

Banking Automation **BULLETIN**



Bright future for multivendor ATM software

Reserve Bank of Australia reviews payment systems reform

Barclays' purchase of Goldfish highlights poor condition of UK credit card sector

Shared branch networks offer solution to UK bank branch closures

Société Générale and La Banque Postale to create e-payments joint venture

Country profile: Ireland



Banking Automation

BULLETIN



Multivendor ATM software comes of age

Banking Automation Bulletin celebrates a milestone this month with the publication of its 250th issue.

The *Bulletin* has focused more on ATM hardware than software during the past 28 years, but the role of the latter has become increasingly important in recent times. The rise of Microsoft Windows as the dominant ATM operating system created the environment for a new breed of software – multivendor software – that allows applications to be developed to run on multiple hardware platforms. Multivendor software also allows new ATM functionality to be rolled out more quickly and cost-effectively, providing benefits to both ATM deployers (mainly banks) and end-users (customers).

Brand new research from RBR (see page 2) shows that multivendor software – deployments where an application is being run on hardware other than the developer's own – is already present on 260,000 ATMs worldwide, representing 15% of the global ATM installed base. Almost half of these ATMs are in western Europe, where the penetration of multivendor software has already reached 35%.

RBR interviewed deployers that had already adopted multivendor software and those that had not, with contrasting results. Users acknowledge that migration to multivendor software is a major undertaking, but almost universally view the move as both successful and worthwhile, primarily because of the speed and ease of rolling out few facilities and the leverage the software provides when selecting hardware. Non-users meanwhile are more sceptical about the benefits and concerned about not only the costs of migration but of the software's reliability. In some cases non-users are right not to have moved, as multivendor software is less valuable to some organisations, but for most banks it is a question of when, not whether, the migration will happen.

With the move from the OS/2 to Windows operating systems on ATMs expected to be largely complete over the next two to three years, and as the enthusiasm of the organisations that have also migrated to multivendor software increasingly rubs off on those that have not, the number of multivendor software deployments will continue to grow strongly over the next few years.

Dominic Hirsch, Editor

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Editor Dominic Hirsch

Managing Editor Morten Jorgensen

Assistant Editors Tomomi Kimura, Rob Walker

Contributors Romina Capaldo, David Cavell, Daniel Dawson, Tom Hutchings

Subscriptions Manager Susie Lens

Advertising Manager Felix Kronabetter

For all editorial and advertising enquiries:

Telephone: +44 20 8940 1398

Fax: +44 20 8940 1527

Email: bulletin@rbrlondon.com

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Retail Banking Research Ltd
304 Sandycombe Road, Kew Gardens
Surrey TW9 3NG, United Kingdom

AUSTRALIAN PAYMENTS

RBA reviews Australian payment systems reform

Two new RBA reports highlight important payment trends and issues

Two reports published by the Reserve Bank of Australia (RBA) at the end of 2007, *Household Payment Patterns in Australia* and *Payment Costs in Australia*, highlight current trends and issues in the payments markets of developed economies. These include: the rapid movement towards electronic payments, but with cash continuing to be the cheapest and by far the most widely-used payment instrument, especially for low-value transactions; the impact of national payment methods, demographics, transaction value and other factors on the use of different payment instruments; the difficulties of finding a standard methodology for establishing the cost of various payment methods; and the relatively high resource and economic costs of cheques and credit/charge cards.

The reports' findings are particularly apposite given SEPA's focus on electronic payments and the attempts by the international payment card schemes and some European central banks to enter a 'war on cash'. They provide useful input into the debate on cash substitution, where incentives and/or marketing effort is being given to the replacement of cash by payment card transactions and by contactless cards in particular – with the latter being touted as an ideal vehicle for low-value transactions (up to \$25 in the USA, €25 in Europe or £10 in the UK).

RBA reviews payment system reforms

The two RBA reports were produced as part of the Reserve Bank's review of the country's payment system reforms. This process was initiated in September 2006, began formally in May 2007 with the publication of a consultation paper on the issues to be reviewed, and is scheduled to release its preliminary conclusions in April 2008. The review's objectives are to evaluate the effects of the payment system reforms that have already occurred in Australia, and to define how regulatory arrangements can best promote competition and efficiency in the country's payments system in the future.

The RBA, which is one of the most proactive central banks in the world, has been extremely active in the country's payments systems since 1998. From 2002 onwards it has introduced a series of payment card reforms, many of which were controversial, criticised as ineffective and/or subjected to unsuccessful legal challenges. Standards have been enacted on credit and debit card interchange fees, the removal of Visa's honour-all-cards rule, and the banning of MasterCard and Visa rules that prohibited surcharging (price discrimination). New access regimes have been established for the MasterCard and Visa credit card, Visa Debit and EFTPOS debit card schemes. In addition, the standards and new access regimes have been supported, where relevant, by associated voluntary undertakings by American Express, Diners Club and MasterCard.

Reports backed by robust methodologies

The findings in the two RBA reports are based upon solid and credible methodologies, which utilise data from a variety of sources that appear to have been subjected to rigorous checks for internal and external consistency.

The main source of data for the household payment patterns study was individuals who completed diaries of the purchases they made over a two-week period in June 2007. This gave a sample size of 662 people who performed a total of 17,000 payments and 1,800 ATM cash withdrawals. This was supplemented by data, mainly for March 2007, from financial institutions who reported on 166 million payment transactions; from 11 retailers with total transaction values of over AUS \$6 billion (€3.6 billion); and from six billers (merchants and other organisations) that accepted over AUS \$2 billion in payments. In addition, data on the acceptance of different payment methods and on their customers' usage of these methods were obtained from a survey of 263 small businesses.

From 2002 onwards the RBA has introduced a series of payment card reforms, many of which were controversial

The payment costs study, which measured each payment method's average cost, obtained information from the RBA and the Royal Australian Mint on the costs of cash production, plus data from nine financial institutions which together hold nearly 20 million personal transaction (current) accounts and nine million personal credit card accounts. Other sources included seven large merchants with aggregate sales of AUS \$83 billion in 2006, and five billers, as well as two retailers with non-POS payments, with total bill payments of almost AUS \$20 billion. These entities account for three quarters of Australia's current/credit card accounts, two fifths of its retail sales and 50% of the country's bill payments.

The payment costs study garnered a substantial body of information and had to tackle numerous issues in order to reach its conclusions. These included the treatment of overhead costs; differences between the average transaction values (ATVs) reported by merchants and those seen across the Australian economy as a whole; varying levels of functionality, with credit cards providing a credit function that is not present with other payment instruments; and the best method of determining the direct payment costs of cash transactions.

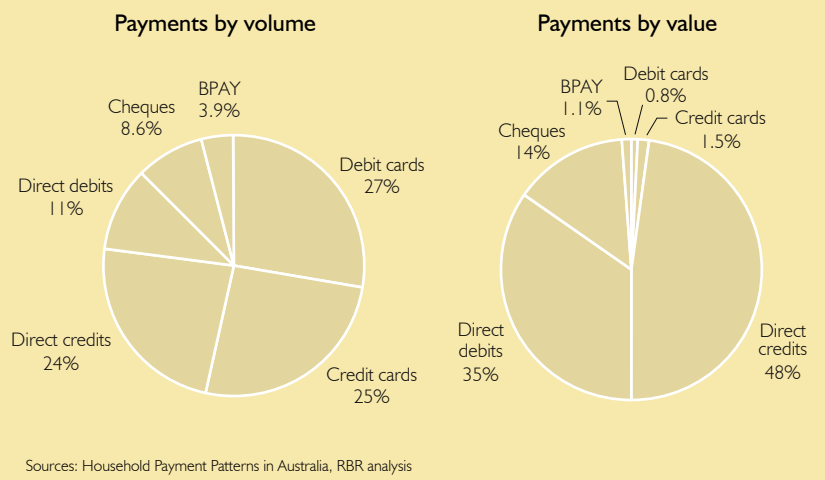
Cards make up over half of cashless payments

The household payment patterns report shows that debit, charge and credit cards were used for over 53% of the 5 billion cashless payment transactions in Australia in the year to June 2007. Direct credits represented 24% of cashless payments, direct debits 11% and cheques just 9%. The least-used cashless payment method was BPAY with just 198 million transactions (4% of the total). BPAY is the national bank bill payment scheme that was inaugurated in 1997, where payments are initiated via the Internet or telephone. Despite its low usage it has grown rapidly since its inception. It is now supported by 180 financial institutions and 15,000 billers and is the most frequently used method for bill payments.

Cashless payment expenditure in the year to June 2007 totalled AUS \$12.3 billion, of which direct credits accounted for AUS \$5.9 billion (48%) and direct debits AUS \$4.3 billion (35%). The relatively low ATVs of payment cards (AUS \$68 for purchases on all types of debit cards and AUS \$138 on credit cards) meant that they represented just 2% of cashless payment values.

Australian cashless payments

Year to June 2007



Cash remains the predominant method

The main finding of the household payment patterns report is that cash remains by a large margin the most widely-used payment method in Australia. Australian households make around 11 billion payments per year, 8 billion of which are cash transactions (businesses make an estimated 0.4 billion cash transactions per year). Each adult in Australia makes around 700 payments per annum, including 490 cash payments (70%), but as cash payments have the lowest ATV (AUS \$28), cash represents only around 38% of personal payment values.

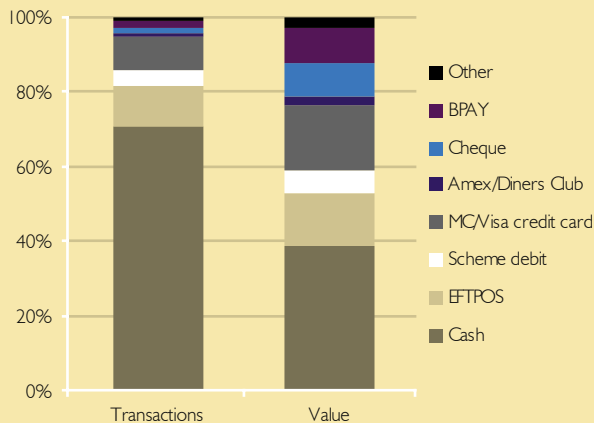
Two thirds of personal payment transactions are under AUS \$30, 91% for amounts less than AUS \$100 and just 2% for values above AUS \$335. Cash is used more frequently than all the other payment methods combined for transactions up to AUS \$50 – it is used for nearly all transactions under AUS \$10 and three quarters of those between AUS \$11 and AUS \$25. At the other end of the scale, cheques and BPAY are prominent for high-value transactions above AUS \$500.

There are several reasons for the continued prominence of cash in Australia and its extensive use for low-value transactions. They include the shorter payment time at points of sale, the fact that around one third of businesses impose a minimum amount for payment card transactions (typically AUS \$10), and demographic factors. There is a clear indication that older individuals use cash more, with people over 60 using cash for over 80% of their payments against 60% for people aged 30 to 39. Around 15% of Australians use cash exclusively, compared

Cash remains by a large margin the most widely-used payment method in Australia

Payment methods by individuals

Australia, 2007



Sources: Household Payment Patterns in Australia, RBR analysis

- ▶ to 20% in the UK according to a 2007 study by APACS, the UK trade association for payments.

Payment cards widely held

Around 91% of Australians hold some type of debit card and 55% a credit card. Cardholding varies considerably by age, with only 78% of people aged over 65 holding a debit card and just 34% of people aged 18-29 having a credit card.

The payment card is the dominant cashless payment method for consumers, accounting for 83% and 65% respectively of cashless payment volumes and values and the majority of all payment transactions with amounts between AUS \$50 and AUS \$500.

The market share of Visa Debit and MasterCard Debit ('scheme debit') cards remains largely unchanged across all transaction values, but that for EFTPOS cards (100% authorised bank-issued debit cards that are accepted via bilateral arrangements between acquirers and issuers) falls consistently as the purchase amount rises.

Around 75% of payment card transactions for AUS \$5 are on EFTPOS cards, compared to less than 20% on credit cards, but these proportions fall and rise in a direct relationship with the transaction value. Over 80% of payment card transactions above AUS \$800 and 90% above AUS \$1,000 are on credit cards, with the market share for EFTPOS cards falling to below 20% and below 5% respectively.

EFTPOS cards typically have daily transaction limits of AUS \$800 or AUS \$1,000, which have a direct impact on their usage. Cardholders tend to use credit cards for high-value purchases of insurance,

holiday travel, professional services and for card not present transactions. Above AUS \$500, credit card payments outnumber debit card payments by a ratio of 4 to 1.

Cheque usage declining except for bill and high-value payments

The use of cheques in Australia has declined significantly over the last decade, with the number of personal cheques written halving since 1994. The household patterns report indicates that only around 30% of people currently have access to a chequebook, with the median number of cheques drawn per account per month being just two and cheques representing less than 2% of retailer turnover. The latter figure is similar to that in a recent survey by the British Retail Consortium, which found that cheques registered just 1% of turnover at large UK retailers, compared to 67% of turnover for payment cards (including 44% for debit cards) and 32% for cash.

Although cheque usage has declined in Australia, cheques still account for 15% of payments of AUS \$500 or over and for 46% of bill payment values. Cheques are just over 10% of bill payment volumes, far behind BPAY (30%) and cash and credit cards (each with 20%).

Further interesting points within the household payment patterns report are that 74% of BPAY payments are originated via the internet; people under 50 years of age use BPAY at three times the rate of those who are 50 or over; and the latter age group writes 63% of cheques by number and 48% of cheques by value.

Similarities between Australian, Belgian and Dutch studies

The RBA's payment costs study was more comprehensive than equivalent recent national studies that have considered the costs of payments, such as that headed by Nederlandsche Bank which produced *The Cost of Payments* report of March 2003 or that chaired by the National Bank of Belgium which led to the document *Costs, Advantages and Drawbacks of the Various Means of Payment* of December 2005. The RBA report examined a broader range of payment instruments, including direct debits and others that are not used at points of sale, analysed the costs for all stakeholders including consumers, and provided detailed estimates of how payment costs vary with the size of payment. What

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is striking, however, are the similarities in the reports' conclusions.

Personal payment costs are 0.8% of GDP

The RBA report's main findings are that:

- The annual costs incurred by Australian financial institutions and merchants for payments made by individuals are at least AUS \$8.5 billion, equivalent to 0.8% of GDP. By comparison, the Dutch study found that payment costs in 2002 represented 0.65% of GDP, while the Belgian study found that payment costs in 2003 were 0.74% of GDP. In both cases a much narrower range of payment instruments was analysed and consumer costs were also excluded.
- The costs associated with cash payments, which constitute around 70% of all payments by individuals, account for almost half of Australia's total personal payment costs. (The Dutch study found that cash payments were around 85% of payments at points of sale and their associated costs were 73% of the total. The Belgian study said that cash represented 81% of POS payments and 78% of payment costs).
- Cash is the lowest-cost payment method for the small transaction sizes for which it is commonly used, with a total production cost of AUS \$0.49 per average POS transaction compared to AUS \$1.01 for an EFTPOS card, AUS \$2.64 for a credit card and AUS \$7.68 for a cheque. It has an important advantage in that cash payments are quicker to process than other payment methods. (The Dutch and Belgian studies produced identical cost rankings, if e-purse transaction costs are ignored.)
- The cost of a cash payment rises with the value of the transaction, so that cash becomes more costly than EFTPOS for payments of moderate value – at around AUS \$40 or AUS \$90 depending upon the approach used for allocating cash costs. The cost of a credit card payment is higher than that using an EFTPOS card for all transaction values. Care must be used when comparing this finding with the Dutch and Belgian studies, which used different methodologies and assumptions. Both studies found that the variable costs of transactions using the national e-purse, Chipnik and Proton respectively, were lower than those for cash and debit cards for low ATVs; and that the variable costs of a debit card purchase were

lower than those of a cash payment for a transaction above €11.63 in the Netherlands or €10.24 in Belgium.

- Credit card payments have higher production costs for POS transactions than cash and EFTPOS cards, with ratios of over 5 to 1 and 2.5 to 1 respectively, although these ratios reduce substantially to around 2 to 1 if one just analyses the costs of the payment function. This is because the latter excludes costs associated with collections, write-offs, the capital for credit risk, and cardholder rewards. In contrast, the Dutch study found that credit cards had much higher ratios, of 12 to 1 for a cash payment and 7 to 1 for a debit card purchase, while the Belgium study calculated ratios of around 5 to 1 against both the other payment methods.
- Cheques have the highest production (resource) costs for both POS and non-POS payments, with the cost for an average transaction being AUS \$7.84 and AUS \$5.21 respectively. Payment function costs were slightly lower in each case. Cheques have markedly higher production costs for financial institutions than all other payment methods, with an average cost per transaction of AUS \$4.70. Neither the Dutch nor the Belgian studies looked at cheques – there are now no cheques in the Netherlands and cheque usage in Belgium in 2005 was only 1.5 per person.
- For non-POS payments, which were not covered by the Belgian and Dutch studies, the cheapest payment method is direct debit with a total production cost of AUS \$0.77 per transaction, followed by BPAY (AUS \$1.01), credit cards (AUS \$2.49) and cheques (AUS \$5.21).
- The inclusion or exclusion of consumers' resource costs, which mainly consist of the time it takes to make a payment, would not have changed the relative cost ranking of the different payment methods.

Valuable input into current debates

The payment cost report is careful to stress that it has merely provided a guide to the average and relative costs of various payment instruments, rather than definitive cost estimates. However its findings provide valuable input into the current debates on the economics and cost-effectiveness of different payment methods, not only in Australia but in developed economies throughout the world. ■

Cash is the lowest-cost payment method for low-value transactions, with a total production cost of AUS \$0.49 per average POS transaction

Cheques have the highest production costs for both POS and non-POS payments, with the cost for an average transaction being AUS \$7.84 and AUS \$5.21 respectively

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