NoteMachine response to Access to Cash Review Call for Evidence

September 2018

Key Recommendations
1. LINK should reconsider implementing the second five per cent reduction (due in January 2019) in light of the impact the reduction in interchange fee has had on the supply of free-to-use ATMs. 2. LINK must also provide immediate clarity over the final five per cent reduction, due in January 2021 to allow ATM deployers to effectively plan and manage their business models in line with expected revenue. 3. LINK and the Payment Systems Regulator must prioritise incentivising and supporting innovation in the ATM sector to ensure the cash network continues to work effectively for consumers and businesses. A "pay-in" tariff should be established immediately to facilitate easier banking for small businesses. 4. The Payment Systems Regulator should establish a working group on remote adviser technology to consider how innovative ATM technology can be deployed across the UK to prevent an increase in financial exclusion in areas where banks are withdrawing branch services.

Executive Summary

- Cash remains a primary payment method in the UK, and ATMs continue to be vital to the UK economy and public. Whilst the number of cash machine withdrawals has fallen, over 50 per cent of UK consumers use their card at a cash machine every week, and the public continues to see access to cash as a priority. This is despite the growth in internet payments and digital payments.
- Continued access to cash is particularly important for demographics which disproportionately rely on cash as their primary form of payment, as well as an important budgeting tool. This includes older people, low-income earners, the "unbanked" and a majority of small businesses operating on local highstreets. For many, a move towards a cashless society is a threat to their ability to access and manage their money.
- LINK's changes to the interchange fee mechanism will lead to a significant decline in the availability of cash for vulnerable groups and small businesses. The current scheduled 15 per cent reduction will make 36 per cent of NoteMachine's ATM estate loss-making. As a result, NoteMachine has downgraded its installation plans for the coming years and will be forced to remove loss-making machines where a new contract with the merchant cannot be negotiated. This will impact 2,887 individual machines.
- It is essential that a sustainable system for interchange fees in the UK is established in the immediate term, to ensure consumers and businesses continue to have access to cash. Without action now, machines will be removed before the full impact is considered.
- It is vital that the UK cash network is maintained to meet consumer demand. A cross-industry approach to sustaining the ATM estate is needed. As an immediate first step, LINK should expedite the process of developing a "pay-in" tariff to facilitate easier banking for small businesses.
- To ensure the cash network continues to work effectively for consumers and businesses, LINK and the Payment Systems Regulator (PSR) should prioritise incentivising and supporting innovation in the ATM sector. As a priority, a working group on remote adviser technology should be established

to consider how this function could prevent an increase in financial exclusion in areas where banks are withdrawing branch services.

Question 1: Cash demand in the UK

- The UK public has enjoyed widespread free access to cash for the last decade. Almost all withdrawals in the UK are currently free at the point of use, and the spread of cash machines outside of banks, including to remote and rural areas, has increased consumer choice and accessibility.
- Cash continues to be a primary payment method in the UK. In 2016, cash payments by consumers totalled £240 billion, with the rate of decline between 2006 to 2016 less than 10 per cent. The average value of cash payments has grown over the period from £15 to £16.
- Despite the decline in the number of cash transactions, the amount of cash in circulation continues to grow. In 2016, the value of cash in circulation outside of the banking system was £71.6 billion compared to £38.8 billion in 2006, an increase of 85 per cent.
- Growth in the volume of digital transactions in recent years has reduced cash's share of all transactions (from 61 per cent to 34 per cent between 2007 and 2017)[1]. However, this statistic is distorted by the inclusion of low value contactless transactions.
- Demand for cash is more accurately reflected in the number and value of cash withdrawals from ATMs. This has remained stable, on average, since 2012. In 2017, £194 billion was withdrawn from ATMs across the UK, and ATMs accounted for 90% of all cash withdrawals.
- In the last three years, there has been a small decline in the number of cash machine transactions, but little change in the total value of transactions. Consumers are making less frequent, but higher value withdrawals.
- Importantly, cash is still widely used as the predominate payment method for many demographics, especially older groups and the financially disadvantaged, who rely on cash as a budgeting tool. The convenience, low cost and familiarity of cash is a major factor in its continuing widespread use: over 50 per cent of all consumers use their card at a cash machine every week.
- Research from *Which?* and the Federation of Small Businesses in 2018 showed that ATMs continue to be vital to the UK economy and public, with an average of £16 per withdrawal spent in nearby stores, and 22 per cent of consumers saying they would be less likely to use a local business if cash was not readily available. [2]

Question 2: Consumer use of cash and digital payments

- The largest single driver of the decline in the volume of cash payments is the shift towards payments by debit cards. Such payments have increased from fewer than five billion in 2006 to 11.6 billion in 2016, with the number in 2016 being 15 per cent larger than the previous year.
- The growth in internet sales has also had an impact on the scale of cash usage, with 16 per cent of non-cash transactions made over the internet in 2017. Wider shifts in consumer behaviour are reflected in greater use of online retail channels, declining footfall in many high street shopping areas and, more recently, the rapid growth in the number of contactless payments.
- However, despite the growth of internet and digital payments, cash continues to hold its own in a digital world. It enjoys the benefits of familiarity, convenience and anonymity. It is also perceived as the most resilient payment method. Recent failures, including the crash of Visa's systems in June

[1] UK Finance, *UK Payment Markets*, 2018
[2] Federation of Small Businesses, *Small firms urge LINK to protect free-to-use cash machines,* March 2018

2018, have highlighted the potential fragility of digital payment methods. Consumers are naturally wary of relying entirely on digital payments they perceive as susceptible to fraud and, often, poor mobile and internet coverage in rural areas.

- As UK Finance statistics show, cash remains the largest single means of payment in the UK and accounted for 40 per cent of the number of transactions in 2016, which was one third more than debit cards, the second most popular means of payment. The average value of cash transactions has risen in nominal and real terms over the decade to 2016.
- In order to preserve consumer choice, it is important that businesses are encouraged to continue to accept cash as a payment method, as removing this excludes demographic groups which rely on cash as their primary payment method. Few shops and leisure outlets as yet refuse to accept cash but the transport and travel sector is increasingly insistent on digital.

Older people

- Cash is disproportionately used by those aged over 54 (comprising 36 per cent of the population), who use cash on average more than once a week for a direct payment. With life expectancy in the UK averaging 80 years old, cash usage by this demographic will need to be supported for years to come.
- There are many reasons for the use of cash as a primary payment method amongst older consumers, but Age UK has found that difficulties with newer technologies, more conservative attitudes to debt, the need to delegate spending to others and to reimburse them, or simply the challenge of changing life-long habits, are some of the reasons behind the choice to use cash.
- A growth in digital payment methods to the detriment of cash does not support older people, due to a lower level of digital skills; 59 per cent of people with low digital skills are aged 60 or over and are unlikely to develop sufficient skills to enable them to successfully switch to a cashless society. The removal of access to cash for this demographic would therefore lead to heighted financial exclusion.

Low income households and the "unbanked"

- 2.7 million consumers relied almost entirely on cash for their day-to-day expenditure in 2016, with cash being particularly important for low-income households. UK households with incomes of less than £15,000 per year account for more than half of all consumers who predominantly rely on cash, primarily as a budgeting tool. This is largely because cash offers greater clarity, security and flexibility, whilst avoiding the likelihood of incurring bank charges.
- There are 1.3 million adults (three per cent of the population) who do not have a bank account, meaning they rely almost entirely on cash as their only payment method. The proportion of "unbanked" adults is particularly high amongst those aged over 85, and those aged between 18 and 24.[3]

Local highstreets

- Cash continues to be central to the sustainability of the high-street, with some retail outlets remaining highly dependent on cash sales. This is particularly true of newsagents, pubs, and convenience stores, where 80 per cent of spending in 2015 was made in cash.
- The Association of Convenience Stores' 2017 Shop Report found 76 per cent of all purchases in the UK's 55,000 convenience stores were made using cash. NoteMachine estimates 40 per cent of cash taken out of a retailer's ATM is then spent immediately in that store.

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[3] Financial Conduct Authority, *Understanding the financial lives of UK adults,* 2017

- Cash continues to be the most cost-effective payment method for small businesses, including an average 1.5p per transaction cost, compared to 5.6p for debit cards and 16p for credit cards. In industries where transaction values are traditionally lower, including newsagents and convenience stores, the cost of processing the transaction via a card payment is greater than if the payment was made in cash.
- Contactless cards attract a higher charge per transaction, ranging between 0.5 to 2.75 per cent. This is despite the fact that the average transaction value for a contactless payment is £9.40, which would attract a 4.7p to 25.9p transaction cost. This compares to 1.5p for the same transaction made by cash.

Question3: Impact of innovation on cash usage

- The role of cash is changing, and the payments sector needs to evolve to ensure that the payments ecosystem continues to work effectively for consumers and businesses.
- The continued decline in bank branches across the UK means that ATM deployers often offer the last remaining access to cash in rural communities, and ATM technology could play a bigger role in supporting financial inclusion.
- Both LINK and the Payment Systems Regulator are charged with supporting innovation in the ATM sector, and NoteMachine is keen to see this demonstrated through the establishment of a “pay-in” tariff to allow small businesses to pay cash in to their bank accounts through the ATM network.
- A vast majority of ATMs are already able to undertake this function, and NoteMachine delivers this function in some of its ATM estate. The establishment of a universal interchange fee through the LINK Scheme would open this function to all banks and small business banking consumers and would allow small business owners to conveniently and safely pay in cash without visiting a designated bank branch.
- As with the current interchange model, the cost of a consumer “pay-in” would be levied by the ATM deployer and processed by the consumer’s bank. As banks already charge customers to pay cash in to their accounts, this method would not involve an additional financial cost, but would remove the need to travel long distances to a bank branch to pay in earnings.
- Government should give additional support to the development of innovative ATM technology such as “remote advisor” technology in order to meet its core objective of reducing financial exclusion by allowing consumers to access bespoke financial services directly from their bank through an independent ATM.
- Remote adviser technology allows consumers to access face-to-face financial advice and services remotely through a mounted screen. Such services are already available in the US and Japan, where 7 Bank has rolled out ATMs with a user interface that connects directly to a remote financial advisor. NoteMachine also already operates this system through its branch network, with on-site ATMs linking customers to NoteMachine advisers through an interactive screen.

Question 4: Regulation of cash

- Continued decline in access to cash poses a considerable risk for small businesses in rural localities, where higher processing costs for card and contactless transactions, coupled with longer journey times to pay in cash at a bank branch, threaten their ability to operate on a profitable basis.
- With 76 per cent of payments in local shops made using cash, it is vital that access to cash is considered on a local basis, with the volume of cash in each area measured relative to population and overall volume of payments. This is particularly important in light of the growth of personal indebtedness and additional costs on small businesses created by the overuse of cards in areas with limited access to cash.

- In the absence of establishing a process to measure cash need in line with population or volume of payments, there will be a decline in businesses operating in areas with limited or no convenient access to cash. This will result in a loss of local economic drivers and growth.
- Assessing local cash usage could be achieved through an annual survey which calculates: the volume of cash transactions, demand from individual consumers and small businesses, and the logistics costs of serving that area.

Question 5: Building a sustainable system for access to cash

- Cash continues to be an effective and popular payment method, with large demographic groups relying solely on cash for their day-to-day transactions and budgeting.
- Despite this, access to cash is declining due to a reduction in the availability of free to use ATMs, and a programme of bank branch closures that is removing over the counter and on-site access to cash and financial services.

Addressing the interchange fee debate

- LINK has stated that its objective is to *"maintain free access to cash for many years to come through an extensive footprint of ATMs.[4]"* However, the ATM footprint is shrinking, and there has been a complete hiatus across the industry on new installations since LINK announced its decision to reduce the interchange fee.
- The effect of LINK's proposed new interchange fee is already being seen. LINK's own data, published in September 2018, shows a two per cent decline in the number of free-to-use ATMs between January 2018 and July 2018, and that 76 "protected" ATMs were removed or deactivated during this period. This is before the first five per cent reduction to the interchange fee was implemented.
- The full 15 per cent reduction, including the second five per cent cut in January 2019 and the potential of a further five per cent reduction in January 2021, will lead to a further decline in the number of free-to-use ATMs across the UK.
- In response to LINK's decision to reduce the interchange fee, NoteMachine has mapped the impact of a 15 per cent reduction on its business and ability to maintain its free-to-use ATM estate. NoteMachine has now categorised individual machines as either: 1) unimpacted by the cut to interchange because of volume of withdrawals, so will continue to be economically viable; 2) impacted by the cut to interchange fee to a degree that the fee paid by NoteMachine to the site owner will need to be renegotiated and reduced; and, 3) severely impacted by the cut to interchange to a degree that the site owner will need to pay a charge to NoteMachine to retain the machine or it will be withdrawn. Without commission paid by the site owner, a number of these machines will become uneconomical over the next three years.
- Without renegotiation of all NoteMachine's contracts with individual merchants, our initial analysis shows that 2,887 individual machines will be loss-making under the reduced interchange fee. This is 36 per cent of NoteMachine's UK estate. This will impact communities across the UK, with greater London, the West Midlands, the North West and Scotland amongst the hardest hit.
- Additionally, the "protected" interchange fee rate applied to remote ATMs (those one kilometre from the next nearest access point) only applies to 313 NoteMachine ATMs. These are often situated in single site stores, such as convenient stores or local pubs, which do not belong to a wider contract agreement. The impact of renegotiating the contracts on these machines therefore places additional pressure on small businesses, which have already stepped in to provide access to cash in the wake of a branch closure.

[4] LINK, *LINK Scheme ATM Footprint Report,* September 2018

- Taking the North West as a case study, a total of 446 NoteMachine ATMs will become loss-making if the full 15 per cent reduction is implemented.
- NoteMachine has downgraded its installation plans by c.20 per cent and anticipates removing c.200 free-to-use ATMs between July 2018 and June 2019. In real terms, 120 fewer machines available to consumers year-on-year.
- Extrapolated across the entirety of the UK's ATM estate, totalling 54,068 machines, a 15 per cent reduction in interchange would result in the economic vulnerability of 20,708 ATMs. Amongst non-branch ATMs (37,606), a 15 per cent reduction would result in 14,403 ATMs being rendered economically unviable. With all of these ATMs located outside of bank branches in rural or residential areas outside of city centres, this would have a significant impact on access to cash for UK consumers and businesses.

The ATM estate as an alternative to bank branches

- The interchange fee must be considered in the wider context of the payment system, particularly the closure of bank branches and building societies in rural communities. Since 2007, the number of bank and building society branches per million people has fallen by around 30 per cent and since 1997 the decline is close to 50 per cent. This has had a compound impact on the number of ATMs available at these sites, with 2,000 fewer machines in 2017 compared to 2014.
- In most instances, independent ATM deployers, like NoteMachine, are offsetting the impact of bank branch closures to communities by providing continued free to access cash in those communities, and of the 44,000 "access points" in the UK, 37,000 are operated by independent ATM deployers. In areas where there is a high geographical cluster of ATMs, this is primarily driven by banks who cluster ATMs at their branches, which are often located in town centres and high streets to drive footfall and ease of access for consumers.
- As independent ATM operators are therefore responsible for a high volume of rural ATMs, the logistical costs of servicing rural areas fall on independent ATM deployers looking to meet the shortfall in access to cash created by the closure of rural bank branches. This includes the cost of obtaining, transporting and re-stocking cash in machines.
- Measures introduced by LINK to "protect" rural ATMs (defined as those a kilometre away from the next nearest ATM), do not sufficiently cover the costs of operating in these areas. Whilst a 30p subsidy on individually identified machines may result in a longer period of maintenance for that machine, it does not incentivise ATM deployers to install machines in areas facing financial inclusion. Similarly, as the interchange fee continues to decline whilst operating costs remain static, the "protected" interchange on these machines will not subsidise the shortfall in funding available for that route of ATMs; thereby leading to the route becoming unsustainable, and the removal of the protected machines alongside the others in that route.
- In the context of a declining number of individual transactions and a reducing ATM estate, the cost of maintaining the current level of free-to-use ATMs across the estate are not sustainable in the face of continued reductions to the interchange fee. Any further changes to the interchange fee should be considered within the context of this changing landscape, with the maintenance of the ATM estate considered alongside the bank branch closures programme.
- A cross-industry approach to maintaining access to cash needs to be taken, with banks actively participating in ensuring that consumer access to cash is maintained in areas where branch access is limited, and that payment mechanisms between banks and independent deployers adequately reflect the cost to serve of ATMs in rural areas.

Annex – number of vulnerable ATMs if 15 per cent reduction implemented.