

# **The Future of ATM Interchange in the United States**



Sponsored by ATMIA and Kahuna ATM Solutions, The Future of Interchange explores options for the future of interchange in the United States by offering perspective about interchange's history, evolution and current condition

# The Future of ATM Interchange in the U.S.

Independent ATM deployers (IADs) throughout the United States have seen ATM-transaction revenue steadily decline over the last 10 years. Market saturation, increasing competition with on-us, surcharge-free ATM transactions offered by issuing banks and credit unions, cash-back debit options and increasing operational expenses resulting from more stringent regulatory scrutiny and security mandates have all taken their toll.

So have fluctuating interchange fees – fluctuations that have not worked in the IAD's favor.

“It just seems to be a fact of life, one that was brought on by retail market pressure put on card issuers for reductions in fees,” says David Tente, U.S. executive director of the ATM Industry Association (ATMIA), an independent non-profit trade association established in the late 1990s to represent the needs of the global ATM industry.

The unforeseen, or perhaps unanticipated, consequences of those fee reductions have hit IADs hard.

Now, ATM industry leaders are working in support of the small U.S. business operators who manage and run over 50 percent of the ATMs currently deployed in the United States. They are pushing Congress and the courts to make changes that will allow for increased competition and greater consumer choice.

This white paper, sponsored by ATMIA and Kahuna ATM Solutions, explores options for the future of interchange by offering perspective about interchange's history, evolution and current condition.



***ATM deployers say the card networks, through tiered interchange, have created unfair business practices. By lowering the fee paid per ATM transaction, independent deployers are at a competitive disadvantage to banks and credit unions.***

Sponsored by





***In the ATM-interchange model, card issuers pay fees to acquirers when cardholders make cash withdrawals. Because the acquiring bank represents the IAD, business or institution that maintains, owns and/or operates the ATM, the issuer pays the fee for the privilege of using the terminal that facilitates the connection to one of the card networks.***

## Interchange in the United States

Interchange comprises a series of fees and payments exchanged between financial institutions for credit and debit transactions that run through networks primarily operated by card brands such as Visa and MasterCard.

In the ATM-interchange model, card issuers pay fees to acquirers when cardholders make cash withdrawals. Because the acquiring bank represents the IAD, business or institution that maintains, owns and/or operates the ATM, the issuer pays the fee for the privilege of using the terminal that facilitates the connection to one of the card networks.

In the merchant-interchange model, the payment is just the opposite, with the acquirer paying the interchange fee to the issuer. In some cases, through what is called ‘reverse interchange,’ an issuer could also pay an acquirer in a merchant transaction.

In all instances, a fee is paid to the card network that facilitates the transaction.

In merchant transactions, those fees are charged to the merchant who in turn passes them along to the consumer through price increases on the goods and services they sell. In ATM transactions, those fees trickle down to the consumer as well.

“The two are different kinds of transactions governed by two completely different sets of rules and serve different purposes,” says Tente. “The use of the same terminology, ‘interchange,’ to describe both merchants’ fees for using payment-card services and ATM operators’ revenues for providing cash-dispensing services potentially engenders confusion.”

Ultimately the card networks, the largest being Visa and MasterCard, benefit most from interchange. It’s the fee they charge to all issuers and acquirers to connect via their networks. The card networks set the interchange structure, which is tiered and based on transaction volume as well as a number of ancillary factors.

Acquirers and IADs benefit from higher interchange rates, too. However, when the fees they collect on transactions decrease, revenue is affected.

# The Case Against Visa & MasterCard

The interchange structure has raised numerous anti-trust issues; consumer, merchant and ATM groups argue the card networks have a monopoly with no oversight because they are owned by groups of issuers and acquirers.

Those anti-trust issues have resulted in numerous lawsuits against Visa and MasterCard.

ATM deployers say the card networks, through tiered interchange, have created unfair business practices. By lowering the fee paid per ATM transaction, independent deployers are at a competitive disadvantage to banks and credit unions.

“In essence, by dropping interchange on a transaction, you’re increasing the costs to the ATM operator,” says Tente. “In a competitive environment, a business would modify the price they charge for a product or service if their expense to buy or produce it increased. And yet for ATM deployers, this rule is in place — fashioned by the networks and passed down through their affiliate banks — that says you cannot reflect differences in the transaction costs you charge to the cardholder. It’s an unfair business practice that may put IADs out of business.”

Fluctuating reductions in interchange have been implemented over time by the card networks to appease merchants.

ATM operators’ interests have been overshadowed in those decisions. The balance between supporting the needs of the issuer and the needs of the acquirer have to be resolved.

“The dominant networks are driving interchange down, with increased ATM-network fees and lower interchange rates, and this is a huge disadvantage to independent operators,” says Mike Lee, CEO of ATMIA.

“There seems to be a competitive agenda behind the reductions, which is to squeeze out smaller and medium sized operators.”

In turn, Lee says, the whole infrastructure of retail/consumer ATMs in the U.S. is indirectly threatened.



***By dropping interchange on an ATM transaction you’re increasing the costs to the ATM operator. In a competitive environment, a business would modify the price they charge if their expense increased. And yet for ATM deployers, this rule is in place that says you cannot reflect differences in the transaction costs you charge to the cardholder. It’s an unfair business practice that may put IADs out of business.***

**— David Tente, ATMIA**



In October 2011, the National ATM Council (NAC), which represents the interests of independent providers of ATMs in the U.S., filed a lawsuit against Visa and MasterCard over their “no differential surcharge” rules. These network rules prevent ATM operators from reflecting different interchange payment levels in the surcharges charged to cardholders for ATM transactions that may utilize different networks.

The ability to have differential surcharges would allow ATM operators to recoup some of the interchange drop, while also charging lower surcharges to cardholders whose transactions utilize networks that are less expensive.

The suit asks the Federal District Court for the District of Columbia to declare MasterCard and Visa’s no-differential surcharging rules unlawful and seeks damages for economic losses that IADs have suffered because of these restrictions.

The court granted Visa and MasterCard’s motion to dismiss NAC’s lawsuit without prejudice in February 2013. In her ruling, Judge Amy Berman Jackson said the complaint was missing important facts establishing the actual injury experienced by ATM operators as a result of the network rules barring differential surcharging. She also indicated that the initial complaint, as filed by NAC, lacked sufficient facts to support the underlying claims of a “horizontal conspiracy” involving Visa, MasterCard and their participating banks, as required by anti-trust laws.

Because the case was dismissed without prejudice, the complaint can be modified and refiled with the court. According to Bruce Renard, NAC executive director, NAC’s legal team is actively working to address the judge’s concerns and file an amended complaint.

“It is not unusual for the court to grant motions to dismiss in cases of the complexity and magnitude involved here,” Renard stated. “Based upon the hearing held by Judge Jackson in September, this was not an unexpected potential outcome.”

Should the court ultimately concur that Independent ATM operators have been injured by the actions of Visa and MasterCard, NAC will have to quantify the financial damages suffered by

***In October 2011, NAC filed a lawsuit against Visa and MasterCard over their “no differential surcharge” rules.***



***The ability to have differential surcharge would allow operators to recoup some of the interchange drop, while also charging lower surcharges to cardholders whose transactions utilize networks that are less expensive.***

ATM providers to establish the specific amount of compensation to which they are entitled. This amount is subject to being tripled, and having interest and attorneys fees added in any final award made in the case.

Independent ATM operators have looked to surcharge or convenience fees as one means of mitigating the impact of interchange erosion.

However, limits on differential (discriminatory) surcharging, which have been in effect since the 1990s, have again given Visa and MasterCard an ATM-network advantage over smaller networks.

“ATMIA has always supported variable surcharging,” notes Tente. “It’s good for competition and good for the consumer. Variable surcharges provide ATM deployers with incentives that result in more choices for the ATM user – and the convenience of an ATM in markets and locations that might not otherwise be served.”

“Several things have resulted from reductions in interchange,” says Tente. “For one, if an independent ATM operator wants to make up interchange losses through surcharges, Visa and MasterCard have prevented them from doing that selectively.”

“‘No differential’ means they have to charge the same surcharge to all the networks,” he says. “For the less expensive networks, ATM deployers might want to drop the surcharge they bring in to help consumers who use lower-cost networks. But under the current interchange structure, they can’t do that. Ultimately, the same interchange has to be in place for the large, higher-cost networks and the small, less-expensive networks.”

The current surcharge restrictions adversely affect both the underlying structure of ATM competition and the transaction volumes that would otherwise be experienced by independent deployers.

Interchange losses, coupled with expenses related to MasterCard and Visa’s demands for compliance with the Americans with Disabilities Act (ADA), the Payment Card Industry (PCI) Data Security Standard, Triple DES and the Europay MasterCard Visa (EMV) chip-card standard, have taken a toll.

ATM deployers feel something has to be done.

It is apparent that something must be done to address the cumulative impacts of these various requirements and initiatives, if the U.S. is to retain the widespread availability of ATMs enjoyed by our nation and its citizens/visitors today, said Renard.

In this regard, it is important to note that the introduction of competition into the ATM marketplace has resulted in there being twice as many cash outlets (ATMs) available in the U.S. Maintaining broad access to cash is more important than ever in the present economy, Renard continues.

In addition to the NAC case and several related consumer class action suits which were joined with the NAC case, there is another anti-trust case pending in federal District Court for the Eastern District of New York against Visa and MasterCard brought by merchants. The lawsuit involves payment-card-interchange fee litigation related to the interchange paid by merchants that accept debit and credit cards.



***Interchange losses, coupled with expenses related to MasterCard and Visa's demands for compliance with ADA, PCI, Triple DES and EMV chip card standard, have taken a toll. ATM deployers feel something has to be done.***

A controversial multi-billion dollar settlement in the merchant case was given provisional approval by the court late last year and the district court's provisional ruling is presently on appeal before the 2nd Circuit federal appellate court, being challenge by a group of merchants.

ATMIA views the proposed class action settlement between merchants and MasterCard and Visa as another potential threat to IAD rights – but a stealthy one that might not emerge for years.

“Although it involves merchant-based claims, the class definition is so broad and so vague that IADs face the risk of being drawn into the suit while, at the same time, being barred from receiving any benefit,” says Tente. “Our concern is that MasterCard and Visa might use the broad release granted by the proposed settlement with merchants as a future defense against IAD claims, generated by objectionable new ATM network rules.”

Acting on those concerns, ATMIA filed an amicus brief calling attention to the fact that ATM deployers were never intended to be included in the settlement – yet they could easily be construed as part of the injunctive class. It was requested that either final approval not be granted or that the language be revised. Modifications were made in the settlement documentation that industry leaders believe provides the necessary clarification that ATM interchange is not part of the settlement.

NAC also filed a motion to clarify the settlement in the merchant case as not adjudicating the issues relating to ATM interchange.

Although the merchant settlement may seem to codify the right to surcharge MasterCard and Visa transactions, there are numerous and complex restrictions. Variable surcharging, such as that supported by ATMIA and NAC, continues to be prohibited in the new merchant agreement. It remains to be seen what, if any, impact this will have on ATM network transactions.



***The dominant networks are driving interchange down, with increased ATM network fees and lower interchange rates, and this is a huge disadvantage to independent operators. There seems to be a competitive agenda behind the reductions, which is to squeeze out smaller and medium sized operators.***

**— Mike Lee, CEO of ATMIA**

## Fluctuating Interchange

Interchange is being influenced by a number of factors, says Bryan Bauer, president of Kahuna ATM Solutions, an Illinois-based company that serves IADs and the interests of more than 18,000 ATMs, accounting for over 64 million transactions annually, throughout the U.S.

“Dodd-Frank, and the implications there for changes to debit interchange, and the proposed settlement between Visa and MasterCard and merchants on the POS (point-of-sale) side are having an impact,” Bauer says.

The Dodd–Frank Wall Street Reform and Consumer Protection Act, which took effect in July 2010, is a piece of regulatory reform designed to restrict fees financial institutions pass along to consumers. A provision in the bill, known as the Durbin Amendment, aims to increase competition in payment processing by controlling interchange fees on debit transactions.

Only affecting banking institutions with more than \$10 billion in assets, the Durbin Amendment mandates that fees charged by card-issuing institutions remain “reasonable” and proportionate to the actual interchange fees that must be paid to process a transaction. The provision restricts anti-competitive practices, encourages competition and includes provisions that allow retailers to refuse card acceptance for low-value purchases. Indirectly, Durbin offers incentives for merchants to encourage cash use or another type of payment card that’s not beholden to the fees assessed by Visa and MasterCard, experts argue.

However in an effort to recover revenues eroded by Durbin, many financial institutions have increased foreign bank ATM fees. These are additional fees a bank or credit union charges its own customers for using ATMs operated by other financial institutions or independent deployers. Foreign bank fees do not fall under the Durbin restrictions – nor are they subject to the same controls as surcharges.

Independents see this as another unfair advantage for financial institutions in a business that already operates on very thin margins, says Tente.

Bauer says the Durbin provision may not have a huge impact on the ATM industry but it’s definitely something IADs are reviewing. “If merchants do encourage the use of more cash, that could benefit independent operators,” he says. “It’s just one area we are reviewing.”



## Why Interchange is an Issue

In recent years, interchange fees have become a controversial subject – a subject at the heart of questions linked to regulatory oversight and anti-trust investigations. Many big-box retailers, such as Wal-Mart, have the ability to negotiate interchange-fee prices. Smaller merchants don't have the same leveraging power and many merchants are reacting by coming up with payments that don't involve interchange.

On the ATM front, the story is a bit different.

“For most independents, the two primary revenue buckets are surcharge and interchange,” Kahuna’s Bauer says. “And IADs’ business models were built based on those revenue buckets.”

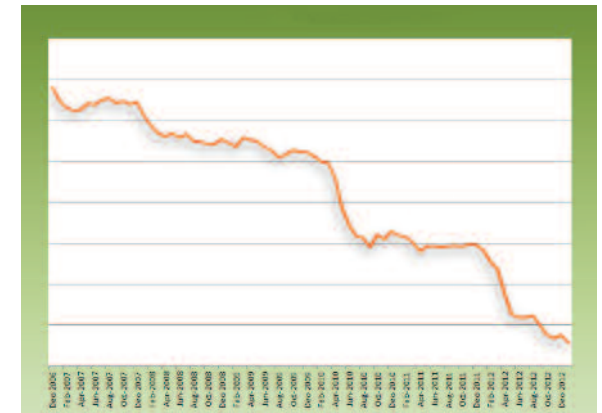
Decreases in network-interchange fees have hit IADs hard, he says. And no IAD can compensate for the lost revenue. Independents cannot afford to absorb all of the expenses without making changes to their business practices.

“Nobody would dare say they see interchange going away,” Bauer adds. “And yet at the end of the day, I don’t know that it matters so much as it does ensuring there is an equitable exchange between the issuer and the acquirer, with the [card] network in the middle.”

“Keep in mind, for the same reason the networks charge interchange for card acceptance at the point-of-sale, independent ATM operators earn the interchange,” continues Bauer. “That reason is ‘the physical burden of cash logistics.’ In other words, processing cards at the point-of-sale removes physical cash logistics and has value to the merchant and their acquiring bank. ATM operators undertake the burden of physical cash logistics, which adds value to the issuing financial institutions and their cardholders who want and need cash.”

The bottom line is that ATM deployers should have the freedom to set their own pricing, he says. If they can ensure their costs are covered, they can ensure a profit. Right now, however, Visa and MasterCard are controlling the pricing.

*For most independents, the two primary revenue buckets are surcharge and interchange. And IADs’ business models were built based on those revenue buckets.*



**Interchange Per Withdrawal: 2006-2012**

*Decreases in network-interchange fees have hit IADs hard. And no IAD can compensate for the lost revenue. Independents cannot afford to absorb all of the expenses without making changes to their business practices.*

**— Bryan Bauer, Kahuna**

# Profitability in an Inequitable Market

IADs have taken steps to increase revenue and subsequent profits by thinking outside the transactional box. Program variations, which require ATM customers with additional services to pay higher fees or add-on offers such as couponing and branding, are being explored as avenues for bringing in additional income.

While the revenue road one IAD pursues may not jibe well with the business practices of another, Bauer offers the following seven tips for additional income generation:

## 1. Update Pricing Strategies

Bauer says IADs must account for fluctuations in network-interchange rates and fees by including or recouping some or all of those revenue losses into the fees they charge for services. This may be a direct pass-through of the fees or interchange declines or indirect pricing strategies. For example, take ongoing service and technical support expenses into consideration, and negotiate those expenses into contracts.

## 2. Increase the Surcharge

Pass more expense along to the cardholder. Force the party or parties participating in the surcharge revenue to help off-set declining interchange revenue.

## 3. Increase Transaction Volume

Joining surcharge-free ATM networks can help independents reap some of the same benefits as bank and credit union deployments; it can especially help the retailer. But this type of model depends on increasing your transaction volumes for profitability and a partnering retailer who sees the value in the increased traffic.

IADs may also consider relying on preemptive balance inquiries and/or marketing messages as additional means to bring ATM

users in. Play a part in helping to drive more traffic to your retailer. More consumers/users translate into increases in transaction volume.

## 4. Upselling

Upselling ATM customers – convenience stores, grocery stores, general retailers and smaller banking institutions – on advertising via ATM screen messages or wraps on ATM enclosures has proven profitable for many IADs. Couponing offers on ATM receipts has been beneficial in some markets as well.

## 5. Outsourcing and Additional Services

IADs have the advantage of not being married to one brand. Often, merchants and smaller institutions interested in off-premises deployments don't want the hassle of managing and maintaining ATM networks on their own. Independents can increase their revenue by providing ATMs for off-premises locations that they own and maintain for retailers and banking institutions. IADs can also partner with other independents for support and joint-venture sales.

## 6. Offset Interchange Losses

IADs should negotiate with retailers and other parties that benefit from interchange, to balance or offset the fees the IAD has to absorb.

## 7. Agreements

Keep service and sales agreements up-to-date to compensate for fluctuations in interchange and allow for flexibility with pricing changes.

## The Future: Thoughts from the Industry

“IADs have been getting hammered by the drop in interchange and it’s particularly difficult with competition on the bank front,” says Bauer. “IADs have to charge customers who use their machines but can’t charge a fee when they use bank ATMs. There are definitely some competitive issues with that.”

“I think people feel pretty helpless in general and they are scrambling to make changes,” he says. “If interchange keeps shrinking it will be a case of who can develop the best strategy to off-set the lost revenue and who can adapt and change the quickest.”

ATM associations are defining ways IADs can work more collaboratively with banks and credit unions to help address that concern. Partnering for ATM placements and servicing deals is part of that but partnering won’t fix everything.

ATMIA has put several committees together to address interchange concerns and other potentials for additional revenue generation, ATMIA’s Tente says. But ways to address interchange losses seem to dominate most conversations.

ATMIA’s Lee says independents in the U.S. and Europe are both feeling the effect, and ATMIA is taking legal action to ensure ATM networks are truly competitive, accommodating a variety of business models and providing a level playing field for ATM operators.

Learning from other international markets could help.

While the dominant card brands have maintained control in the U.S. and much of Europe, Lee points to Australia as an example of how direct charging can work.

In March 2009, the Reserve Bank in Australia enacted direct charging, a pricing model that lessened the financial burden on IADs.

With direct charging, the ATM owner at the time of the transaction charges a direct fee to the consumer. The amount of fee is up to the ATM operator, and the fee often varies from ATM to



***Upselling ATM customers – c-stores, grocery stores, general retailers and smaller banking institutions – on advertising via ATM-screen messages or wraps on ATM enclosures has proven profitable for many IADs.***



***In March 2009, the Reserve Bank in Australia enacted direct charging, a pricing model that lessened the financial burden on IADs.***

***With direct charging, the ATM owner at the time of the transaction charges a direct fee to the consumer. The amount of fee is up to the operator, and the fee often varies from ATM to ATM, depending on the ATM location and/or type of transaction.***

ATM, depending on the ATM location and/or type of transaction. A fee may also be assessed by the issuing institution, typical in foreign bank ATM transactions.

The purpose of the direct-charging model is to make ATM fees more transparent, and ensure consumers have widespread availability and access to cash. Independent ATM deployments ensure that, Lee says, and provide greater choice and convenience for customers.

“In South Africa, we submitted a well-researched white paper to the Reserve Bank to contribute to their formal review of interchange, urging the bank to give careful consideration to the normal business principles of risk/return and fair return required for sustainable businesses,” Lee explains.

The U.S. could benefit from a similar model but the complexity and dynamic nature of the U.S. payments infrastructure poses challenges. The lacking oversight of one entity over interchange and payments poses additional challenges.

As independent ATM deployers work with associations to address mounting interchange issues, some of those concerns will have to be addressed, industry experts agree. Working through associations, like ATMIA, however, are the best recourses for IADs.



## About the Sponsors



The ATM Industry Association is a global non-profit trade association with over 3,700 members in 60 countries. The mission of ATMIA is to promote ATM convenience, growth and usage worldwide, to protect the ATM industry's assets, interests, good name and public trust; and to provide education, best practices, political voice and networking opportunities for member organizations. To learn more about the association, visit [www.atmia.com](http://www.atmia.com).



Kahuna ATM Solutions is the ATM industry's ONLY business development service company dedicated to the success and profit maximization of independent ATM deployers and ATM operators. Originally founded in 1995, Kahuna ATM Solutions has been considered a trusted industry leader for over a decade. Currently, the Kahuna affiliate network contracts for the processing and management of more than 18,000 ATMs across the United States; accounting for over 64 million transactions annually. To learn more, visit [www.KahunaATM.com](http://www.KahunaATM.com) or call 1-888-357-8472.

### ATMIA Disclaimer

The ATM Industry Association (ATMIA) publishes this information in furtherance of its non-profit and tax-exempt purposes. ATMIA has taken reasonable measures to provide objective information and recommendations to the industry but cannot guarantee the accuracy, completeness, efficacy, timeliness or other aspects of this publication. ATMIA cannot ensure compliance with the laws or regulations of any country and does not represent that the information in this publication is consistent with any particular principles, standards, or guidance of any country or entity. There is no effort or intention to create standards for any business activities. This information is intended to be read as guidance only. The responsibility rests with those wishing to implement a compliance regime for their organization to ensure they do so after their own independent, relevant risk assessments and in accordance with their own regulatory frameworks. Further, neither ATMIA nor its officers, directors, members, employees or agents shall be liable for any loss, damage or claim with respect to any activity or practice arising from any reading of this manual; all such liabilities, including direct, special, indirect or consequential damages, are expressly disclaimed. Information provided in this publication is "as is" without warranty of any kind, either express or implied, including but not limited to the implied warranties of merchantability, fitness for a particular purpose, or freedom from infringement. The name and marks ATM Industry Association, ATMIA and related trademarks are the property of ATMIA.