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ATM Surcharges and the Expansion of Consumer Choice

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Introduction

The 1996 decision by the two largest automated teller machine (ATM) networks in the United States--Cirrus and Plus--to lift their bans on transaction fees has sparked an organized campaign by consumer groups, small banks, and credit unions to outlaw such charges. Sen. Alfonse D'Amato (R-N.Y.), chairman of the Senate Banking Committee, is leading the effort on Capitol Hill. D'Amato, who has denounced what he calls the large banks' attempt to "nickel-and-dime the consumer to death!" has introduced the Fair ATM Fees for Consumers Act (S. 885) that would ban the imposi- tion of surcharges by ATM owners.[1] He wants to prohibit financial institutions from charging fees when customers of other financial institutions use their ATMs for transactions.[2]

Naturally, few consumers want to pay for services that were once provided free. But the increased imposition of surcharges by ATM owners has spurred the spread of ATMs to the benefit of millions of Americans. Banning ATM surcharges would end up hurting customers as well as banks.

Consumer Benefits

ATMs have provided an important expansion of banking services that has benefited all consumers. Before the introduction of ATMs in the early 1970s, bank customers' access to their cash was limited to traditional banking hours. Customers often found themselves waiting in long lines on Friday afternoons just to withdraw enough cash to carry them through the weekend. ATMs opened a whole new world of convenience by eventually allowing access to banking services 24 hours a day, 365 days a year. Networks between banks, such as Plus, Cirrus, and Honor, developed so that customers could have access to their money through other institutions' ATMs throughout the world. To pay for that service, banks typically charge a fee to help defray the cost of belonging to the network.

Before the 1990s owners of ATMs typically did not charge other banks' customers for the use of ATMs; indeed, such surcharges were expressly forbidden by most networks. But, in the early 1990s, local banks and other ATM owners, who could not cover the cost of maintaining ATMs that face a high demand for cash withdrawals from nonlocal banks, pushed for lifting the voluntary ban on surcharges. As a result, legislatures in 23 states passed laws that allowed individual members of ATM networks to impose surcharges. Operating an ATM that receives a lot of traffic but that not many local customers use makes no sense. ATMs generate huge costs, so banks were unwilling to provide free ATM services to noncustomers.[3]

Restricting surcharges provoked the interest of the U.S. Department of Justice as unfair pricing. Under pressure from local banks and nonbank ATM owners, the Department of Justice began considering whether the ban on ATM surcharges was anti-competitive and harmful to consumer welfare.[4] Feeling pressure from state and federal authorities, Cirrus and Plus "bowed to the inevitable" and removed their voluntary restriction of fees.[5] That action limited their chance of being sued by the government and allowed them to better meet the specific needs of their network members. It is ironic that the government forced the end of the voluntary ban on ATM surcharges but now wants to do the opposite under the direction of D'Amato. If he succeeds in prohibiting surcharges, however, he will limit an important timesaving option for all Americans.

D'Amato and other critics of the ATM surcharge should recognize that some banks still choose not to charge fees and use their free ATMs to attract customers. Moreover, the introduction of surcharges has increased the deployment of ATMs to more convenient locations, reducing search and travel time. Individuals can use the time saved for more important activities. In 1996 alone the number of ATMs shipped to operators increased by 40 percent.[6]

Much of the ATM growth is due to the increase in purchases by nonbank and nonthrift firms. Of the new shipments in 1996, almost half (16,122 units) went to nonbank or nonthrift owners. Two ATM vendors, Triton and Tidel, that target the nonbank and nonthrift markets nearly doubled their sales. Triton shipments were up 91 percent, and Tidel's increased by 115 percent.[7] And the second largest owner of ATMs in the country is EDS, a Texas-based, nonbank, nonthrift company. Since nonbank and nonthrift owners of ATMs have no base of bank clients, the only way for them to earn money from their ATMs is by charging fees.

Banks have also responded to consumer needs by expanding their ATM networks beyond their branch offices. The number of off-premises installations of ATMs by banks and thrifts increased 24 percent from 1995 to 1996, compared with on-premises installations that only increased by 9 percent.[8]

The reason for that growth is simple: Allowing ATM surcharges has encouraged firms outside the banking industry, as well as banks, to put ATMs in more convenient locations where, without surcharges, ATMs may not generate enough bank customer traffic to be profitable. Those locations include supermarkets, convenience stores, and airports. Consumers now have the option of paying a surcharge for getting money from the new machines or going to other, less convenient, ATMs.

The recent surge in ATMs in convenience stores and supermarkets is evidence that consumers value the ATMs and are willing to pay the surcharge. Because of the surcharge, ATM owners are now able to provide consumers with better services:

• From 1995 to 1996, the percentage of ATM owners supplying ATMs in convenience stores rose from 36 percent to 50 percent; the percentage supplying them in supermarkets rose from 28 percent to 35 percent.[9]

• The percentage of supermarkets with ATMs increased to 40.5 percent in 1996, up from 37.7 percent in 1995.[10]

• In 1996, 53 percent of convenience stores contained ATMs compared to 41 percent in 1995.[11]

The fact that such ventures are increasing is an indication that consumers are willing to pay fees for the convenience they are receiving. Consider the case of an average busy couple. While doing the weekly grocery shopping, they can get cash in the store for a fee of $2, or they can make an extra trip to their own bank. Instead of dragging the kids across town just to avoid the surcharge--even a location only a few blocks away may involve a 20-minute drive--they may be willing to pay the surcharge, thereby saving them the cost of the trip. They undoubtedly benefit from that transaction since they prefer the convenience of withdrawing money on the spot to leaving an additional $2 in their checking account.

Critics argue that without the surcharge consumers would get the convenience without the fee. In other words, consumers would still get the same service for free. In fact, fees have played a significant role in making ATMs more widely available. Before surcharges, a low-cost ATM needed 3,000 transactions a month to break even. Today, with income from surcharges, the same ATM can break even with only 500 transactions a month.[12] Prohibiting surcharges would limit the number and location of ATMs and inconvenience consumers. In effect, government would be levying a "time tax" on consumers by denying them the choice of convenience and forcing them to travel to their own banks to get cash.

Are ATM Profits Excessive?

Banks have also been accused of unfairly charging fees when ATM services are actually cheaper to provide than teller services. A recent study by U.S. Public Interest Research Group stated that "surcharge revenue is virtually all profit."[13] Another study by U.S. PIRG and the Center for the Study of Responsive Law reported that banks increased their profits by $2.2 billion in 1995 by substituting ATM transactions for teller transactions.[14] The same study stated that ATMs generated $3.1 billion in fees while costing banks $3.2 billion, which is a $100 million loss. The supposed profit comes from $2.3 billion savings from replacing tellers--for a net profit of $2.2 billion. The cost savings in that study, however, do not match the results of other, more objective studies. That study assumes, incorrectly, that ATM transactions are a one-for-one replacement of teller services.

When ATMs were first deployed, banks hoped that they would replace tellers. Two studies in 1978 and 1980, based on Federal Deposit Insurance Corporation data, predicted large economies of scale in ATM use due to the replacement of bank branches.[15] But that cost saving has not been realized because ATMs have not replaced tellers. Bank customers like ATMs, but they still prefer to use tellers for some transactions, such as depositing money. The number of staffed bank offices has actually increased by 15 percent since 1985, despite a sevenfold increase in the number of ATMs.[16] Also, the number of tellers has decreased by only 8 percent since 1983.[17] Instead of substituting for and replacing tellers, ATMs have become a complementary service offered by banks.

Because of the easy access ATMs provide, customers tend to use them often. A study by economist David Humphrey at Florida State University calculated that bank customers use ATMs twice as much as they use traditional banking ser- vices.[18] Bank customers tend to withdraw less money at a time and increase their trips to the ATM. Increased use of ATMs tends to eat up the cost savings that might be achieved if consumers simply substituted ATM transactions for the same number of teller transactions. According to Humphrey, "This suggests that the cost savings, which could have been reaped by banks by substituting ATMs for branch offices, have instead largely flowed to depositors who have showed their preference for the increased convenience provided by ATMs."[19]

The consulting firm of McKinsey & Co. estimates that ATMs have added $1.5 billion in additional costs to banks and created less than $200 million in savings from replacing tellers.[20] The Federal Reserve Board's Functional Cost Analysis shows that ATM expenses exceeded the income generated by ATMs by an average of $10,445 per ATM per year from 1991 to 1995. The average yearly loss for the industry due to ATMs is more than $1 billion.[21]

So why do banks continue to deploy ATM machines? Humphrey believes banks increase their base of customers who use other bank services by adding ATMs, which is why banks incur the direct loss of providing ATMs. "Overall," he states, "it is probably the case that users of bank deposit services have benefited more from the change in the delivery of services than have the banks."[22]

Are ATM Fees Anti-Competitive?

Credit unions and smaller banks have complained that ATM fees are a plot by big banks to use surcharges on noncustomers to induce members of credit unions and customers of small banks, which have very few ATMs, to take their business to bigger banks that have many machines. The alleged scenario is that customers of small banks will get tired of paying ATM fees and will shift their accounts to larger banks to avoid the surcharge. Community banks will be squeezed out, creating a less competitive banking industry.

The supposedly less competitive atmosphere is a myth. Since Cirrus and Plus lifted their prohibition on surcharges, only 3.7 percent of Americans say they have moved their accounts to banks with more convenient ATMs.[23] Many banks and competing networks still do not charge fees, and the proliferation of fees has provided a new push for competition among banks. According to the General Accounting Office, fees are charged for use of only 54 percent of the ATMs in the United States.[24]

Before surcharging, smaller institutions benefited from other banks' vast ATM deployments without having to pay the cost of installing their own machines. The installation and maintenance costs were borne by the customers of banks with large numbers of ATMs. Customers of large banks were subsidizing the ATM use of customers of small banks, who generally receive better rates and service. Now smaller institutions are claiming that free ATMs are an entitlement for all bank customers.

Moreover, community banks are not averse to charging fees. A recent survey by Grant Thornton LLP found that 85 percent of those smaller institutions viewed "increasing fee income" as critical to their continued success. Thirty-two percent imposed ATM surcharges on noncustomers, and 16 percent more planned to do so in 1997. And because of the decline in free ATM service for their customers at other banks, half of all community banks plan to install more ATMs of their own.[25] Those banks can increase their revenues by charging noncustomers for using their machines, thereby increasing the incentive to deploy machines that benefit their own customers.

Community banks and credit unions do not compete with larger banks in the provision of the same services. Normally, individuals bank with smaller institutions because they prefer personal service, better rates of return on deposits, and fewer fees. Because community banks concentrate on those areas, they may be less able to expend resources on extensive ATM networks. Customers who prefer to be served doughnuts and coffee as they buy certificates of deposit and never use ATMs will continue to use small banks. Other customers who have only money market accounts and bank through ATMs at odd hours will choose larger banks with extensive ATM networks.

Even if small financial institutions were to lose business as a result of the imposition of surcharges by larger banks, that would not provide a reason for government action. There is no reason to protect smaller banks that do not provide the services consumers want and can get only from larger banks. In the U.S. economy, innovative firms that meet the needs of consumers traditionally replace firms that do not.

Are Consumers Charged Twice for the Same Service?

Many critics also complain that surcharging amounts to charging the consumer twice for the same transaction. That is often referred to as "double dipping." Noncustomers are often assessed two charges for using an ATM that is not owned by their bank, but the charges cover two different costs. The first fee, which has always existed, is charged by the customer's own bank. That fee goes to cover the bank's cost of belonging to the network and for completing the transaction. The second fee, or surcharge, is assessed by the owner of the ATM. That fee covers the installation, maintenance, rental space, and security costs of the ATM. The second fee differs from machine to machine because each individual ATM owner, not the ATM network, sets its own surcharge. That is why the fees are separate. If the surcharge were eliminated, banks would have to come up with a formula for charging their customers a single fee that averaged out all of the possible surcharge fees by ATM owners. Because of the diversity of charges throughout the world, there is no way to know in advance if a flat fee charged by the customer's institution would be enough to compensate an ATM owner.

Most important, if the two fees are separate, consumers can choose whether they want to pay different fees at different locations. That feature encourages thrifty customers to search for other cash options, while customers who value time more highly may choose to pay a steep fee at a more convenient location. Eliminating the separate surcharge might force a single, higher fee to be charged by a customer's own bank to cover the variable compensation costs to ATM owners. So a withdrawal at an ATM in a shopping mall that used to cost $1 might rise to $2. The higher fee would subsidize the less thrifty consumer in a casino who might otherwise have paid a surcharge of $3. The thrifty end up subsidizing those who are not so thrifty. When the basic fee is separate from the surcharge, consumers bear the costs of their decision to use another bank's ATM.

Consumer Choice

Consumers are not helpless when it comes to avoiding surcharges. Consumers are fully aware that surcharges exist, and many have altered their behavior because of them. Federal Regulation E mandates that all ATM terminals must warn consumers about surcharges and give them the opportunity to refuse to make a transaction without having to pay a fee. Most networks also require surcharges to be posted. But some critics of surcharges claim that the disclosure of ATM surcharges is not enough to prompt consumers to take the card out of the machine when it says there is a fee. D'Amato stated, "When a consumer uses an ATM, he or she is usually a captive audience. The consumer rarely has much of a choice."[26] You would think the senator was talking about the addictive powers of heroin.

D'Amato grossly underestimates the intelligence of the American people. As Pat Bond, a computer consultant, recently noted in the New York Times, "The banks think we have no choice but to pay these fees. Well, there is [a choice]. I can still walk away with my feet to a bank that doesn't charge a fee."[27] The alternatives to paying surcharges are numerous. They include using only your own bank's ATMs (90 percent of all banks provide free ATM service at their own terminals); using ATMs that do not charge fees; increasing the amount of cash withdrawn and reducing the number of transactions made at other banks' terminals; and using checks, credit cards, and travelers checks. There is even a site on the World Wide Web (www.surcharge-free-atms.com/ surchargefree.html) that provides a list of all ATM terminals that can be used without payment of a surcharge.

Consumers are not unswervingly committed to their current pattern of ATM use. A March 1997 nationwide survey by the American Bankers Association showed that many customers had changed their banking behavior in response to the imposition of surcharges: 24.6 percent said that they now use only their own bank's ATMs, and 21 percent said they now use mostly their own bank's ATMs and limit the amount they use ATMs not owned by their bank.[28]

ATM surcharges also have created another area of competition for banks. In California a "No Surcharge Here!" campaign was launched by a coalition of seven banks and major credit unions that have more than 2,000 ATMs in five western states. Similarly, 92 of 217 banks in Massachusetts and the Community Bank of New England, with a total of 1,100 ATMs, have formed no-surcharge coalitions.[29]

Conclusion

Consumers have the ability to obtain money from their bank accounts without paying a surcharge. ATM surcharges allow banks and other ATM operators to deploy machines in more convenient locations than might otherwise be possible. Customers who are unwilling to pay a surcharge incur the cost of inconvenience, while those who value the convenience more than the cost of the fee have the option of paying for it. Senator D'Amato, Rep. Bernie Sanders (I-Vt.)--Congress's self-proclaimed socialist--and numerous consumer groups have formed an unlikely coalition to put an end to ATM surcharges. If successful, that campaign would limit the options of consumers, since there would be no means to support the more convenient ATM machines. Prohibiting ATM surcharges would only harm consumers by slowing the expansion of ATMs and reducing the number of ATMs currently deployed without making anyone better off.

Notes

1. Alfonse D'Amato, "People Shouldn't Pay Twice Just to Get Their Own Money," American Banker, May 13, 1997, p. 4.

2. See John Charles Bradbury, "Ban Fees, and You Banish ATMs," Wall Street Journal, July 14, 1997, p. A14.

3. Valerie Block, "Banks Hit Jackpot with Casino ATMs As Resurgence in Gambling Spreads," American Banker, May 9, 1994, p. 15.

4. David Balto, "Payment Systems Face More Antitrust Scrutiny," American Banker, June 14, 1994, p. 12.

5. Beth Piskora, "Visa Will Let ATM Owners Slap Fees on Noncustomers," American Banker, November 27, 1995, p. 1.

6. "The Good Times Roll for ATM Vendors," Bank Network News 15, no. 20 (March 12, 1997): 1. There were 33,406 ATMs in 1996. That number is greater than the total number of ATMs shipped between 1991 and 1993--31,900.

7. Mentis Corporation, "Non-banks Increasingly Drive ATM Growth," News release, March 27, 1997, p. 1.

8. Ibid., p. 2.

9. Ibid., p. 3.

10. "The Food Marketing Industry Speaks: 1997," Food Marketing Institute, Washington, p. 10.

11. "1997 State of the Industry Report," National Association of Convenience Stores, Alexandria, Virginia, 1997.

12. "The Good Times Roll for ATM Vendors," p. 4.

13. U.S. Public Interest Research Group, "Twice As Many Charge Consumers Twice," Washington, April 1, 1997.

14. Center for the Study for Responsive Law and U.S. PIRG, ATM Profits Soar, Yet Banks Now May Hit Consumers with Double Fees (Washington: U.S. PIRG, March 1996), p. 1.

15. David Walker, "Economies of Scale in Electronic Funds Transfer Systems," Journal of Banking and Finance 2 (June 1978): 65-78; and David Walker, "Electronic Funds Transfer Cost Models and Pricing Strategies," Journal of Economics and Business 33 (Fall 1980): 65-78.

16. Eleena de Lisser, "Customers Thwart Banks' Plans to Cut Branches," Wall Street Journal, May 16, 1997, p. B1; and 1996 Statistical Abstract of the United States, vol. 1, p. 517.

17. Philip Hudson of the American Bankers Association, Statement before the Subcommittee on Financial Institutions and Consumer Credit of the Senate Committee on Banking, Housing, and Urban Affairs, April 24, 1996, p. 147.

18. David Humphrey, "Delivering Deposit Services: ATMs versus Branches," Federal Reserve Bank of Richmond Economic Quarterly 80 (Spring 1994): 67-70.

19. Ibid., p. 77.

20. de Lisser, p. B1.

21. Calculated from Functional Cost Analysis (Richmond, Va.: Federal Reserve Bank, 1991-95).

22. Humphrey, p. 77.

23. American Bankers Association, Nationwide Customer Telephone Survey, March 21-23, 1997. Polling done by TeleNation.

24. General Accounting Office, "Automated Teller Machines: Banks Reported That Use of Surcharge Fees Has Increased," May 16, 1997.

25. Grant Thornton LLP, "ATM Fees Not Just for Large Banks," News release, March 17, 1997.

26. D'Amato, p. 4.

27. David Morrow, "Is Your ATM Ripping You Off?" New York Times, May 4, 1997, sec. 3, p. 1.

28. American Bankers Association, Nationwide Customer Telephone Survey.

29. U.S. Public Interest Research Group, p. 4.

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