustain an ATM. A key criterion was to ensure that an ATM was available within a one kilometre distance of the target area. The one kilometre will now be interpreted flexibly to mean travelling distance not geographical distance, as in some areas one kilometre as the crow flies could mean many kilometres by car and an impossible walking distance. The LINK Board has taken power to provide a premium of up to 30p to support the installation or maintenance of ATMs in all areas that would not otherwise justify one. There is now no geographical limit on the Programme and no financial limit on the cost of it. The Programme generally is moving from a fairly blunt, albeit effective, instrument that has seen the installation of over 1,000 free ATMs to a more sophisticated one allowing for greater differentiation in interchange rates to ensure an adequate geographical spread.
27. The general conclusion is that given the strengthening of the Financial Inclusion Programme there will be no reduction in the geographical coverage of ATMs as a result of the planned reduction in the interchange, because that reduction will not apply to any existing ATM one kilometre or more away from the next free ATM and given the ability to pay a substantial premium to install or maintain in any otherwise underserved area anywhere in the country.
28. It is important to note that this analysis applies to the impact of the changes in the interchange methodology announced by the LINK Board. The point was made at the beginning of this paper that there is a downturn in the use of cash to finance transactions and in the use of ATMs and this in itself will cause a reduction in the number of ATMs as supply adjusts to demand. Therefore, some ATMs will close and others will open – as has been the case for many years – as a result of market forces rather than the announced changes in interchange. However, the strengthened Financial Inclusion

Programme will enable a wide geographical spread of ATMs to be maintained, through subsidising some existing ATMs that would otherwise be closed and subsidising ATM deployers to install new machines.

29. KPMG was asked to model the possible impacts of the reduction in interchange on the number of free remote ATMs. KPMG's analysis is appended. Its key conclusion was that the full 20% reduction in the interchange, once the strengthened Financial Inclusion Programme has been applied, would in the long-term lead to a reduction in free remote ATMs equal to 8 to 18% of the current estate of free remote ATMs. This analysis does not take into account some mitigating factors which may reduce the impact of the change in interchange. In LINK's assessment, this figure can be considered to be an upper limit, and the actual number will be much lower and in the 1 to 11% range. This is a result of the following mitigating factors:

- 29.1. As noted by KPMG, the cost of removing ATMs may mean that in the shorter term, the impact is smaller than the long-term impact estimated by KPMG.
- 29.2. Income from free ATM sources that are not LINK interchange (and are not considered by the Cost Model) may increase over time, including International Card Scheme interchange, advertising on ATMs, and foreign currency dispense, to some extent offsetting the reduction in interchange.
- 29.3. Contracts that allow for costs such as rent to be reduced if interchange income falls may offset some of the reduction in interchange.
- 29.4. Ongoing efficiency savings that are typical for remote deployer operations may mitigate the effect of interchange falls.
- 29.5. Other "non-commercial interests" such as a remote site host's desire to have an ATM for competitive, brand or convenience purposes even if not directly profitable.
- 29.6. Some contracts will be for ATMs at all of a client's locations, not just the marginally profitable ones and therefore "unprofitable" sites are supported by other, busier ones.

Attachments:

KPMG Impact Assessment Report

Europe Economics Impact Assessment (commissioned and published by the PSR)