LINK Access and Governance Working Group report

April 2006
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FOREWORD

This is the report of the LINK Access and Governance Working Group (the Working Group) set up by the Payment Systems Task Force in July 2005 to consider access and governance issues related to LINK, including an evaluation of the benefits and weaknesses of the current arrangements, potential changes to remedy any identified weaknesses, and the demand for change, including the wider society case for change and the costs and benefits of such changes.

The Working Group initially considered the current access and governance criteria, and any perceived problems with the existing arrangements. The Working Group looked at the issues raised by the Cruickshank report of 2000 and the Office of Fair Trading’s (OFT) report *UK payment systems 2003* (OFT658), and how things had changed since those reports. It then looked at alternative arrangements, including industry-accepted best practice, and how similar issues had been addressed in ATM schemes in Canada and Portugal. It also sought comments from stakeholders in LINK via a questionnaire.

The Working Group noted the significant changes that had taken place since the Cruickshank report and welcomed the further changes recently agreed by the LINK card scheme. It noted the commitment from the LINK card scheme to review and report back to the Task Force on the effectiveness of the key changes. The Working Group also supported the three key changes being considered in the governance arrangements of the LINK processing company.

The Task Force is currently considering proposals put forward by APACS which, if implemented, would have a significant effect on the governance arrangements of a number of payment schemes, and could well apply to other domestic schemes such as LINK. The deliberations of this Working Group are contributing to that process.
I am very grateful to all the individuals involved on the Working Group for their wise and helpful approach to the issues raised and for the time they have given to the difficult process of agreeing the draft report. I am also grateful to the organisations listed in Annexe A. The consumer organisation Which? was initially a member of the Working Group, but had to withdraw for resource reasons. Both Which? and the National Consumers’ Council (NCC) are, however, members of the Task Force. Inevitably, the demands on time and resources have been greatest on LINK itself, and I am particularly grateful to the staff of the LINK company and the LINK card scheme for the full cooperation we have received.

I commend the report to the Task Force.

Gover James
Head, Payment Systems Team, Office of Fair Trading
Chairman, LINK Access and Governance Working Group
April 2006
EXECUTIVE SUMMARY

Background

This is the report of the LINK Access and Governance Working Group (the Working Group), the third such Group to be established by the Task Force, set up to examine and, if necessary, to take forward work on various access and governance issues related to LINK.

The Working Group was set up to look at the ability of companies to access the LINK card scheme, the governance arrangements of LINK, the potential impact of increasing the separation between the LINK card scheme and the supporting infrastructure, and the representation of users (including consumers).

LINK has two constituent parts: the LINK card scheme and the processing company. The LINK card scheme, which currently has 49 members, determines the interchange fees and the Operating Rules and procedures. The governing body of the LINK card scheme, on which each Member of the LINK card scheme is represented, is the Network Members Council (NMC). The processing company, LINK Interchange Network Limited, (the LINK company) is owned by 22 of the United Kingdom’s largest banks and building societies, each of which nominates a non-executive director to the board of directors.

Issues

The key issues looked at by the Working Group with regard to the LINK card scheme were:

- whether current voting arrangements in the NMC were the fairest, most efficient and most supportive of innovation
- whether any wider changes to the governance of the LINK card scheme would be of value
- whether access criteria for joining the LINK card scheme were as fair and unrestrictive as possible, and
- whether the LINK card scheme took into account the views of non-member stakeholders sufficiently, or whether additional mechanisms would be of benefit.
With regard to the LINK company, the Working Group looked at the possibilities for, and benefits of:

- opening up ownership of the company to bodies that were not currently owners
- the addition of a number of independent directors to the board of the LINK company, and
- changes to the structure of the LINK company board - in particular, breaking the automatic link between ownership of shares and membership on the board.

The Working Group noted that the LINK company board had already commenced work on the detail of governance changes that might address some of these potential issues. It also noted that the Task Force was currently considering proposals put forward by APACS which, if implemented, would have a significant effect on the governance arrangements of a number of payment schemes, and could well apply to other domestic schemes such as LINK.

The Working Group also looked at the relationship between the LINK card scheme and the LINK company, and the benefits and drawbacks of greater separation between them.

In looking at these issues, the Working Group considered, first, the changes recommended in the Cruickshank Report of 2000, the position as noted in the OFT’s own report on *UK payment systems* in 2003, and the changes since that time. These changes included, on the LINK card scheme side, the changed voting arrangements for the NMC, the formal objectives introduced for the LINK card scheme, the existing access arrangements (which were given careful consideration in light of Post Office Ltd’s application to join the LINK card scheme), and the existing proposals to set up a Standing Committee on Consumer Issues and the associated consultation procedures.

With regard to the LINK company, the Working Group looked at the possibilities for, and benefits that may be derived from, selling shares outside the present limited ownership, the benefits the appointment to the board of independent directors might bring and the possibilities for, and benefits of, changing the board structure.
Key recommended changes

The Working Group has concluded that:

- **LINK card scheme**
  - the LINK card scheme should report back to the Task Force on the success of the recently introduced changes to the voting arrangements following the 12 months review of these arrangements to which it had committed when they were agreed
  - the LINK card scheme should reinforce its existing objectives to promote innovation, efficiency and the interests of consumers, responding to user and market needs in an efficient and cost-effective manner
  - Members of the LINK card scheme and Post Office Ltd should continue negotiations to establish if a commercial arrangement can be found that is acceptable to all parties that would allow free cash withdrawals at Post Office counters for all consumers holding a current account with a major financial institution, within a reasonable timeframe. Agreement was not reached by the Working Group on whether current arrangements to access the LINK card scheme were sufficiently wide
  - The Working Group welcomed the LINK card scheme’s agreement to create a Standing Committee on Consumer Issues to represent the interests of consumers, and the LINK card scheme’s commitment to continue regular consultation with consumer bodies

- **LINK company**
  - ownership of the LINK company should be opened up to bodies that were not currently owners by implementing a mechanism that facilitated the sale of shares to such bodies from willing sellers
  - a smaller, more effective board should be introduced, which would include independent directors, and directors that had been voted on by the company’s owners
  - a number of independent directors should be introduced to the board of the LINK company (in addition to the independent Chair) to represent shareholders not present at the board
• Relationship between LINK card scheme and LINK company

  - the degree of separation should be increased, though falling short of a full legal split, subject to agreement on a robust Service Level Agreement between the company on the one hand and scheme/Members on the other.

**Next steps**

Work has already started: the LINK card scheme executive and the independent chairman of the NMC are already putting together the Standing Committee on Consumer Issues, and the NMC has reviewed and updated the scheme objectives, taking into account the views of the Working Group.

Both the NMC and the Standing Committee will report on the effectiveness of the new governance arrangements within a year of their implementation to the Task Force, when the effect of the more formal separation between the LINK card scheme and the LINK company will also be reviewed.

Negotiations will continue between Post Office Ltd and Members of the LINK card scheme in relation to a separate, voluntary scheme for Post Office Ltd. The Working Group recommends that the application by Post Office Ltd for membership of the LINK scheme be on the agenda of the first meeting of the Standing Committee on Consumer Issues.

The LINK company is currently reviewing and, where necessary, working to reform its governance arrangements in line with the recommendations in this report. Implementation will follow provided the detail of changes is completed and agreed.

Work is already under way to increase the degree of separation between the LINK card scheme and LINK company, including introducing a Service Level Agreement between the two, and separating the reporting lines of the scheme executive.

The Task Force will be regularly updated about progress made in implementing these recommendations.
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1 INTRODUCTION

1.1 The Payment Systems Task Force (the Task Force), chaired by the Office of Fair Trading (OFT), brings together banking industry, business, consumer and government representatives (as observers) with an interest in payment systems. It was established in 2004 to identify, consider and seek to resolve competition, efficiency and incentive issues relating to payment systems over four years, particularly looking at the network effects of the existing payment mechanisms. Where appropriate, issues affecting consumers which derive from, or are associated with, features of payments systems are also considered.

1.2 This is the report of the LINK Access and Governance Working Group (the Working Group), the third working group to be established by the Task Force to examine and, if necessary, to take forward work on various issues. The Working Group was set up by the Task Force at its meeting of 21 July 2005. The first such group, the BPSL Innovation Working Group, reported in May 2005;1 the industry recently reported on how it would take forward those recommendations.2 The second working group, the BACS Access and Governance Working Group, reported in March 2006.3

1.3 LINK is the leading automated teller machine (ATM) switching network in the United Kingdom. It enables cardholders to withdraw cash and obtain balance information from all but a handful of the 57,9004 ATMs in the United Kingdom, as well as supporting some other transactions from ATMs such as PIN change or mobile phone top ups. In 2005, LINK processed around 2.5 billion transactions5 and United Kingdom ATMs dispensed over £91 billion in LINK cash withdrawals. On peak days, LINK processes over 10 million transactions and £500 million is

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4 At end December 2005 – source LINK.
5 Transactions include cash withdrawals, balance enquiries and rejected transactions.
dispensed across the network. LINK transactions represent around 56 per cent of all transactions at the ATMs of LINK Members: the greater part of the remaining 44 per cent are where a card is used in an ATM owned by the card issuer, or Visa and MasterCard transactions which do not cross the LINK switch, although both remain as actual and potential alternatives to LINK.

1.4 LINK has two constituent parts: the card scheme and the processing company, called LINK Interchange Network Limited. The processing company (which is explicitly ‘for profit’) provides the technical, commercial and financial infrastructure that supports the LINK card scheme. It also manages the development and implementation of wider transaction management services. The company is limited by shares wholly owned by twenty-two of the United Kingdom’s largest banks and building societies. Each of these organisations is permitted to nominate a non-executive director and an alternate to the board of directors. The company board endorses the strategic direction of LINK Interchange Network Limited.

1.5 The other constituent part of the LINK payment system is the card scheme. Most major United Kingdom financial institutions as well as a number of independent ATM deployers (IADs) are members of the LINK card scheme. There are currently 49 LINK members: 35 financial institutions and 14 non-financial institutions.

1.6 The LINK card scheme determines the interchange fees and the Operating Rules for transactions between scheme members, while detailed operational procedures assist in the day to day running of the Network. The governing body of the LINK card scheme is the Network Members Council (NMC). Each Member of the LINK card scheme is represented on this body. The NMC has an independent chairman.
1.7 The Working Group looked at:

- current access and governance criteria
- recent and proposed changes and how they affected or would affect the access and governance arrangements
- the current arrangements against accepted industry standards and best practice guidelines
- the demands of various interested parties in LINK, via a questionnaire
- governance and access arrangements in ATM schemes in Canada and Portugal, and
- the potential costs and benefits of a legal separation of scheme and infrastructure in addition to the current logical separation.

1.8 This report includes recommendations for immediate changes to access and governance arrangements, recommendations to continue with changes already being implemented, and recommendations for the Task
Force to review the effects of changes. It also eliminates a number of possible changes to those arrangements. An extended discussion of changes considered is set out in Annexe C, and is summarised in Chapter 6.

1.9 Underlying the work of the Working Group is the recognition that the stability of payment systems is essential to the United Kingdom financial sector and wider economy. It is also acknowledged that the need for innovation must be balanced against implications for the cost and reliability of existing core payment systems. The recommendations suggested here acknowledge this and that any changes made to LINK must not adversely affect levels of reliability or integrity.
2 THE LINK NETWORK, CRUICKSHANK AND SUBSEQUENT DEVELOPMENTS

The Cruickshank Report

2.1 The Cruickshank Report, published in 2000, raised competition concerns about United Kingdom payment schemes. The report found economic characteristics of payment systems, including LINK, that did not deliver price transparency, good governance, non-discriminatory access, efficient wholesale pricing or innovation.

2.2 This report deals with the access and governance concerns affecting LINK. Payment schemes including LINK are mutually governed - the scheme is governed by its Members. Cruickshank identified mutual governance as a cause of competition concerns in LINK and in other payment schemes.

2.3 Cruickshank's key concern with mutual governance was that '... schemes are run in the interests of the banks that own them. This produces inefficient outcomes when the interests of the controlling banks diverge from the public interest. And payment systems have other stakeholders whose interests are not directly represented in decisions about their development. These include personal consumers, business customers, government and potential new entrants.'

2.4 Cruickshank's concerns with perceived anticompetitive restrictions on access were that, 'In all payment schemes considered here, full access to the scheme and its infrastructure is granted only to full members.' Non members or associate members must access the scheme through a full member. In effect, membership requirements also restrict access, putting non members at commercial disadvantage. Not only must they

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6 Cruickshank, para 3.61
7 LINK allows Certified Service Bureaux (CSBs) to offer connection services between LINK members and the LINK switch, without requiring these CSBs to be members.
depend for access on a competitor, but they must pay for the gateway service and can expect to receive poorer information about the scheme.  

2.5 Cruickshank made several additional comments specifically in relation to LINK and ATMs. The report was concerned that:

- there was a lack of transparency in ATM charges at the time of the transaction
- membership of LINK required that a Member could not be an acquirer unless they were also an issuer and that Members had to be a bank or other financial institution, which had resulted in a lack of innovation
- LINK’s interchange fee arrangements favoured large players and those who both issued and acquired, thus creating barriers to entry
- issuer charging by larger banks was discriminatory and bore no relation to costs.

The report noted, however, that LINK had recently 'made a number of important steps' towards meeting these concerns.

The Office of Fair Trading

2.6 In April 2000, following some changes to the network rules, LINK notified the OFT of a number of agreements under the Competition Act 1998 (the Act came into force on 1 March 2000). In October 2001 the OFT stated that the centrally set multilateral interchange fee in the arrangements for the operation of the LINK network had an appreciable effect on competition but that the requirements for individual exemption

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8 Cruickshank, para 3.67.
were met. The OFT also concluded that neither the switching and settlement fee nor the gateway fee appreciably restricted competition.\(^9\)

### 2.7 In its 2003 *UK payment systems* report\(^{10}\) the OFT also noted some benefits of the LINK card scheme. These included:

- the advantage of securing wider access to ATMs for final customers, and
- the presence of a 'hub and spoke' system allowing access to the ATM system more easily and cheaply.

### 2.8 The OFT also noted that amendments made to the operating rules for LINK had provided for non-financial institutions (independent ATM deployers, or IADs) to join the scheme.

#### Changes to the LINK structure since Cruickshank

### 2.9 Since the Cruickshank Report LINK has made changes to the way the scheme is operated. The main changes are highlighted below.

#### Transparency of Retail Charges

### 2.10 From 2000, customers have been told of the amount of any issuer and acquirer charge at the time of transaction and given the opportunity to cancel the transaction without charge. It is thus impossible for a customer to incur a charge for use of an ATM through the LINK system without being told of the total amount and then specifically opting to accept the charge (or to cancel without charge). Of necessity, this dialogue comes late in the transaction, after the customer has inserted his or her card, and entered the relevant PIN and transaction details. The ATM acquirer cannot know the amount of any issuer charge until details

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\(^{10}\) *UK payment systems* (OFT658) May 2003.
of the proposed transaction have been passed to the issuer and a response received back.

2.11 As a further aid to transparency, in the case of ATMs at which an acquirer charge is likely to be made, additional requirements came into force in April 2004. These required external signage on the ATM warning that a charge was likely to be made. These signage rules were reviewed after six months' operation and, as a result, further rules came into force in July 2005 requiring that, among other things, the amount of the likely acquirer charge be displayed on screen before a card was inserted.

Membership Criteria

2.12 In 2000 the membership criteria of the LINK card scheme were changed so that it was no longer a requirement that Members had to be financial institutions. LINK upholds that membership criteria are based solely on ensuring that the security and integrity of the network is maintained, for institutions that either issue cards, deploy ATMs or both. At the same time, the requirement for acquirers also to be issuers was dropped. As a result of these changes, the membership of the LINK card scheme now includes 14 non-financial institutions and around 40 per cent of United Kingdom ATMs are now deployed by IADs.

Innovation

2.13 Product and service innovations that are now available to Members and others across the LINK network and infrastructure, and that relate to the LINK card scheme include:

- PIN change for chip cards at ATMs, and
- voucher dispensing at ATMs.
Innovations that relate to the company include:

- mobile 'Phone Top-up at ATMs
- branch sharing
- connection of Post Office Ltd via the LINK switch to 17 financial institutions (see para C76 for details), and
- a successful joint bid (with Voca) to run electronic Faster Payments, due to enter service in 2007.

2.14 Other services are in the course of development. LINK, via its outsourcing subsidiary Avantra, has also developed a range of commercial services which offer easy technical entry into, and support within, the LINK system. None of these innovations or new products is mandated on existing scheme members, who are free to accept the new services or not, as they wish.

Interchange Fees

2.15 There has been considerable change in LINK’s interchange fee arrangements since 2000. Interchange fees are cost based and currently vary only by type of transaction (that is, cash or non-cash) and by category of ATM (branch or non-branch). Thus the size of the Member (whether large or small) and status of the Member (for example, issuer, acquirer or both) has no influence on the interchange fees. For ATM transactions to which an acquirer surcharge is applied, however, no interchange is paid.

Charging

2.16 In 2000 LINK introduced a 'no double charging' rule at ATMs. This means that there cannot be both an issuer charge and an acquirer charge on the same LINK transaction. For debit cards, acquirer charges take precedence over issuer charges and for all other cards, issuer charges take precedence.
2.17 LINK does not set retail charges – they are set by the issuer or the acquirer. Issuer charging has now, however, virtually disappeared among the large banks for LINK debit card transactions. On credit and store cards, the issuer normally applies a cash advance fee but if these cards are used to withdraw cash through the LINK network an additional charge cannot be applied by the ATM operator.

2.18 Customers are notified of all charges on debit cards at the time of the transaction and, as explained above, given the option to cancel the transaction without charge.

The Current Market Position

2.19 LINK is a shared ATM scheme that operates in the United Kingdom and all but a handful of the 57,900 ATMs in the United Kingdom are connected to the LINK network. The LINK rules do not demand exclusivity and the majority of ATMs are also connected to the Visa/MasterCard ATM networks. Approximately 56 per cent of ATM transactions are made through the LINK switch, with the greater part of the remaining 44 per cent through proprietary networks (see paragraph 2.20 below). The Visa/MasterCard share of ATM withdrawals is negligible, although both remain as actual and potential alternatives to LINK.

2.20 Most of the LINK card scheme’s card-issuing members have their own proprietary ATM networks. In the case of the large card issuers, these networks are extensive. The use of proprietary systems – when a bank customer uses his or her card in an ATM belonging to their bank - means that transactions do not go through the LINK switch. Proprietary systems provide scope for competition between LINK members, as banks can and do offer their own customers a variety of services over their proprietary networks without requiring the agreement of other LINK members. Examples of such additional services include deposits, mini-statements and cheque book ordering. Smaller card-issuing members can also compete by offering new services to their customers but will be
more reliant on the LINK scheme to offer geographic reach as they often do not have extensive ATM networks, and negotiating bilateral arrangements can be difficult. This report does not cover the use of proprietary systems, but, where appropriate, acknowledges their competitive influence or other relevance.

2.21 At the end of 2004 166 million United Kingdom issued cards had ATM functionality: 69.9 million credit cards, 4.4 million charge cards, 66.8 million debit cards and 24.8 million ATM-only cards.\(^\text{11}\) The 91.6 million debit and ATM cards are LINK-enabled cards and can be used through the LINK system; transactions with credit and charge cards are typically routed through one of the International Card Schemes. Around 32 million different LINK cards are used in a typical month.

2.22 Of all cash acquired in the United Kingdom in 2004, 59 per cent of the total value of cash acquired was dispensed by ATMs (70 per cent by volume of transactions), 24 per cent by other withdrawals from bank accounts (including card and cheque transactions at branch counters and debit card cashback, or 15 per cent by volume), with the remainder including state benefits paid at the Post Office and through direct receipt of cash in wages. Of the cash dispensed through ATMs in 2004, 53 per cent by value was withdrawn through transactions across the LINK network. The majority of the remaining ATM cash withdrawals are within proprietary systems and some (predominantly using credit cards) are across the Visa/MasterCard networks.\(^\text{12}\) Overall, just under one third of all cash by value is withdrawn through LINK transactions.

2.23 In 2001 48 per cent of the total cash value was dispensed by ATMs compared with 59 per cent in 2004. LINK accounted for around 39 per cent of total ATM transactions in December 2001 compared with 56 per cent in December 2005.

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\(^{11}\) Source APACS Plastic Card Review 2005

\(^{12}\) APACS and LINK statistics
ATMs

2.24 At the end of December 2005, there were 57,900 active ATMs connected to LINK, of which 33,085 were free (13,872 at locations other than branches), and 24,823 surcharging. The number of free ATMs increased from 29,254 to 33,085 between 2001 and 2005 whereas the number of surcharging ATMs has increased from 7,056 to 24,823 over the same period. The number of surcharged transactions has, however, remained relatively small – in December 2005, four per cent of cash withdrawals were surcharged.

2.25 Free ATMs are largely operated by financial institutions, although IADs operate over 1,000 free ATMs. Charging ATMs are largely operated by IADs although both Co-operative Bank (over 200) and Alliance & Leicester (over 1,000) also operate charging ATMs.

2.26 Only a handful of ATMs are not connected to the LINK network, including ATMs at the Bank of England, and at Harrods Bank.
3 REGULATION, COMPETITION AND GOVERNANCE IN PAYMENT SYSTEMS

Introduction

3.1 This chapter looks at factors which have been identified as potentially limiting innovation in payment schemes. It also looks at potential solutions in relation to payment schemes in general.

3.2 The factors which have been identified as potentially limiting innovation in payment schemes are:

- certain aspects of the way schemes are governed, including common ownership and mutual governance of the scheme, and the close relationship between the scheme and the company that runs the infrastructure for the scheme
- economic features of payment schemes, such as ‘free banking’ while in credit for consumers, and the universal reach of payment services, neither of which encourage banks to offer new services, and
- a lack of incentives to establish competing schemes.

3.3 The potential solutions include:

- introducing greater competition
- direct regulation, and
- effective access and governance arrangements as a means of self-regulation.

3.4 The previous chapter noted the analyses of the Cruickshank and OFT reports which saw the governance of payment schemes as potentially causing competition concerns by restricting innovation and access to schemes. The primary motivation of the Working Group in considering access and governance issues was to address the potential causes of
competition concerns rather than the symptoms that can arise due to a lack of competition.

Factors leading to competition concerns in payment schemes

3.5 Certain aspects of scheme governance can affect the incentives to innovate in the provision of payment methods:

- common ownership of schemes may limit the incentive for different schemes to provide payment methods that may compete with other existing payment methods and hence reduce their market share (competition between payment methods is considered further below)
- mutual governance of schemes can also mean that it may be necessary to gain near universal support for an innovation for it to be introduced. This can lead to movement at the 'pace of the slowest', and
- scheme and infrastructure being within the same organisation may limit the extent to which the infrastructure is able to innovate to provide services to other schemes or financial service providers. It may additionally limit the ability of the scheme to get value for money by receiving competitive tenders from alternative infrastructure providers.

3.6 These concerns may be exacerbated by economic factors which limit the incentive to innovate:

- the fact that many financial service providers do not charge the majority of users directly for payment transmission services may limit the private return they receive from introducing services, thus blunting incentives to innovate, and
- the universal reach of payment schemes, which is a key to their success, means that a financial service provider cannot expect to gain a competitive advantage by introducing an innovation through a
payment scheme since such a service is likely to be available to all users. An innovation at the scheme level will probably, therefore, be introduced by all providers simultaneously, further reducing incentives.

3.7 Incentives to establish competing schemes may also be hampered by additional factors:

- economies of scale - the costs of having one system may be far lower than having more than one system

- network effects - payment systems are networks that exhibit critical mass effects. In making a choice to join a payment network, all other concerns being equal, an individual will prefer to join a bigger network, allowing them to transact with a larger group. This feature can make it harder for a new scheme to become established, as it must achieve this critical mass to be viable. If, however, the cost of joining multiple schemes is low (cardholders often hold multiple credit cards and/or one or more debit cards), these barriers may be less significant, and

- interoperability - competing payment systems that were not interoperable (in that a payment originating in one payment system could not be received in another) would significantly reduce their attractiveness to users.

Greater competition in the market

3.8 The nature of payment schemes is that they bring together competitors to design payment services cooperatively which will then, usually, be commonly offered by them all. While a common product may be available through an agreed cooperative scheme, there is scope for individual providers to differentiate their offering to drive competitive activity. This makes some payment schemes quite different from the provision of services in other markets where joint cooperation in the production of a service may be less likely. The need for cooperation between scheme members, as well as some of the governance features
noted above, can lead to a conclusion that there is a lack of competition between schemes and their members to provide similar payment methods. This may be shown through a tendency for there to be one payment scheme for each payment method and for schemes not actively to target the market share of other payment schemes by creating new payment methods.

3.9 While the nature of payment schemes, and their governance, may limit the incentives for competition between schemes, scheme competition is only one area where competition may arise in the market for payment services. There is already significant competition between payment service providers in some markets such as credit cards,13 or in the provision of the range of retail banking services (current accounts, lending, deposit taking etc).

3.10 There is increasing evidence of both competition and co-operation (on specific projects) between payment processing infrastructures – most recently, the joint venture between LINK and Voca which secured the contract for the new faster electronic payments service in the face of competition from other potential providers.

3.11 Payment schemes are often simply a set of operating rules and standards ensuring a common approach to providing a particular payment instrument. As such, competition between schemes may hold little logic, and active competition between schemes could lead to significant costs without significant consumer benefits.14 It is important, however, to explore what mechanisms can ensure that the scheme is responsive to users' demands (and potential demands) when market forces may not serve this role. Greater competition in this market may

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13 Payment service providers are those institutions providing payment services to end users of these services. These providers include banks and building societies, but also non-financial institutions which provide alternative payment methods, such as Western Union and Paypal.

14 Furthermore, the example of the Portuguese system, SIBS, suggests that greater innovation may arise out of a system where all the processing for a number of payment methods is carried out centrally. This shows that there may be benefits to having more, rather than less, processing in the cooperative space.
be reflected in the provision of new payment methods, or the creation of new functionality in existing payment methods, rather than schemes directly competing to provide the same payment method.

3.12 Despite these factors, there are examples of competition between schemes. Such examples are seen in international and United Kingdom payment card schemes, payments through Automated Clearing Houses in countries such as Sweden and in high value payments in Europe and the United States. There are likely to be historical and regulatory reasons for the existence of more than one system, which are stronger than any economic rationale that may suggest having only one. A major factor is likely to be where there is different ownership between systems – where, for example, one payment system is supported by the central bank or post office system and another is supported by the commercial banks.

3.13 The incentive to create two competing systems is likely to be limited if the same institutions are shareholders in both systems. Lowering entry barriers (such as removing restrictive access conditions) to schemes may, however, encourage competition between schemes. Lowering entry barriers to scheme A may allow institutions, which are not members of any scheme, to join scheme A. These institutions may demand innovations which cause scheme A’s payment methods to compete more actively with scheme B’s payment methods. These new members of scheme A would have an incentive for scheme A to win business away from scheme B, with a service more attractive to users. This is different from creating two schemes with homogenous, and therefore directly competing, products. A related point is that some payment methods can be substituted for each other in certain market segments.
Competition in the provision of ATM services

3.14 In its recent study on banking, the Competition Authority of Ireland noted that ATM networks were inherently different from other payment clearing systems.15

3.15 For many transactions, ATM usage involves only a bank and its own customers. A bank or provider can gain benefits from certain innovations without needing to wait for all other participants to agree and can use this to gain competitive advantage over other players. Enhanced ATM services can, therefore, be provided by one bank directly to its customers without any cooperation with other banks. Examples of innovations introduced in this way through proprietary ATM networks include the ordering of full statements from ATMs, and the ability to make deposits. The LINK network allows this potential to be further enhanced by enabling any group of two or more members to provide additional services to each others’ customers. The LINK company, subject to normal business case requirements, is happy to support this. An example of this type of LINK-facilitated service is the branch-sharing arrangement currently used by two smaller LINK members. Another example offered by many but not all card scheme members is PIN-changing services. If applicable, scheme type rules can also be developed for these arrangements.

3.16 However, smaller card-issuers will generally be more reliant on the LINK scheme to offer geographic reach as they often do not have extensive ATM networks and negotiating bilateral arrangements can be difficult. Therefore, although the concerns expressed above may be less marked in the case of ATM service provision because of the effect of

15 ‘The ATM network is not directly comparable to paper and electronic clearing. This is because ATMs are used as competitive tools by financial institutions ... Decisions regarding the location and functionality of ATMs form part of the commercial competitive strategies of banks, leading to greater choice and innovation, to the ultimate benefit of consumers.’ (Paragraph 4.33, Competition in the (non-investment) banking sector in Ireland, The Competition Authority, September 2005).
competition through proprietary ATM networks, where co-ordination is necessary at inter-bank level, they remain relevant. Good governance of an ATM scheme is very important in ensuring that appropriate scheme-level innovations can be driven forward. Any changes to governance will need to be made with this goal in mind, although at the same time recognising the positive impact that proprietary ATM networks can have on competition in the market.

Direct Regulation

3.17 Market forces and incentives to innovate may thus be weak in all payment schemes (although some Working Group members considered that these concerns may be of less significance in relation to ATM schemes, such as LINK). The importance of payment schemes, in how they support economic activity and the systemic risks involved, means that major payment schemes are often subject to direct regulation.

3.18 Dealing with competition concerns through increased regulation has been implemented in a number of countries and was recommended in the Cruickshank report. While not necessarily any less effective, it is generally the case that the regulatory influence on payment systems in the United Kingdom has been lighter than elsewhere. The Task Force has been developed as an alternative to regulation although HM Treasury has stated that there will be direct regulation should the Task Force prove to be ineffective.

The role of the central bank in payment systems

3.19 Central banks have a public policy role in payment systems due to the systemic risk that arises in such systems – the aggregate risk facing the network is greater than the sum of the risks of each participant were they to operate in isolation.

3.20 Individual participants may have neither the ability nor the incentive to mitigate fully these systemic risks. As a consequence, there is a clear rationale for some third party to provide directly, or secure indirectly, the
public good of systemic stability in payment systems. This third party is usually the central bank.

**The role of the Bank of England**

3.21 Neither the Bank’s responsibilities nor its powers for payment systems oversight are defined in statute. The 1997 Memorandum of Understanding between the Bank of England (the Bank), HM Treasury and the Financial Services Authority therefore formalised the responsibilities of the Bank in respect of the oversight of United Kingdom payment systems.\(^\text{16}\)

3.22 As with other payment systems in the United Kingdom, the Bank has oversight responsibilities in respect of the LINK card scheme. The objective of such oversight is to assess risks to the wider economy – ‘systemic risk’ – arising through the LINK card scheme and, if necessary, to seek to ensure their mitigation. The Bank does not oversee other schemes related to LINK Interchange Network Ltd.\(^\text{17}\) The Bank does, however, maintain an interest in these schemes through its relationship with LINK Interchange Network Ltd – the provider of infrastructure services to the LINK card scheme. The Bank also acts as settlement agent to LINK.

3.23 Reflecting the absence of statutory powers of oversight, the Bank does not determine the LINK card scheme’s membership criteria or governance arrangements. Among other things, however, the Bank assesses the access and governance arrangements of the LINK card scheme against the minimum standards set out in The Committee on Payment and Settlement Systems (CPSS) *Core Principles for*

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\(^{16}\) *Memorandum of Understanding between HM Treasury, the Bank of England and the Financial Services Authority*, available at: [www.bankofengland.co.uk/financialstability/fs_moren.htm](http://www.bankofengland.co.uk/financialstability/fs_moren.htm)

\(^{17}\) for example, Mobile Phone Top-Up Scheme.
Systemically Important Payment Systems, which provide an internationally recognised benchmark.¹⁸

3.24 Two of the ten Core Principles are relevant to this report in that they relate to the need to meet users' requirements and the scheme's access and governance regime. In particular, they suggest that:

- the system should have objective and publicly disclosed criteria for participation, which permit fair and open access (Core Principle IX), and

- the system's governance arrangements should be effective, accountable and transparent (Core Principle X).

3.25 The Bank has published a detailed assessment of the LINK card scheme against the Core Principles in its 2005 Payment Systems Oversight Report.

Effective access and governance arrangements

3.26 Paragraph 3.2 above noted the factors that give rise to concerns on innovation in payment schemes. The Working Group has considered the extent to which competition may limit these factors in relation to the LINK card scheme. Cruickshank recommended that where competition concerns remained, direct regulation may be necessary to deal with them. The Working Group believes, however, that designing and implementing appropriate access and governance arrangements can provide an effective, proportionate, long term solution to the potential competition concerns identified. This solution would have the aim of making payment schemes more responsive to their users and limiting any disincentives that may exist to innovatory behaviour due to current governance and access arrangements in, first, the scheme, secondly, in the infrastructure and, thirdly, in their relationship with each other.

¹⁸ The Committee on Payment and Settlement Systems: a forum for central banks to monitor and analyse developments in payment, settlement and clearing. See www.bis.org/publ/cpss43.htm
3.27 Annexe C to this report examines the extent to which the competition concerns are extant and substantive in the LINK system. It then goes on to assess whether current access and governance arrangements, and proposed reforms to these arrangements, are sufficient and proportionate to ameliorate any concerns.
4 LINK CURRENT ACCESS AND GOVERNANCE POSITION

The LINK card scheme

4.1 LINK is the United Kingdom’s leading payment scheme which facilitates shared ATM transactions for debit card customers. Institutions that issue cards usable in the LINK network, and/or operate ATMs connected to the LINK network, are members of the LINK card scheme. Members of the LINK card scheme include most major United Kingdom retail banks and building societies and a number of IADs. There are currently 49 LINK Members – 35 financial institutions and 14 non-financial institutions.

4.2 The LINK card scheme determines the Operating Rules and procedures that define the terms on which card issuers and ATM operators may participate in the network, as well as the methodology for calculating the fees payable from issuers to acquirers - the multilateral interchange fee (MIF) determined annually via a Cost Study managed on behalf of the members by KPMG - for transactions where the cardholder does not pay the acquirer. (In the latter case the MIF is disallowed.) These Rules cover technical issues, such as the type of card that can be accepted, security issues, such as how PIN data should be protected and how communications should be encrypted, as well as rules on how obligations are settled. They also cover the types of charges that can be applied to cardholders (the level of charges is a matter for individual Members), and how those charges must be made clear to cardholders.

LINK card scheme governance

4.3 The governing body of the LINK card scheme is the Network Members Council (NMC). Each Member of the scheme is represented on the NMC. The NMC has an independent chairman. Independence from any Member allows the chairman to be neutral between issuer and acquirer interests, and to take an independent view of how the LINK card scheme addresses cardholder as well as Member-facing objectives.
4.4 Because the NMC has 49 members, efficient debate can be difficult. As a result, an NMC Review Group has been set up. This group has demonstrated that it has the capability to act as a forum for discussion of any individual member’s particular issues in a timely and efficient manner. Any Member can attend any meeting of the Group which can discuss key issues before they are submitted as recommendations to the full NMC for voting. The Review Group’s meeting notes are available to all NMC members.

**LINK card scheme objectives**

4.5 The LINK card scheme is a non-profit making body. Its main objectives, agreed by the NMC in late 2004, have been:

- to be the United Kingdom’s ATM interchange scheme of choice for card issuers and ATM operators
- to ensure that it meets all legal and regulatory requirements
- to ensure that there is clear, transparent access while safeguarding the interests of the current Members
- to ensure that there is a balance of interests between issuing and acquiring Members and between other groups that have differing views on particular topics
- to ensure that Members receive a robust and reliable processing service and that required service levels are met
- to ensure that core and optional scheme services are provided in a flexible and easy-to-use manner and to facilitate the introduction of new services
- to benchmark the price and performance of the processing company that provides the scheme with services and to represent Members’ interests with the processing company
to take a pro-active stance on industry issues that do not raise competition issues between Members

to represent Members' collective interests in dealing with external bodies and regulators in the United Kingdom and the EU

to provide thought-leadership for the ATM and payments industry;

to provide universal acceptance of cards in ATMs in the United Kingdom

to provide transparency on direct charging at ATMs

to ensure clarity of branding so that customers know who is responsible for each ATM that they use, and

to ensure that Customers have secure, reliable, access to cash at ATMs.

4.6 In December 2005, informed in part by debate in the Working Group, the NMC updated this list to include objectives to:

- be an effective self-regulatory organisation with respect to public and consumer interests
- listen to and take account of the interest of cardholders, and
- promote innovation and efficiency in ATM transactions, responding to user and market needs in an efficient and cost-effective manner.

**LINK card scheme access**

4.7 LINK membership requirements, rules and fees are made available to all potential applicants, subject to a standard form of non-disclosure agreement. The level of fees depends on the method of connection, the number of ATMs deployed and/or cards issued, and the level of participation in the scheme. Decisions on applications to join the scheme are made by the card scheme executive alone and not referred
to members provided the applicant meets the membership criteria. Where an application would require a change of rules this is discussed with the NMC. The approved membership criteria are decided by the NMC.

**Changes to LINK card scheme governance**

4.8 The LINK card scheme has been reviewing its own governance arrangements. Over the past year, a number of changes have been agreed, and have either recently taken effect, or are now taking effect.

4.9 Before January 2006, 40 per cent of NMC votes were reserved for the owners of the company. From 1 January 2006 25 per cent of the votes have been allocated equally between all Members, with the remaining 75 per cent allocated according to use of the network. This allocation aims to ensure that small Members enjoy a larger percentage of votes than before, without giving majority power to Members who account for only a small proportion of the traffic over the network (which would be the result of a one-member, one-vote arrangement). The new system will also include provisions restricting a single member’s voting allocation to 15 per cent, while a 'super majority’ of 80 per cent will continue to be needed for certain decisions such as a change to the methodology for calculating interchange fees, and a 60 per cent majority for a change to the Operating Rules. Transaction volumes in 2005 mean that in its first year of operation under this system, the biggest five banks will still hold more than 50 per cent of the vote, but less than 60 per cent. The NMC is able to alter its rules through a decision of the requisite majority to allow for certain issues to be considered by only a part of the NMC.

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19 Any two or more members with a collective vote of more than 20 per cent can ask for a ruling by a set of independent adjudicators on a decision relating to interchange (see paragraph C16).
4.10 In September 2005, the NMC agreed to set up a Standing Committee on Consumer Issues. This development responds to the House of Commons Treasury Select Committee recommendation that LINK should take steps to improve consumer representation within its organisation. The Standing Committee will include a minority of Members of the card scheme and a majority of independent representatives to represent consumers. The Committee will be chaired by the Independent Non-Executive Chairman of the NMC.

4.11 The Standing Committee will advise the NMC on consumer issues that relate to the ATM network and LINK card scheme rules. Its terms of reference (the initial terms of reference are at Annexe H) require it to look to the interests of all groups of consumers including those who may be considered disadvantaged in relation to access to financial services. The Standing Committee will advise, comment and make recommendations on existing and developing LINK card scheme policy and practices that affect cardholders. The NMC is required to respond in writing to its recommendations. The Standing Committee will speak on behalf of consumers by reviewing, monitoring and reporting to the NMC on the effect of the LINK card scheme’s policies and practices on consumer interests, and will assess the effectiveness with which the NMC has delivered its objectives with respect to cardholders. The dialogue between the NMC and the Standing Committee will establish a consultation process to ensure that the views of consumers are taken into account. In addition to the Standing Committee, the LINK card scheme executive will also continue to have regular meetings with the Citizens Advice Bureau, the National Consumer Council and Which?.

4.12 LINK card scheme Members are also in the process of collectively agreeing a Service Level Agreement (SLA) between Members and the company. This will form part of a formal benchmark and assessment process to assess the quality and price of the services provided to the scheme by the company.
The company

4.13 The company provides the network and switching services that connect Members of the LINK card scheme and processes the ATM transactions between them. The company does not own the LINK card scheme, which is separately governed by its Members, and has no voting rights in relation to, for example, the LINK card scheme rules.

Governance of the company

4.14 The company is explicitly a 'for profit' company. It is limited by shares wholly owned by 22 banks and building societies. Ownership of the company is currently restricted to the existing shareholders. The company board is considering, although has not yet approved, a relaxation of this restriction (see Chapter 6). Each of these organisations is able to nominate a non-executive director and an alternate to the board of directors. The CEO of the company and two executive directors also sit on the board although they have no votes. The board endorses the strategic direction and management structure of the company. The nominee directors have votes which are related to the number of shares each owner possesses, which, until 2003, were directly driven by the volume of transactions processed. Since 2003 the owners have been able to buy and sell shares among themselves on a 'matched bargain' basis (although no transactions have, in fact, taken place). Weighted votes are used only very rarely. The company has an independent chairman.

4.15 An Executive Committee of 10 shareholder-elected directors, three executive directors and the independent chairman operates on a one-member, one-vote basis (including the executive directors) to run the infrastructure below the full board. This Committee has fewer members than the board to facilitate debate and decision-making (all shareholders retain some influence through a process of electing members of the Executive Committee). On a day-to-day basis the company is run by a
Management Board consisting of the independent chairman, the CEO and six executive directors.

**Innovation by the company**

4.16 In addition to providing switching services to the LINK card scheme, the company also manages the development and implementation of wider payment transaction management services including:

- outsourced ATM acquiring and card issuing services
- mobile phone top ups (at ATMs, and, in the future, over the internet)
- mobile phone based services such as balance enquiries, authentication and, in the future, payments
- gateway services to Visa and MasterCard networks
- bank and building society branch sharing services, and
- transaction processing service to support a free cash withdrawal service over Post Office Ltd’s counters through bilateral agreements with a number of individual banks and building societies.

A number of these services are offered to institutions that are not members of the Card Scheme.

4.17 In addition, the company has successfully bid, with Voca, to supply the infrastructure for the new faster payments services being implemented by the banking industry.\(^{20}\)

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Changes to company governance

4.18 The company is reviewing its governance and considering a package of reforms including changes to the composition and size of the board, and to the restrictions on ownership. Any reforms will accompany the agreement of the Service Level Agreement with the LINK card scheme noted in paragraph 4.12 above, and changes to the reporting line of the LINK card scheme executive for card scheme matters.

Subsidiaries of the company

4.19 The company also owns Avantra (previously known as ATMOS). Avantra provides outsourcing services to Members (services necessary to support ATMs or issue cards on an outsourced basis – with membership of the LINK card scheme remaining with the relevant Member responsible for those ATMs or cards). A majority of its current customers are IADs, though others are not Members of the LINK card scheme at all. Avantra competes in this market with other processing companies (such as IBM, Euronet, TNS, Wincor, Calypso). It buys transaction processing services from the main LINK company on a commercial basis. A key feature of the organisational structure is that such services are provided on terms and conditions that are not reviewed by or visible to the LINK company board in order to avoid potential visibility to competitors. The fiduciary duty of the directors is satisfied by a reporting mechanism which involves providing audited reassurance to the board at regular intervals.
5 RELATIONSHIP BETWEEN LINK CARD SCHEME AND INFRASTRUCTURE

5.1 As noted in Chapter 2 above, one of Cruickshank’s key concerns was that competition in the payment market was weak. Cruickshank considered that schemes did not compete with each other across markets, with schemes not offering a close substitute to services offered by another scheme. A possible substitute to competition within a market, is competition for a market. While finding that there was significant competition between members of LINK outside the central system, recognising that multiple processors were allowed to exist within the LINK scheme, and that two other companies already provided central ATM switching (for Visa and MasterCard cards, albeit with a negligible market share, which principally relates to cash withdrawals made on credit cards), the Working Group noted that LINK provided the central switch for 53 per cent of all ATM cash withdrawals by value and a slightly higher proportion of ATM transactions by volume. The Working Group therefore considered whether splitting the LINK card scheme and the company, thus facilitating potential bids for infrastructure provision if considered appropriate in the future, would make an appreciable difference to competition. This chapter considers this possibility. Further details are contained in Annexe C.

5.2 The Working Group has concluded that the best approach would be to increase the degree of separation between the LINK card scheme and the company by the negotiation of Service Level Agreements (SLA) between LINK card scheme Members and the company, and their regular review.

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21 A number of Members already used one alternative processor or CSB, while several institutions had been certified as CSBs, including during the course of the Working Group’s work. For transactions between two Members using the same CSB, the LINK company does not act as a central switch.
Background

5.3 Ensuring that there are no restrictions on the ability of other potential infrastructure providers to compete to run an ATM network creates a strong incentive for the current infrastructure provider (the LINK company) to offer a better deal to the members of the LINK card scheme than its rivals. This proposition could include a more efficient service, more products and services that Members want, and lower costs. The BACS scheme uses this model of competition for the market, with Voca currently running the infrastructure. Currently, LINK card scheme rules allow Members individually or as a sub-group to use an alternative processing provider, which is then allowed to route any transactions that involve other Members using a different processing provider through the LINK switch (a number of members currently use TNS as a processing provider in precisely this way). The LINK company also has no power to prevent members of the LINK card scheme collectively deciding to seek processing services from another provider. There are known to be several potential competitors very interested in providing alternative processing systems or indeed, possibly to buy the LINK company.

5.4 Among other reasons, given that contracts for processing services are between the LINK company and each individual LINK card scheme member, it is not clear that separately incorporating the LINK card scheme would materially alter the competitive pressure faced by the LINK company. There are also potential drawbacks to splitting LINK card scheme and company. The present link allows certain economies of scale, with LINK card scheme and company employees able to help each other out. A formal split would necessarily reduce the level of communication between the two. There are also considerable costs associated with such a split (albeit some of them only one-off), including legal costs, relocation costs, and staffing costs. However, going forward a robust SLA will be needed to ensure this relationship has an appropriate formality and that Members and the scheme executive are empowered to challenge the company where needed. This will be especially true if there is a change of ownership – the current mutual
governance ensures that the company is responsive to user concerns which in turn reflect consumer needs, notably the provision of a reliable service. The current mutual arrangement does not require detailed agreements and structures.

5.5 Most LINK card scheme Members and the company also considered that the main point of introducing a formal split - to increase innovation - was unnecessary. LINK has been an innovative payment system (as noted in Chapter 4 above), and one view in the Working Group was that the LINK company could not have been significantly more innovative even if it had been facing greater competition for its role as infrastructure provider. Similarly, the Working Group was concerned that a split between card scheme and company would actually serve to reduce innovation. Currently the scheme executive forms a part of the company, where its use of expertise to help support other payment services where scheme structures may assist innovation is under consideration. One example is the service supporting mobile 'phone top ups from ATMs and potentially also the internet. By developing scheme rules and structures for network services and products that only a subset of Members of the LINK card scheme, or indeed institutions outside the card scheme, wish to provide, the problem of moving "at the speed of the slowest" (the Cruickshank concern flagged in Chapter 3 above) can be avoided. If the LINK scheme executive was separated from the LINK company, the LINK card scheme executive could no longer facilitate innovative new schemes.

5.6 This point is, however, mitigated by the fact that the company could simply start the new services on a normal commercial basis, as has, in fact, been the case with mobile 'phone top-ups, the current Post Office services and the Mutual Plus counter sharing scheme. There must be safeguards to ensure that any new schemes taken on by the LINK card scheme executive do not affect the integrity of the core ATM scheme.

5.7 There is already a limited split between the LINK card scheme and the company insofar as there are distinct governing bodies for each entity. Objectives for the LINK card scheme are set by the NMC, and the
company plays no part in this. The company also has no say over the rules of the scheme, which are determined solely by the NMC. The twenty-two banks and building societies who are members of the NMC and owners of the company are asked not to send the same representative to both (although sometimes they do). As of 1 January 2006 banks and building societies who own the company no longer have additional votes on the NMC.

5.8 The Working Group considered that a compromise solution, between a full legal split and the current position, would be the best option. This would seek to ensure that communication and efficiency links between the two were kept at a high level, but that there would be changes made to ensure that full incentives to innovate existed.

5.9 A key step in further separation might be to introduce strict reporting lines for the scheme executive: its objectives (for each scheme it supported) would be set by the NMC (or other scheme governing body), rather than by the company. This may assist in reducing potential conflicts of interest, currently possible because the LINK scheme executive’s objectives are, in theory, set by the company Chief Executive. This would go some way to addressing the requirements of the CPSS Core Principles for Systemically Important Payment Systems (Core Principle X) which states that governance arrangements should avoid conflicts of interest (see paragraph 3.24 above).

5.10 At present, the company Chief Executive normally attends the NMC. To further the degree of logical separation, an alternative may be that the CEO of the company (and / or others from outside the company, including potential competitors) attend only by invitation and withdraw if appropriate at specific points in the meeting.

5.11 Most importantly, an SLA would be introduced between the Members of the LINK card scheme and the company to ensure that the company was contractually committed to provide services, and to help ensure that the price and quality of these services could be benchmarked with those potentially offered by competitors, thus reinforcing competitive pressure.
on the company. The SLA would be agreed between the Members of the LINK card scheme and the company.

**Conclusion on relationship between the LINK card scheme and the company**

5.12 The Working Group has concluded that the best approach would be to increase the degree of separation between the LINK card scheme and the company. The benefits of the LINK card scheme and company being linked (good communication links and efficiency) might be lost if the two were legally split. At the same time, the further degree of separation would provide benefits in terms of separating the reporting line of the LINK card scheme executive from the company, and formalising the ability of the NMC to open its meetings to potential competitors to the company. Most importantly the negotiation of an SLA between LINK card scheme Members and the company (and its regular review) would formalise a process in which the services provided by the company were benchmarked, and could be compared with those offered by potential competitors.

5.13 The Working Group recommends that this issue should be considered again by the Task Force in February 2007 to ensure that the expected benefits have, in fact, been achieved.
6 CHANGES CONSIDERED

6.1 The LINK Access and Governance Working Group welcomed a number of recently agreed changes, and changes under consideration, which it believes will contribute to incentives to compete and to innovate, and to increase stakeholder involvement in the scheme. These changes fall into two groups:

- changes to scheme governance, and
- changes to company governance.

6.2 This chapter summarises the discussions on key issues which led to these conclusions. A full report of the discussions is in Annexe C to this report.

The LINK card scheme

6.3 Chapter 3 explains the background as to why competition problems in payment schemes can be addressed by good governance as well as legislation or enhanced competition, and Chapter 4 explains the key features of the LINK card scheme. The changes to the access and governance arrangements of the LINK card scheme considered by the Working Group were:

- whether current voting arrangements in the NMC were the fairest, most efficient and most supportive of innovation
- whether any wider changes to the governance of the LINK card scheme would be of value
- whether access criteria for joining the LINK card scheme were as fair and unrestrictive as possible, and
whether the LINK card scheme took into account the views of non-member stakeholders sufficiently, or whether additional mechanisms would be of benefit.

NMC voting arrangements

6.4 The LINK card scheme has recently introduced new voting arrangements for the NMC, and the Working Group debated whether those new arrangements were the fairest, most efficient and supportive of innovation. These arrangements allocate a proportion of the votes (25 per cent) equally between all Members, with the remaining 75 per cent allocated to Members depending on how many transactions involving that Member are performed through LINK. Opinion was largely split between the banks and building societies who supported the new arrangements, and the IADs who argued for either one-member, one vote, or a voting system which balanced transaction-weighted votes with ATM ownership.

6.5 The Working Group could not, however, identify any instances in which innovation had not occurred as a result of the voting arrangements in place prior to January 2006. Scheme Members had already agreed that the recently introduced voting arrangements would be reviewed 12 months from their inception, and agreed to report back to the Task Force on the findings of that review.

Structure of the NMC

6.6 HM Treasury, the Bank of England and the OFT supported the idea that the NMC should be replaced by a smaller decision-making body. They felt that a smaller decision-making body would make decision making more effective: six questionnaire respondents thought that decision making at the NMC was difficult due to its size, although the Working Group had not heard of any examples of issues where the NMC’s size had prevented it from making decisions. As a smaller decision-making body would not represent all members directly, HM Treasury, the Bank of England and the OFT thought that independent delegates should be
appointed to the smaller decision-making body, to ensure that it represented the interests of all members of the scheme and avoided potential conflicts of interest. Independent delegates might also have greater regard for the interests of non-member stakeholders.

6.7 The LINK card scheme executive and LINK Members noted that the NMC was not the same as a company board in which shareholders might be expected to have common fiduciary interests. The NMC made decisions on matters that were of core commercial importance to each card scheme Member in its capacity as card issuer or ATM deployer rather than as shareholder, and on which each Member’s interests could differ greatly from those of other Members. The card scheme executive and Members were concerned that it might not be appropriate to ask some Members effectively to give up to other Members or to independent representatives their direct say over these key commercial matters.

6.8 The card scheme executive believed that a balance needed to be struck between allowing all Members, regardless of size, directly to represent themselves and smaller groupings that might in some respects be more efficient. The creation of the self-selecting NMC Review Group was intended to be part of the balance by enabling efficient debate without denying any Member a voice or a vote. In addition Members were concerned about how and to whom any independent representatives would be held accountable should they have power over scheme issues.

**Wider governance changes to the scheme**

6.9 The Working Group welcomed the fact that the scheme’s objectives included aims to promote innovation, efficiency and the interests of consumers. The Working Group agreed on the importance of new objectives, which would reinforce the existing scheme objectives concerning innovation and cardholder interests:

- The LINK card scheme will promote innovation and efficiency in ATM transactions, responding to user and market needs in an efficient and cost-effective manner, and
• The LINK card scheme will listen to and take account of the interests of cardholders.

6.10 The Working Group agreed that these objectives, when allied with the Standing Committee on Consumer Issues (see below), would provide the LINK card scheme with an incentive to act in the interests of consumers. The Standing Committee would be able to report publicly on the LINK card scheme’s performance against these objectives, as would the NMC.

**LINK card scheme access arrangements**

6.11 One of Cruickshank’s key concerns was that access to each scheme was controlled by the members of the scheme. This therefore gave a potential incentive for each scheme not to admit new members which could compete with existing members.

6.12 The Working Group therefore looked at the access arrangements agreed by the NMC for bodies that wanted to join the LINK scheme. In particular, the Working Group examined the criterion that to join the LINK scheme either LINK-enabled cards must be issued, or ATMs with a connection to the LINK switch or a connected processor must be deployed.

6.13 One member of the Working Group, Post Office Ltd, had applied to join the LINK card scheme. As a result of proposing neither to deploy ATMs (although many Post Office Ltd branches contain ATMs, they are operated by third parties, not Post Office Ltd), nor issue LINK-enabled cards, Post Office Ltd did not meet the access criteria for the LINK scheme. Post Office Ltd requested that the criteria and rules be changed to allow it to join with an over-the-counter service. In May 2005 Post Office Ltd received a reply declining its request that the rules be changed to permit its participation.

6.14 The Working Group considered various arguments for and against changing the LINK access rules. These are set out in full in Annexe C. The Working Group discussed a number of options including making no change, amending the access rules to allow over-the-counter cash
withdrawals, extended bilateral agreements between Post Office Ltd and major banks and building societies, and the development of a separate standardised scheme-type arrangement for over-the-counter cash withdrawals in Post Office branches.

**Conclusion on access concerns**

6.15 No agreement was reached on this issue by the Working Group. The current Members of the LINK card scheme on the Working Group considered that the LINK card scheme rules should not be amended to allow over-the-counter cash acquisition as well as ATMs. The Post Office Ltd considered that the existing rules should be amended to include over-the-counter withdrawals.

6.16 All parties supported the principle of the alternative suggestion of developing standard terms and conditions and some scheme infrastructure for a service offering over-the-counter cash withdrawals over Post Office counters. While some banks would not commit to membership of an alternative scheme at this time, consideration of membership would be the subject of regular commercial review. Post Office Ltd’s position is that in these circumstances there might be limited benefits from forming a separate scheme since there would not be a significant increase in the number of LINK-enabled card holders who could use the Post Office Ltd service.

6.17 Negotiations will continue between Post Office Ltd and Members of the LINK card scheme to establish whether a commercial arrangement can be found that is acceptable to all parties that would allow free cash withdrawals from Post Office counters for all consumers holding a current account with a major financial institution. Post Office Ltd was keen to ensure that urgent focus was given to this issue by the Members of the LINK card scheme so that it could be resolved within a reasonable timescale.
Stakeholder input to the LINK card scheme

6.18 The Working Group welcomed the formation of the Standing Committee, to be chaired by the independent non-executive Chairman of the NMC, as proposed by the LINK card scheme. The Working Group believes this would give consumers a much greater say in the provision of ATM services. The Standing Committee’s membership would consist of:

- four or more independent members, who will represent the views of consumers. They will be invited to join the Standing Committee by the independent Chairman, and may include representatives from consumer organisations. It is envisaged that these will be part-time paid positions, and

- four representatives of NMC members, providing that at least two shall be from NMC members that issue cards and that at least two shall be from acquirer-only NMC members.

6.19 The NMC and LINK card scheme executive will approve the Committee’s annual budget and expenditure in accordance with established spending limits. Administrative support will be provided by the LINK card scheme executive. The Terms of Reference for the Standing Committee will be set by the NMC, and reviewed at the first meeting of the Standing Committee, and again after a full year of the Standing Committee’s operation by both the Standing Committee and the NMC.

6.20 It is envisaged that the Standing Committee will:

- represent the interests of consumers by advising, commenting on, and making recommendations on, existing and developing LINK card scheme policy and practices that affect cardholders

- speak on behalf of consumers by reviewing, monitoring and reporting to the NMC on the effectiveness of the LINK card scheme’s policies and practices, and
• consider issues such as membership criteria, rule changes and the implications to consumers of declined applications for membership if Standing Committee members consider these issues relevant to the interests of consumers.

6.21 It is also envisaged that the Standing Committee will report on the way that the LINK card scheme has addressed its consumer facing objectives, as discussed at paragraph 4.10. The Standing Committee can give advice to the NMC, and can publicly object if the NMC acts against its advice.

6.22 The LINK card scheme executive would also continue to hold regular meetings with consumer organisations including the Citizens Advice Bureau, the National Consumer Council and Which?

The company

6.23 The Working Group considered the current access and governance arrangements of the LINK company, and has made a number of recommendations. An internal review is currently being held by the LINK company and board and has proposed similar changes as part of this governance review process. The internal governance reform process has a number of objectives but these are primarily about improving governance in line with best practice and increasing the efficiency of the governance process. The internal review is operating to a slightly later target date than the Working Group, and it will include the recommendations of this Working Group in its work.

6.24 Currently, the LINK company is owned by 22 banks and building societies, and shares are restricted to those owners (that is, while shares can be traded between current owners, non-owners can not buy shares in the LINK company). The 22 owners then appoint an Executive Committee to govern the company. Notwithstanding LINK’s strong track record in terms of innovation, the inability of outside companies to buy into the LINK company, and also be represented on the board, may be seen to lead to a disincentive for the LINK company to seek new
opportunities and innovate. While the LINK company’s non-executive directors all come from financial institutions, LINK itself is essentially a technology company and is very different from a financial institution. Directors from wider backgrounds might add to the existing expertise of directors.

6.25 The Working Group considered whether changes to these governance arrangements might act as an incentive for the LINK company to seek new opportunities. Three main changes were considered:

- opening up ownership of the LINK company to bodies that were not currently owners

- the addition of a number of independent directors to the board of the LINK company (it already had an independent Chairman), and

- a break between the automatic link between ownership of shares and membership of the LINK company board.

6.26 The Working Group therefore considered, first, whether the LINK company would benefit from opening up its ownership. It was felt by some Working Group members that new owners would contribute to innovation of the company by providing a different perspective from that of the banks and building societies, contributing different and potentially innovative ideas. There was general agreement in the Working Group that owners should be able to sell their shares to non-owners if they wanted to, which in turn could increase innovation, by, for example, ownership of some shares by an investment entity with a strong profit drive and hence an incentive to innovate. New owners may also bring new expertise to the board of the LINK company.

6.27 Secondly, unlike the LINK card scheme, there was general agreement that independent directors would have a significant voice on the proposed 13-seat company board. Working Group members also considered that it was best practice for a for-profit company to have independent directors that represented shareholders that could not all be present on its board.
Finally, the Working Group agreed that a new board structure should be introduced alongside the two other changes discussed above. The Working Group considered that a smaller board, with board members elected by the owners, would be a more efficient way of governing the LINK company. This would tie-in effectively with the break between ownership and board membership, and would give greater weight to the independent directors appointed. The LINK company had previously instigated a review of its governance procedures and it plans to have agreed and implemented changes by mid-2006.

Conclusion on recommended changes

The Working Group welcomed a number of changes already being put in place by the LINK card scheme:

- the recently introduced voting arrangements, and the commitment to review these after a year of operation

- the LINK card scheme’s new objectives to promote innovation, efficiency and the interests of cardholders, and establishment of a mechanism by which there would be an independent public report on the scheme’s success with regard to fulfilling objectives relating to cardholders

- the creation of the Standing Committee to represent the interests of consumers by advising, commenting and making recommendations on existing and developing LINK card scheme policy and practices that affect cardholders, and

- the scheme’s commitment regularly to consult with consumer groups on decisions or changes which might potentially have a significant effect on consumers, in conjunction with the Standing Committee.

In addition, the Working Group recommends that Members of the LINK card scheme and Post Office Ltd should continue negotiations to establish if a commercial arrangement can be found that is acceptable to
all parties that would allow free cash withdrawals at Post Office counters for all consumers holding a current account with a major financial institution within a reasonable timeframe.

6.31 The Task Force is currently considering proposals put forward by APACS which, if implemented, would have a significant effect on the governance arrangements of a number of payment schemes, including, conceivably, LINK. The deliberations of this Working Group have contributed to that process, but the proposals could potentially have the effect of superseding the proposals put forward in this report.

6.32 The key changes recommended by the Working Group to the LINK company are that:

- ownership of the LINK company is opened up to bodies that are not currently owners by implementing a mechanism that facilitates the sale of shares to such bodies from willing sellers

- a smaller, more effective board should be introduced, which will include independent directors, and directors that have been voted on by the company’s owners, and

- a number of independent directors are introduced to the board of the LINK company (in addition to the independent Chair) to represent shareholders not present at the board.
7 NEXT STEPS

7.1 In a number of areas work has been done during the course of the Working Group, has been started, or will start with the publication of this report. The LINK card scheme executive has already started to form the Standing Committee, and the Members of the card scheme agreed to various changes to its objectives, informed by the views of the Working Group, in December.

7.2 Both the NMC and the Standing Committee will report on the effectiveness of the changes to NMC voting arrangements within 12 months of their inception. This report will be sent to the Task Force, which will then consider whether there are any issues that do not appear to have been addressed. Similarly, the effect of the more formal split between the LINK card scheme and the LINK company, discussed in Chapter 5 will be reviewed at the same time should the Task Force consider there to be unresolved issues.

7.3 Negotiations will continue between Post Office Ltd and Members of the LINK card scheme to establish, within a reasonable timeframe, whether a commercial arrangement can be found that is acceptable to all parties. The Working Group recommends that the application by Post Office Ltd for membership of the LINK scheme be on the agenda of the first meeting of the Standing Committee on Consumer Issues.

7.4 As discussed above, the LINK company will be continuing the implementation of its governance reform programme during the course of 2006, and will report to the Task Force on progress in 2007.

7.5 The Task Force will be updated on the progress made on implementing these recommendations.
ANNEXES

A  LIST OF MEMBERS OF THE LINK WORKING GROUP

Office of Fair Trading (Chair)
Alliance and Leicester
APACS
Bank Machine
Barclays Bank
British Bankers' Association
British Retail Consortium
Calypso Europe Ltd
CardPoint UK
Electronic Money Association (EMA)
Euronet Worldwide Inc
HBOS
HSBC
LINK
Lloyds TSB
Nationwide
Post Office Ltd
The Royal Bank of Scotland Group
Transaction Network Services UK (TNS)
TRM
Bank of England (sitting as observers)
HM Treasury (sitting as observers)
B LINK WORKING GROUP TERMS OF REFERENCE

Introduction

The Payment Systems Task Force has agreed to establish a Working Group on the access and governance arrangements of LINK. Membership will be drawn from Task Force members and from outside the Task Force, including members of LINK.

Objectives and Scope

To consider any membership and governance issues related to LINK, including:

- evaluation of the benefits and weaknesses of current arrangements in light of how the market has developed;
- analysis of potential changes to rectify identified weaknesses (if any):
- Examination of the demand for change and the costs and benefits of change, including the wider society case for change.

Governance issues

- What benefits and weaknesses are caused by the mutual governance system?
- What are the potential benefits and weaknesses of other potential governance systems?
- What benefits or disbenefits can be attributed to the separation of scheme and infrastructure within LINK with regard to conflicts of interest, ease of access, membership and innovation?
- Does the relationship between owners of LINK and other LINK members cause any difficulties with respect to access for new members and innovation?
• Does the commonality of membership with other payment schemes lead to a dampening on competition between schemes and a lack of innovation in the LINK scheme?

• Does the current governance structure provide sufficient, proportionate and fair representation to all members?

• To what extent do LINK’s current governance arrangements meet best practice for governance of payment schemes?

• What benefits or drawbacks have arisen from the appointment of independent chairmen to the governing boards of the scheme and the infrastructure?

• What advantages and disadvantages would there be to introducing independent directors, additional to the chairmen roles already instituted in the scheme and infrastructure?

**Membership and Stakeholder Issues**

• Are LINK membership criteria open, transparent and objective?

• What are the relative benefits and dis-benefits of membership of LINK?

• LINK allows both ATM acquiring only and card issuing only membership. LINK also allows non-financial institutions to become members. What difficulties and/or benefits arise from these features of the access criteria?

• Are any problems caused by the current LINK membership structure? If so, what are the costs, benefits and risks of potential changes?

• Do the views of other stakeholders (e.g. consumers, non-member processors etc) receive adequate consideration and are these groups provided with sufficient information?
• To what extent do the demands of users, and the market more generally, feature in the objectives of LINK?

• How well do technical committees represent the views of interested parties who are not members of LINK (for instance ATM manufacturers)
C EXTENDED DISCUSSION OF CHANGES CONSIDERED

C.1 The Working Group considered many potential issues that had been raised either as part of the Cruickshank analysis, or subsequently by interested parties. The Working Group found that some of these issues had been addressed or did not require any further action. Where there was agreement that some action was needed, the Working Group considered the reforms being put in place by the LINK card scheme and LINK company, and has made its own recommendations. Where the Working Group came to no clear consensus about further action, its opinions are recorded below, along with further steps to be taken.

C.2 The Working Group divided the potential issues into three categories; those that applied to the LINK card scheme; those that applied to the LINK company, and those that applied to the relationship between the two.

Research methodology

C.3 The Working Group initiated three new forms of research. This research covered the key areas of:

- member demands and requirements - a questionnaire sent to 55 organisations that either are LINK card scheme members, or have an interest in the scheme

- international comparisons - telephone conferences and meetings with representatives from ATM schemes and ATM scheme members from abroad. Two countries with interesting ATM schemes or governance arrangements were contacted, Canada and Portugal, and

- best practice guidelines - the access and governance arrangements of LINK were compared with best practice contained in the Committee on Payment and Settlement Systems report on Core Principles for Systemically Important Payment Systems (referred to
here as the CPSS Core Principles), and in the Combined Code on Corporate Governance (2001, revised 2005).\textsuperscript{22}

Questionnaire

C.4 The purpose of the questionnaire was to find out from Members of the LINK card scheme (and bodies who had an interest in the LINK card scheme) whether they were satisfied with the current arrangements, or whether changes should be made. Of the 55 questionnaires sent out, 38 went to financial institutions. Nine of the 55 questionnaires went to institutions which were not LINK members. Respondents were allowed to reply anonymously. 21 responses were received. 14 were from financial institutions such as banks, and seven were received from non-financial institutions. The questionnaire asked 36 questions grouped under the topic headings of:

- governance
- relationship between LINK card scheme and company
- the relationship between the LINK company and Avantra
- the potential role of independent directors and chairmen
- voting rights
- transparency
- access to the LINK card scheme and company
- stakeholder representation

\textsuperscript{22} The Combined Code on Corporate Governance sets out standards of good practice in relation to issues such as board composition and development, remuneration, accountability and audit and relations with shareholders. See www.mutualinsurers.org/documents/AMI-Combined-Code.pdf
• competition

• wider objectives of the LINK card scheme, and

• compliance.

**International comparisons**

**C.5** The purpose of the international comparisons research was to examine the access and governance arrangements of a number of ATM schemes from outside the United Kingdom, to see if arrangements differed, and if so, whether they brought any particular benefits (perhaps in innovations offered, or efficiency). As well as desk research through publicly available material such as the websites of the ATM schemes and the Bank for International Settlement’s publications on various payment schemes, telephone conferences and meetings were held with:

- for Canada, Interac, the Canadian ATM service, and Alterna Savings, and indirect member of the Interac Scheme, and

- for Portugal, SIBS, the Portuguese ATM service.

**C.6** Where appropriate in this annexe the report refers to information gathered in this exercise, and uses that information as evidence to support a finding, recommendation or opinion. However the many differences between the countries examined (such as historical development of the banking system, regulation, geography etc) means that direct comparisons should be made with caution.

**Best practice guidelines**

**C.7** Published best practice was consulted to provide objective criteria on access and governance arrangements against which LINK’s current arrangements could be judged. The Working Group considered carefully

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23 See Annexe I for a table comparing the different features of these systems.
where any areas appeared less relevant to LINK, or where current or proposed changes would meet the objective criteria in a different way. The two best practice guidelines used were:

- CPSS Core Principles, of which two of the ten Core Principles are relevant. They relate to the need to meet users’ requirements and the payment scheme’s access and governance regime. In particular, they suggest that:
  - the system should have objective and publicly disclosed criteria for participation, which permit fair and open access (Core Principle IX), and
  - the system’s governance arrangements should be effective, accountable and transparent (Core Principle X), and
- the Combined Code on Corporate Governance, which sets out standards of good practice in relation to issues such as board composition and development, remuneration, accountability and audit and relations with shareholders.

C.8 Additionally, the Working Group accepted evidence from a range of other sources, including:

- meetings with key parties with an interest in LINK
- previously published research and papers, such as the Cruickshank report, and the OFT’s 2003 UK payment systems report, and
- work of previous Payment Systems Task Force Working Groups, such as the BPSL Innovation Working Group and the BACS Access and Governance Working Group.24 25

The LINK card scheme

C.9 As stated in Chapter 4 the LINK card scheme determines the Operating Rules for transactions between scheme Members, while detailed operational procedures assist in the day to day running of the Network. The governing body of the LINK card scheme is the Network Members Council (NMC). Each Member of the LINK card scheme is represented on this body. At the time of publication there are 49 LINK card scheme Members; 35 financial institutions and 14 non-financial institutions.

C.10 A smaller group has been formed called the NMC Review Group. The Review Group has no formal powers, and is self-selecting in that any member of the NMC can attend any meeting. In practice, Members attend the Review Group when it is debating an issue of relevance to those Members.

C.11 Four key issues, all stemming from the Cruickshank analysis were considered under the LINK card scheme:

• whether current voting arrangements in the NMC were the fairest, most efficient and most supportive of innovation

• whether any wider changes to the governance of the LINK card scheme would be of value

• whether access criteria for joining the LINK card scheme were as fair and unrestrictive as possible, and

• whether the LINK card scheme took into account the views of non-member stakeholders sufficiently, or whether additional mechanisms would be of benefit.

26 A full description of the LINK Network is in Chapter 4 of this report.
Issue: voting arrangements for the LINK card scheme

C.12 A minority of Working Group members expressed concern about the voting framework within the NMC. Three respondents to the OFT's questionnaire claimed that the big banks could potentially dominate proceedings. Their concern arose from voting rights being chiefly based on transaction volumes rather than alternative arrangements like ATMs deployed or one–member, one-vote. IADs on the Working Group also expressed concern.

C.13 The CPSS Core Principles state that:

'Systems owned by their participants may also need to make special efforts to seek the views of a wide range of users, especially if a small number of larger participants dominate the decision making process because of voting rules linked to transaction volumes or values. In these circumstances, governance arrangements may need to give special consideration to the role of smaller participants'.

C.14 From 1 January 2006, the system under which 40 per cent of NMC votes previously reserved for the owners of the company was replaced with one which allocated 25 per cent of the votes equally between all Members, with the remaining 75 per cent allocated according to use of the network. This allocation aims to ensure that small Members enjoy a larger percentage of votes than currently, without giving majority power to Members who account for only a small proportion of the traffic over the network (which would be the result of a one-member, one-vote arrangement). The new system will also include provisions restricting a single member's voting allocation to 15 per cent, while a 'super majority' of 80 per cent will continue to be needed for certain decisions such as a change to the methodology for calculating interchange fees (see below), and a 60 per cent majority for a change to the Operating Rules.

27 CPSS Core Principle X (7.10.15).
Transaction volumes in 2005 mean that, in its first year of operation under this system, the biggest five banks will still hold more than 50 per cent of the vote, but less than 60 per cent. The NMC is able, by requisite majority, to alter its rules to allow for certain issues to be considered by only a part of the NMC.

C.15 In the event of difficulties in reaching the requisite majority (80 per cent) on votes at the NMC relating to interchange fees, the NMC resolved on 19 March 2002 that a binding adjudication process be established in order to resolve any disputes between Members arising out of the annual cost study or the setting of the Interchange Fee.

C.16 A dispute may relate either to an issue of principle (for example whether a particular element of cost should be included in the interchange fee calculation) or an issue of methodology (for example, where it is claimed that an error in the methodology used to calculate the interchange fee has been made). The requisite proportion of votes at the NMC for the adjudication process to be initiated is 20 per cent.

Potential detriment arising from voting arrangements and NMC structure

C.17 According to some questionnaire respondents and members of the Working Group, the possible detriments arising from this arrangement include:

- a possible limiting of innovation in the LINK card scheme.
  Cruickshank wrote that payment schemes 'controlled by existing players have little incentive to change their infrastructure purely to benefit customers or new entrants'.28 Any potential for control of the NMC by the big banks, offering existing LINK card scheme services, could mean that it is more difficult for smaller banks to introduce new services through the scheme. Some IADs in meetings with the

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28 Cruickshank, para 3.124.
OFT raised this as a concern, and five respondents to the OFT questionnaire thought that innovation in the LINK card scheme was 'at the pace of the slowest' although no examples have been given to corroborate this

- the expansion of the LINK card scheme to different sorts of organisations possibly being limited, because control over the access requirements of the scheme is held by one subset of the members. Cruickshank raised this as a particular concern, stating 'existing players enjoy the right to approve new entrants. Full access to a payment scheme is a source of competitive advantage and sharing the privilege with new players weakens this advantage'.²⁹ In the history of LINK, however, only two organisations had ever been refused membership. In neither case had any Members considered that either application should have been accepted

- decisions possibly being made in the interests of the largest Members rather than for the general enhancement of the LINK card scheme or the benefit of end users. Cruickshank was concerned that payment schemes 'are run in the interests of the banks that own them'.³⁰ Only two respondents to the OFT’s questionnaire thought this currently applied to LINK, however

- the ability of larger Members to make rule changes that primarily affect smaller Members (for example, IAD signage). Only two respondents to the questionnaire felt that this was a concern, and

- inefficient and slow decision making. The NMC is a large body, more akin to an annual general meeting than an executive board. The NMC Review Group, although smaller, is not a decision making body. Six

²⁹ Cruickshank para 3.69.

³⁰ Cruickshank para 3.61.
respondents to the OFT questionnaire felt that debate was difficult in
the NMC because of its size, though again no specific examples
were given.

**Potential solutions considered**

The voting arrangements introduced in January 2006

C.18 The first solution considered was to allow the new voting arrangements
time to be tested before deciding whether change was necessary. The
new voting arrangements replaced arrangements whereby 40 per cent of
the votes cast at the NMC were reserved for the Members of the LINK
card scheme who also owned the LINK company. These 22 LINK
compány owners are exclusively banks and building societies. Some
members of the LINK Working Group argued that the new arrangements
would address the potential concerns raised about governance. For
instance, it was argued that the CPSS Core Principle X concern that
'special consideration be given to the role of smaller participants' was
covered by 25 per cent of the votes cast being shared equally among
Members, not according to transaction weighting.

C.19 In response to the concern that transaction-weighted voting stifled
innovation, some LINK card scheme Members considered that the LINK
model allowed innovation, and quoted examples such as mobile 'phone
top ups from ATMs, and the use of LINK as a gateway service for other
networks such as Visa and MasterCard. Another example of innovation
was the branch sharing arrangement currently used by only two of the
card scheme's relatively small members. This view of LINK as
innovatory was supported by responses to the OFT's questionnaire
where seven respondents did not consider the rate of innovation to be
slow.

C.20 In response to the concern that voting arrangements could narrow
access to the LINK card scheme due to the big banks' reluctance to
allow potential competitors to enter, it was pointed out that the scheme
executive, rather than scheme Members, assess whether potential new
Members meet the criteria. Furthermore, as stated above, in the history of LINK only two applicants had been refused entry to the scheme. One had been refused on the grounds of financial robustness (it subsequently went bankrupt), and the second is discussed below at paragraph C55 et seq.

C.21 Although it was acknowledged that, even under the new voting arrangements, the big five banks would hold a simple majority of votes and could veto decisions, it was pointed out that more than a simple majority was needed to change LINK card scheme rules (60 per cent) and to agree the MIF (80 per cent). Most respondents to the OFT questionnaire considered that it was fair for the bodies which processed the most transactions through LINK to have a greater say in how it was run. Furthermore, evidence was presented to the Working Group which did not support any suggestion that the big banks had voted as a block on any occasion where there had not also been consensus among other members. Only two respondents to the OFT questionnaire thought that decisions at the NMC were taken in the interests of the big banks. More respondents felt that decisions were made in the interests of either all members (three responses), consumers (three responses), or a combination of the above (four responses).

C.22 LINK has different types of organisations as members, principally financial institutions and IADs. Some organisations may be impacted in a far greater way than others by the LINK card scheme rules. Consideration was therefore given to whether certain issues should be ring-fenced to be considered only by a subgroup of LINK card scheme Members. The banks considered that it was appropriate that all LINK card scheme Members voted on all matters. The inter-dependency between the members of LINK meant that there were very few issues that affected only one type of member. Even an issue such as IAD signage would affect banks, as it was the banks’ customers that would

31 See Chapter 4 for a full explanation of these voting arrangements.
be withdrawing the money. Ten respondents to the OFT’s questionnaire felt that no decisions of the LINK card scheme should be 'ring-fenced' to be considered only by a sub group of those directly and significantly impacted by these decisions.

C.23 In conclusion, it was felt that all LINK card scheme Members enjoyed the right of being on the NMC and having their say. For many, even the smaller Members, this was paramount, and it outweighed the inefficiency of the NMC. Lastly, it was felt that the NMC Review Group had been a successful addition and that it had addressed some of the need for a smaller body. Due to its self-selecting nature, it was popular with both large and small Members of the LINK card scheme.

To introduce alternative voting arrangements

C.24 Alternative suggestions for dealing with the concerns raised above were considered by the Working Group, including a one-member, one-vote system, and a system that would balance transaction-weighting against the number of ATMs deployed. Both potential changes were considered by the IADs on the Working Group to be a fairer reflection of the LINK card scheme and to prevent the big banks from dominating to the same degree. The IADs felt that innovation would benefit because IADs would have more weight behind their requests for innovations within the scheme. Three OFT questionnaire respondents considered that the current system would be improved by introducing a one-man, one-vote system. However no evidence was introduced to indicate that innovation had been stifled under the current system.

C.25 The IADs also thought that a change to the voting arrangements would not just increase innovation but would benefit the LINK card scheme as a whole by generating consensus. This was because a voting arrangement proportioning votes based on LINK membership, rather than transaction volumes, would require agreement across a broader group of Members on the LINK card scheme than is currently the case. In turn, this would mean that decisions would be taken in the interests of the vast majority of scheme Members. It was felt by some Working Group members that
one-member, one-vote would ensure equal weight was given to all LINK card scheme Members, and would prevent dominance by the banks. However, evidence was presented that the larger banks had not voted as a block against other Members in the past.

C.26 On the other hand, the voting arrangements have recently been changed to take into account the interests of smaller LINK card scheme Members which will now have disproportionately greater voting rights on the NMC. There may be some benefit to seeing how the new arrangements work in practice. It is also noteworthy that no single NMC Member has sufficient voting rights to veto an amendment to the rules.

C.27 Changes to the current arrangements for transaction-weighted voting were largely supported by the IADs on the Working Group, but were opposed by the banks.

Replacing the NMC with a smaller governing body

C.28 Another option considered was to replace the whole NMC and Review Group with an alternative approach to governance. The concept considered was to replace the NMC with a smaller, more manageable governing body elected by LINK card scheme Members. This governing body would include around a dozen Members, and each constituency (financial institutions and IADs) would elect a set number of delegates to the governing body. Additionally, two of the delegates could be wholly independent, and could represent the interests of non-member stakeholders, such as consumers. An example of the make-up of the governing body could be six delegates elected by the financial institutions, four by the IADs, two wholly independent delegates, and one independent non-voting Chairman. Each board member would have one vote.

C.29 Some members of the Working Group (including HM Treasury, OFT and the Bank of England) considered that this option would increase the efficiency of the LINK card scheme, by making decision-making more manageable (six questionnaire respondents thought that decision making
at the NMC was difficult due to its size). It was also felt that it would create a balance between the different constituencies in the LINK card scheme, allowing no one group dominance, but still ensuring that the group with the largest number of delegates (financial institutions) was the group with the largest number of transactions. Although the NMC was not the same as the board of a company\textsuperscript{32}, this would also be supported by the Combined Code on Corporate Governance (Section 1, A.3) which states:

'An effective board is neither too large nor too small in composition . . . No small minority should be able to block the decision making process'.

C.30 It was also felt by some members of the Working Group that a governing body of this nature would address any existing concerns about the dominance of the big banks, and would also create an enhanced incentive for innovation. The introduction of wholly independent delegates in particular could lead to a greater incentive to provide other stakeholders with new products. It was also felt that the independent delegates would hold the balance in the governing body, so that if there were to be a polarisation in the NMC between financial institution and IAD delegates, the independent delegates’ vote would be of great importance.

C.31 Another potential benefit of the addition of independent delegates would be their impartial approach to the extension of the LINK card scheme. Independent delegates would have no incentive to keep potential competitors to existing members from the LINK card scheme, and would be able to judge the membership of each potential entrant on the benefits or detriments it would bring the scheme. Although carrying only two votes on the governing body, it was felt by some members of the Working Group who were not Members of LINK that the impartiality of

\textsuperscript{32} The Combined Code on Corporate Governance is designed for public listed companies who decide how best to interpret these guidelines. Schemes are not public listed companies, but, rather, are special purpose organisations that are system user groups.
the independent delegates would give them a greater moral weight in deciding on access for potential entrants. There is no allegation that the scheme executive does not apply the membership criteria rules objectively but that the NMC (not the scheme executive) designs the rules and that these may be overly limiting.

C.32 The smaller representative body, although popular with some Working Group members such as the OFT, HM Treasury and the Bank of England, did not gain the approval of either the banking or IAD members of the Working Group. LINK card scheme Members valued the NMC, because all Members could have a say. LINK card scheme Members did not feel comfortable with electing potential competitors to the governing body without having a seat themselves. Neither did they feel that independent delegates (in addition to the independent chairman) would add much. Furthermore, it was felt that agreeing the allocations on the governing body between financial institutions and IAD board members would be problematic.

C.33 LINK card scheme Members felt that the NMC Review Group was effective as a decision making annexe to the NMC, and benefited from being much more manageable. Lastly, the Canadian Interac system uses a system of governance similar to the one described above, whereby a number of seats on the scheme board are reserved for members who connect directly to Interac (usually the big banks), and a number of seats are reserved for members who connect indirectly to Interac (often smaller banks and IADs). The Interac system did not appear to offer as many services as LINK, and therefore did not support the case that a smaller, balanced board would be innovative.

**Conclusion on voting arrangements**

C.34 No consensus was reached on voting arrangements. None of the options considered above was acceptable to all members of the Working Group. IADs considered that some greater level of representation for themselves was required than was contained in the current arrangements. The banks
and building societies were very reluctant to agree to any further weakening of the principle of transaction-weighted voting. LINK card scheme Members on the LINK Working Group rejected the idea of a smaller governing body, although HM Treasury, the Bank of England and the OFT remained in favour.

C.35 LINK card scheme Members will therefore report to the Task Force 12 months from the date of the inception of the current voting arrangements on their effectiveness.

**Issue: other potential governance changes**

C.36 Two other potential governance changes were considered. One was the introduction of wholly independent delegates to the NMC (as opposed to the introduction of independent delegates to a new, small governing body). The other potential change was a reinforced set of objectives against which the NMC could be measured, building on the existing objectives referring to innovation, efficiency and the interests of consumers.

**Potential governance change: introduction of independent delegates to the NMC**

C.37 The potential benefits of introducing wholly independent delegates were discussed by the Working Group. The OFT, HM Treasury and the Bank of England considered that the benefits of introducing wholly independent delegates to the NMC and the NMC Review Group would address many of the concerns that were expressed about governance and voting arrangements.

C.38 The OFT, HM Treasury and the Bank of England argued that independent delegates would be able to represent the interests of the LINK card scheme and of other stakeholders of the scheme (for instance consumers) without any conflict of interest. Other NMC members may face a conflict of interest in representing these wider interests when they do not coincide with the commercial interests of their company,
although no evidence of such a problem was presented to the Working Group. Independent delegates may also be well placed in assessing whether the criteria for accessing the LINK card scheme are fair and open. Unlike other members of the NMC, there would be no incentive for independent delegates to interpret the access conditions in such a way as to exclude potential competitors from the LINK card scheme. The decision as to whether individual companies actually meet those criteria would fall to the scheme executive (as is currently the case).

C.39 Finally, depending on the background of the independent delegates, they may also be able to add wider experience to the NMC than that provided by the current banker and IAD members. This is supported by the Combined Code on Corporate Governance, which states:

'Except for smaller companies, at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. A smaller company should have at least two independent non-executive directors'.

C.40 Although the Code applies to companies rather than schemes, the OFT, HM Treasury and the Bank of England still thought that independent non-executive delegates (that is, delegates that did not represent the NMC Members) would positively contribute to the NMC for the reasons outlined above.

C.41 The alternative view supported by other Working Group members was that the addition of further independent voices to the NMC (there is already an independent non-voting chairman) would not provide significant additional benefits to the scheme. Responses to the OFT questionnaire suggested that while the independent Chairman was greatly valued, little additional value would be gained through having additional independent delegates.

33 Combined Code on Corporate Governance, Section1, A.3.2.
C.42 APACS noted that board directors were usually appointed to represent shareholders. In the case of the LINK card scheme, as all LINK members were already represented on the Network Members Council, it was questionable who an independent delegate would represent and what additional benefits they would bring.

C.43 Some members of the Working Group noted that the LINK card scheme executive and independent chairman already had a role in balancing the interests of issuer and acquirer members, together with the scope to suggest innovative compromise where this might be possible. The LINK card scheme had also agreed to set up the Standing Committee which would have a majority of independent consumer representatives. This could meet the desire to add a wider experience than that provided by the bankers and IADs. The Standing Committee could also consider whether the criteria for accessing the LINK card scheme were fair and open. The NMC had accepted an obligation formally to respond to any questions from the Standing Committee, and the Standing Committee would be invited to make a public report on LINK’s website.

C.44 A number of questionnaire responses noted that there would be little point in introducing independent delegates while voting and governance arrangements based on transaction volumes were in place and all Members of the LINK card scheme were represented at the NMC. Without changes to the size of the NMC, two independent delegates would add just two voices to those already on the NMC, and they would represent no transaction volumes. Even if independent delegates joined the NMC Review Group, that body did not make decisions, so the input of the independent delegates would be limited.

C.45 Working Group members who supported the introduction of independent delegates recognised that they would have limited influence in the currently styled NMC. These members therefore recognised the merits of having a smaller decision-making for the LINK card scheme where the independent delegates would have influence. They would also represent the interests of all scheme members, particularly those that were not directly represented at the smaller decision-making body.
Conclusion: introduction of independent delegates to the NMC

C.46 The Working Group concluded that without a reform of the NMC, independent delegates would add little to the LINK card scheme, and that any future consideration of independent delegates should therefore be part of the review of the new governance arrangements in 12 months from January 2006. However, HM Treasury, the Bank of England and the OFT all remained in favour of the appointment of independent delegates to the NMC.

Potential governance change: introduction of a wider scheme objective

C.47 The Working Group considered whether the LINK card scheme should have broader objectives than those that it had adopted in late 2004. The Working Group noted that existing objectives, to a degree, covered innovation, efficiency and user requirements, but considered whether they could be reinforced.

C.48 The LINK card scheme objectives agreed in late 2004 contained these aims relating to innovation and cardholders:

- to provide universal acceptance of cards in ATMs in the United Kingdom (and potentially Europe)
- to provide transparency on direct charging
- to ensure that customers have secure, reliable access to their cash (through ATMs), and
- to ensure that core and optional scheme services are provided in a flexible and easy to use manner and to facilitate the introduction of new services.
While the Working Group applauded these objectives it agreed that there was scope to reinforce and give greater prominence to innovation and cardholder interests by introducing reinforced objectives in the constitution of the LINK card scheme. The Standing Committee would be able independently to assess the LINK card scheme’s performance against the reinforced objectives relating to consumer interests, and to publish its views in its annual report, should it wish to do so.

**Conclusion: a wider objective**

The Working Group concluded that the LINK card scheme would reinforce its commitment to promote innovation, efficiency and the consumer interest by giving prominence to the following objectives:

- ‘The LINK card scheme will promote innovation and efficiency in ATM transactions, responding to user and market needs in an efficient and cost-effective manner’, and

- ‘The LINK card scheme will listen to and take account of the interests of cardholders’.

These objectives were agreed by the NMC on 13 December 2005 and will be reported against by both the LINK card scheme and the LINK Standing Committee.

**Issue: access to the scheme**

One of Cruickshank’s key concerns about the United Kingdom’s payment systems was that access to each scheme was controlled by the Members of the scheme. This gave a potential incentive for each scheme not to admit new members which could compete with existing members. The Working Group considered LINK’s access arrangements.

The current LINK card scheme access criteria were agreed by the NMC. To be eligible to join the LINK scheme, the criteria require that the applicant either issues cards that are LINK-enabled, or operates ATMs with a connection to the LINK switch or a connected processor. Further
criteria largely concerning financial robustness and the security of the LINK system must also be met.

C.53 Although the NMC sets the access criteria, it is the LINK card scheme executive which actually judges each membership application against the criteria. Since LINK was created, only one organisation which has either offered to deploy LINK-enabled cards or operate ATMs connected to the LINK switch has been refused membership of LINK (on grounds of financial robustness). That company later went bankrupt.

C.54 Some Working Group members (notably Post Office Ltd and HM Treasury) were concerned that the access criteria agreed by the NMC might be overly restrictive. However, the Working Group was satisfied that there was no evidence that the LINK card scheme executive had ever judged potential members against the application criteria unfairly or restrictively.

Post Office Ltd’s application to join LINK

C.55 Post Office Ltd wished to join the LINK card scheme to provide a universal free of charge over-the-counter cash withdrawal service to all LINK-enabled card holders from its 14,500 branches across the United Kingdom. LINK is the leading ATM switching network in the United Kingdom. Currently, Post Office Ltd is able to provide such services only to customers of partner banks with whom it has negotiated bilateral agreements (see paragraph C68). The LINK card scheme rules (see paragraph C52 above) would need to be amended to include a new category of member before Post Office Ltd could be allowed to join the scheme to offer cash withdrawals over the counter. Post Office Ltd has not found bilateral agreements to be a viable alternative to LINK card scheme membership, having encountered practical difficulties, and time and resource costs in attempting to negotiate them.

C.56 Post Office Ltd applied for membership of the LINK card scheme in December 2004. As a result of proposing neither to deploy ATMs (although many Post Office Ltd branches contain ATMs, they are
Post Office Ltd considered that the LINK card scheme access criteria were restrictive, by only permitting cash to be distributed through ATMs. Post Office Ltd argued that the access criteria should be changed to include cash to be distributed through means other than ATMs, such as over-the-counter. Many other members of the Working Group, including the LINK card scheme executive and those who were Members of the LINK card scheme, considered that including over-the-counter cash acquisition in the existing LINK scheme would create a number of risks to the LINK card scheme.

**Arguments for changing LINK’s access rules**

Post Office Ltd has an objective of providing a universal free of charge cash withdrawal service from each of its branches. Although some Post Office Ltd branches have an ATM service, Post Office Ltd does not consider it commercially viable to achieve this objective by placing free ATMs in all its branches. Post Office Ltd has calculated that the majority of its branches have insufficient transaction volumes to support a free ATM and it therefore wished to provide cash withdrawals through the LINK scheme over its counters.

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34 Post Office Ltd's ATM services include around 650 free ATMs in its branches. This is expected to increase to around 1,000 free ATMs over the next five years, through Post Office Ltd's new partnership with Bank of Ireland. There are currently around 1,900 surcharging ATMs in retail businesses with a Post Office on the premises. Additionally, Post Office Ltd is withdrawing from its contracts with suppliers of surcharging ATMs.
C.59 Post Office Ltd argued that the current access arrangements effectively restricted competition and innovation. Post Office Ltd did not consider that the LINK scheme should allow cash to be distributed only through ATMs, and that, by doing so, it unnecessarily restricted access to the LINK scheme. Post Office Ltd considered that the method of dispensing cash should not be a criterion for refusing membership of LINK. This in turn led to fewer outlets able to offer cash acquisition through LINK to consumers. Post Office Ltd considered that it was in the interests of the Members of LINK to maintain the status quo rather than expanding free access to cash over Post Office counters, because Members would face increased competition from Post Office Ltd’s membership of LINK, and would pay Post Office Ltd an interchange fee for each transaction. The banks had benefited from the growth of surcharging ATMs since no interchange fee was payable on cash withdrawal transactions made at surcharging ATMs35 and the IADs were able to protect their revenue from surcharges paid by consumers that might be at risk if free access to cash were to be available at more outlets. Post Office Ltd said that, in its view, cashback was not an attractive alternative for retailers as the retailers had to pay a merchant acquirer fee for the purchase associated with the cashback, and, if a retailer has not previously accepted debit cards for payment, a terminal rental fee, in addition to the cash provision costs, but without earning the compensating commission they would gain on LINK scheme withdrawals. Indeed, the 2005 APACS Market report noted that, 'The scope for increasing the number of cashback locations may be limited as cash-dominated businesses such as convenience stores and pubs are targeted by IADs, which often offers a more compelling business case as a method of recycling cash'.

C.60 Some Working Group members suggested that consumers could switch bank accounts if they were interested in being able to access their cash at a Post Office Ltd branch but were unable to do so. Post Office Ltd

35 Although over 40 per cent of machines are surcharging, less than four per cent of transactions took place at surcharging ATMs in 2005.
considered that there were a number of practical issues to be taken into consideration in a decision to change bank accounts.

C.61 There are two current levels of fees – or interchange rates – payable by card issuing banks and building societies to the operators of ATMs for LINK transactions that are free to cardholders: a branch interchange rate applicable to a bank or building society’s ATMs located in its own branches and a higher non-branch interchange rate for ATMs in other locations. There are separate rates for cash withdrawals and balance enquiries. Post Office Ltd had proposed fees for over-the-counter transactions - payable by the card issuing bank or building society - at which cash withdrawals without a corresponding balance enquiry would be more expensive than the current non-branch interchange rate, but cash withdrawals with a balance enquiry would be cheaper. Post Office Ltd considered that the average fee to the card issuer per customer visit to a Post Office counter would be lower than the average fee to the card issuer per customer visit to a non-branch ATM. Post Office Ltd argued that most over-the-counter transactions would migrate from non-branch ATMs, and that card issuers would make a net saving for this type of transaction. The prices proposed were also lower than those currently paid by card issuers in relation to the basic bank account over-the-counter service.

C.62 Post Office Ltd recognised that, if it were allowed to join the LINK card scheme, this would result in some costs being incurred, as well as some offsetting savings being made, by card issuers. For example, no cash interchange rate is payable to deployers of surcharging ATMs and so transactions switching to the Post Office Ltd service from surcharging

36 Of Post Office Ltd’s 14,500 branches, 500 are directly managed, with 14,000 where Post Office Ltd does not own the premises or employ staff.

37 Assuming that 50 per cent of customers that make a cash withdrawal at a non-branch ATM also obtain a balance enquiry, compared with 25 per cent of customers making a cash withdrawal at a Post Office counter also obtaining a balance enquiry.
ATMs would result in additional fees being paid by the card issuer. For non-surcharged cash-withdrawal transactions switching to the Post Office Ltd service, the card issuer would pay a higher interchange rate than at present. However, it argued that card issuers would make a saving from reductions in the number of balance enquiries on which interchange rates higher than Post Office Ltd fees were currently being paid, particularly at non-branch ATMs.

C.63 Post Office Ltd considered that an amendment to the rules of the LINK card scheme to allow cash acquisition over-the-counter, as well as through ATMs, would allow Post Office Ltd to offer a universal service in a way that was not practicable through bilateral arrangements. The nature of the LINK card scheme had evolved in the past when a rule change in 2001 had allowed IADs to enter the market.

C.64 HM Treasury considered that if the LINK card scheme rules were not to be changed to allow over-the-counter cash withdrawals, there needed to be clear, convincing arguments for the current position.

Financial inclusion

C.65 Post Office Ltd argued that its potential membership of LINK would bring consumer benefits in the form of increased availability of a free cash withdrawal service, particularly relevant to consumers in urban-deprived and rural areas, and in savings for consumers currently paying fees at surcharging ATMs.

C.66 Post Office Ltd also argued that its membership of the LINK scheme would reduce financial exclusion through widening free access to cash. First, 93 per cent of consumers lived within one mile of a Post Office Ltd branch, giving greater geographical spread than is at present possible for free ATMs. This would be of particular benefit to socially disadvantaged consumers and those in rural areas, where 84 per cent of consumers live within one mile of a Post Office. While only ten per cent of rural villages have a bank branch, 65 per cent have a Post Office. In urban areas, more than 95 per cent of consumers live within one mile of a Post
Office. Post Office Ltd considered that consumers living in rural and urban deprived areas who cannot currently access their bank account at the Post Office counter would like to be able to do so. Secondly, Post Office Ltd would provide the over-the-counter service free of charge to consumers (costs would be borne by card-issuing banks and building societies). Post Office Ltd considers that this would offer benefits to consumers, providing some cardholders whose banks did not already offer this service an alternative means of free access to cash that might be more convenient than the nearest free ATM. This might be particularly valuable to consumers in rural areas, considered against a backdrop of surcharging ATM numbers rising much more rapidly than the number of free ATMs.

**Arguments against changing LINK’s access rules**

C.67 Other members of the Working Group, including all the Members of LINK represented on the Working Group, considered that the LINK card scheme rules should not be changed to allow over-the-counter cash withdrawals as well as cash withdrawals through ATMs.

C.68 These members pointed out that 17 financial institutions (most of them LINK Members) already offered some or all of their customers free cash withdrawal over Post Office Ltd counters. All the largest clearing banks offered a Basic Bank Account offering this service, including all Basic Bank Accounts opened since universal banking services came into existence in April 2003. Consumers who valued being able to withdraw cash at a Post Office Ltd counter could therefore do so by opening an account with one of the participating banks or building societies, or any Basic Bank Account offered by a bank or building society with whom Post Office Ltd has a bilateral agreement. Post Office Ltd pointed out that its individually negotiated bilateral agreements with banks and building societies for Basic Bank Accounts and other accounts were not facilitated by the LINK card scheme although the network infrastructure was provided by the LINK company. LINK members argued that this demonstrated that the Card Scheme rules had not prevented competition or innovation where terms acceptable to both card issuer and Post Office
LTD could be agreed. This was not a case in which the network effects described in the Cruickshank Report prevented a service being developed because it could only be introduced at the level of the scheme as a whole.

C.69 LINK card scheme members argued that the current scheme access criteria were not restrictive and had facilitated significant expansion of the ATM network since 2000, with increases in the number of free machines, as well as surcharging machines in many lower-footfall locations. They calculated that 86 per cent of the population lived within one mile of one of the 33,000 free ATMs, and 93 per cent within two miles. ATMs at Post Office Ltd branches, some of which charge for cash withdrawals, formed part of this network, and the LINK card scheme fully supported the introduction of these, or any further ATMs, at Post Office branches.

C.70 Cash acquisition was also available from other sources. Cashback was available when making a purchase at many retail outlets. Post Office Ltd was free to offer a cash-back service at its retail counters but did not currently do so. In addition to cash withdrawals for LINK-enabled cards, Post Office Ltd could explore opportunities to acquire MasterCard and Visa transactions, or offer cash advances.

C.71 Card issuing banks and building societies would have to pay for each cash withdrawal made by their cardholders over Post Office Ltd counters. The price currently being offered by Post Office Ltd was significantly higher than that payable in the LINK scheme for withdrawals at branch-based ATMs. Although no banks and building societies currently participating in the Post Office Ltd counter service charged their cardholders a direct fee for withdrawals made at these counters, the costs ultimately had to be borne by bank customers and shareholders and building society members. In some respects ATMs, where available 24 hours a day, also offered a better service for cardholders than counters available only during opening hours. For banks and building societies looking to provide services to their
customers in urban or remote rural areas, an agreement with Post Office Ltd might not necessarily be the best or most cost-effective option. Banks and building societies also needed to consider the effects of transactions migrating from their own ATMs or branches to Post Office Ltd counters. LINK Members argued that this could make it less economic to maintain free ATMs or bank branches in quieter locations.

C.72 Changing the rules of the scheme to require all LINK card issuers to pay for cash acquisition over-the-counter as well as at ATMs would, however, carry a number of risks for the LINK scheme. The LINK card scheme executive noted that there could be competition law issues if the LINK scheme required card issuers to pay for counter withdrawals as a condition of their cards being eligible for ATM transactions covered by the scheme. There might also be competition law issues in seeking to set a common fee for over-the-counter transactions, particularly as the methodology for calculating interchange fees for ATM transactions (based on the costs of installing and running ATMs) was not suitable for a counter service given that counters did not exist solely for cash withdrawals.

C.73 If over-the-counter cash acquisition were required, the scheme could potentially expand to include shops, railway stations and other organisations with a counter service. Imposing on LINK card issuers the costs of paying for cash withdrawals at all these locations could make it uneconomic for many card issuers to remain part of the scheme, persuading them to withdraw from the scheme and so losing the current benefit to cardholders of near-universal access to ATMs.

C.74 In conclusion, the LINK card scheme executive argued that it would not support cash withdrawals over-the-counter as that would mean requiring LINK Members to pay for their cardholders to be able to withdraw cash over-the-counter, regardless of whether or not they considered the price of providing this service acceptable for them, and indirectly, for their customers. Providing such a service should be a commercial decision of each LINK Member. Alternatively, they would have to leave the scheme.
Potential solutions to access concerns

C.75 Post Office Ltd’s preferred solution would be for the LINK card scheme to amend its membership criteria to allow over-the-counter cash acquisition. This would be free to cardholders, but the costs would be borne by the financial institutions. Other potential solutions were, however, also considered by the Working Group.

C.76 As noted above, Post Office Ltd already offered over-the-counter cash withdrawal service to all LINK card-holding customers of ten financial institutions (including Barclays and Lloyds TSB, but not the other three largest clearing banks). Around 40 per cent of customers with LINK-enabled cards were therefore able to withdraw cash over Post Office Ltd counters. Post Office Ltd also had bilateral agreements with a total of 17 financial institutions (including all five of the largest clearing banks) relating to Basic Bank Accounts (BBAs). While each institution offers a BBA package that gives access to free cash withdrawals over Post Office Ltd counters (including all BBAs opened since the creation of the Universal Bank service in April 2003), the BBA bilateral agreements do not allow all BBA customers to withdraw cash at the Post Office Ltd counter: only 37 per cent of all BBA customers can do so. The processing service for these bilateral links is provided by the LINK company.

C.77 It was suggested by various members of the Working Group that the effect of Post Office Ltd joining the LINK card scheme could be mirrored by all the banks and building societies that form the LINK card scheme entering into separate bilateral agreements (with processing by the LINK company) with Post Office Ltd. In the view of some Working Group members, this would provide the same customer proposition. Post Office Ltd, although not opposed in principle to this suggestion, pointed out that the remaining three large clearing banks who would be required to enter into these agreements in order to provide coverage equal to that of the LINK card scheme have, to date, declined to do so for other than their BBA holders.
C.78 A similar proposition could involve Post Office Ltd forming an alternative and additional service to that being offered by the LINK card scheme. Post Office Ltd would provide over-the-counter services to customers of banks and building societies, but with standard terms and conditions agreed between Post Office Ltd and the financial institutions. This would have the benefit of being easier to grow and administer than the present system, which is based on bilateral links. It may also make Post Office Ltd’s proposition more attractive to those banks which have presently declined to enter into such an agreement. The LINK card scheme executive and LINK card scheme Members were happy to provide assistance in developing scheme-type rules for such an arrangement, and the LINK company could, as now, provide processing services. As with the bilateral agreements, however, the three remaining high street banks have, at present, declined to commit to join such a scheme. In such circumstances, Post Office Ltd considered that there would be limited benefits from forming this scheme since there might not be a significant increase in the number of LINK-enabled card holders who could use the Post Office Ltd service.

Conclusion on access concerns

C.79 The current Members of the LINK card scheme on the Working Group considered that the LINK card scheme rules should not be amended to allow over-the-counter cash acquisition as well as ATMs. The Post Office Ltd considered that the existing rules should be amended to include over-the-counter withdrawals. No agreement was reached on this issue by the Working Group.

C.80 The alternative suggestion of developing standard terms and conditions and some scheme infrastructure for a service offering over-the-counter cash withdrawals over Post Office Ltd counters was put forward by the LINK company, LINK scheme executive and Members of the card scheme. All parties supported the principle of this scheme and while some banks would not commit now to membership of an alternative scheme, consideration of membership would be the subject of regular commercial review. Post Office Ltd’s position is that in these
circumstances there would be limited benefits from forming a separate scheme since there might not be a significant increase in the number of LINK-enabled card holders who could use the Post Office Ltd service.

C.81 Negotiations will continue between Post Office Ltd and Members of the LINK card scheme to establish if a commercial arrangement can be found that is acceptable to all parties that would allow free cash withdrawals from Post Office Ltd counters for all consumers holding a current account with a major financial institution. Post Office Ltd was keen to ensure that urgent focus was given to this issue by the Members of the LINK card scheme so that it could be resolved within a reasonable timeframe.

**Issue: representation of wider stakeholders**

C.82 Another key concern of Cruickshank was that payment systems, because of their mutual nature, often do not face direct competition, which reduces the incentive for schemes to react to end-user requirements. The CPSS Core Principles say that:

'It is important that those served by the system should be able to influence its overall objectives and performance. This can be achieved by various means depending on ownership. Representation on the governing body is one such means. Some structured forum for wider consultation can also be useful'.

C.83 The Working Group therefore considered ways in which consumer representation could be enhanced on the LINK card scheme.

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38 CPSS Core Principle X 7.10.8.
Potential detriment arising from a lack of stakeholder involvement

C.84 Although a number of cash acquisition possibilities are open to consumers (such as using proprietary ATM networks and cashback), for the majority of debit and ATM card cash withdrawals at ATMs not owned by a cardholder’s own bank, consumers do not in practice have a choice other than to make a transaction under LINK rules. While there may be benefits to there being only one set of scheme rules applying to all Members of LINK, there are also concerns that this limits the incentives to amend the rules in response to current or prospective demands of end users. The Working Group therefore considered that some form of formal consumer input into the LINK card scheme would be of benefit to ensure that customer requirements were taken into account.

C.85 This is not to say that there is no competition for LINK users. Although for many consumers, the LINK network is the most convenient way to withdraw money, there are many levels in the provision of cash acquisition or payment services at which there may be competition. These include competition between the banks and other financial institutions in providing services to their customers, competition between IADs to deploy ATMs and offer services from these and potentially competition between payment processors for the services they provide to schemes.

Potential solutions to lack of stakeholder involvement

Standing Committee on Consumer Issues

C.86 The LINK card scheme had recently agreed to set up a Standing Committee on Consumer Issues (the Standing Committee), which would advise the NMC on consumer issues that relate to the LINK ATM network and LINK card scheme rules, and would represent the interests of consumers. The Standing Committee would not hold voting rights at the NMC. Instead, it would be able to make objective analyses and
criticisms of NMC policies, and the NMC would be obliged to answer any questions put to it by the Standing Committee. The initial Terms of Reference for the Standing Committee were agreed by the NMC (attached at Annexe H), and will be reviewed as part of the first meeting of the Standing Committee, and once again after a full year of the Standing Committee’s operation by both the Standing Committee and the NMC. The Standing Committee will publish an Annual Report summarising its findings, recording any minority views.

C.87 The Standing Committee would be chaired by the Independent non-executive Chairman of the NMC and would consist of:

- four or more independent members to represent the views of consumers. They will be invited to join the Standing Committee by the Independent Chairman, and may include representatives from consumer organisations. It is envisaged that these will be part-time positions, paid where appropriate, and

- four representatives of NMC members, elected on a one-member, one-vote basis, providing that two shall be from NMC members that issue cards and that two shall be from acquirer-only NMC members.

C.88 The NMC and LINK card scheme executive will approve the Standing Committee’s annual budget and expenditure in accordance with established spending limits. Administrative support will be provided by the LINK card scheme executive.

C.89 It is envisaged that the Standing Committee will:

- represent the interests of consumers by advising, commenting on and making recommendations on existing and developing LINK card scheme policy and practices that affect cardholders

- speak on behalf of consumers by reviewing, monitoring and reporting to the NMC on the effectiveness of the LINK card scheme’s policies and practices, and
consider issues such as membership criteria, rule changes and declined applications for membership if Standing Committee members consider these issues relevant to the interests of consumers.

Independent delegates

C.90 Some members of the Working Group considered that wholly independent delegates, with a particular responsibility for consumer interests should be appointed to the NMC. They thought that one or more voices on the NMC whose main concern was that of consumer welfare would help to focus the NMC into promoting innovations for consumers. They also thought that independent delegates (who would be independent in the sense that they would have no commercial interest in the LINK card scheme except by their direct remuneration) would be able to attend the smaller NMC Review Group, and therefore would play a proportionately greater role than merely being one (or two) of more than fifty members of the NMC.

C.91 Another view expressed at the Working Group was that independent delegates with a particular responsibility for consumer welfare would not be required on the NMC. Some members of the Working Group considered that the NMC as a whole had an interest in consumer welfare given that cardholders were their customers. Most agreed that the Standing Committee would be a more efficient and focussed way of bringing consumer concerns to the attention of the NMC as it would have a voice which was, to some extent at least, independent of the NMC and thus capable of making objective criticisms of NMC policy. This would particularly be the case if the Independent NMC Chairman also chaired the Standing Committee. Some Working Group members considered that without a reform of the NMC (see paragraphs C28 onwards) the voices of two NMC members out of more than 50 would carry very little weight.
Scheme objectives

C.92 The Working Group considered the objectives for the LINK card scheme. The Working Group agreed that these objectives should be enhanced with a more specific reference to listening to and taking account of the interests of cardholders. The Standing Committee would report on progress against this objective, alongside the LINK card scheme’s other cardholder-facing objectives, as part of its Annual Report.

Consultation process

C.93 In addition to the Standing Committee, the LINK card scheme executive would continue to seek regular meetings with consumer organisations such as the Citizens Advice, the NCC and Which?

Conclusion on stakeholder involvement

C.94 The Working Group agreed that the Standing Committee would address some of the concerns about a lack of stakeholder involvement in the LINK card scheme. Although not a part of the NMC, it was felt that the Standing Committee would carry some weight because of its powers to request answers to its questions from the NMC, its ability to publish an Annual Report on the NMC’s performance against objectives, and because the chair of the Standing Committee would also chair the NMC.

C.95 The Working Group agreed that regular consultation between the LINK card scheme executive and consumer groups should continue.

C.96 As noted above, it was agreed that the LINK card scheme would retain and reinforce its objectives relating to the interests of cardholders.

C.97 The Working Group decided that the introduction of independent delegates to the NMC with a focus on consumer welfare would not contribute greatly to the interests of LINK’s consumers. Among other reasons, this was because a small number of independent delegates
may only have a small impact unless the decision-making body, the NMC, is smaller than is currently the case.

The LINK company

C.98 The LINK company provides the network and switching services that connect Members of the LINK card scheme and process the ATM transactions between them.\textsuperscript{39} The LINK company is limited by shares wholly owned by 22 of the United Kingdom’s largest banks and building societies. Each of these organisations nominates a non-executive director and an alternate to the board of directors.

C.99 For operational, rather than strategic, matters an Executive Committee of ten shareholder-elected directors, three executive directors and the independent Chairman operate on a one-member, one-vote basis to run the infrastructure below the full board. More detail on the governance arrangements of the LINK company is given in Chapter 4.

C.100 Two key issues were discussed in relation to the LINK company:

- eligibility for share ownership of the LINK company, and representation of other stakeholders, and

- the relationship between the LINK company and Avantra.

C.101 The Working Group discussed the possible detriment arising from the current arrangements, solutions to the issue (including maintaining the status quo), and conclusions on the recommendations reached.

\textsuperscript{39} Except where Members both use the same Certified Service Bureau (CSB) and transactions are not therefore routed over the LINK network. Any scheme Member is entitled to use a CSB.
Issue: ownership and governance of the LINK company

C.102 As stated above, the company is owned by 22 of the United Kingdom’s largest banks and building societies, and shares are restricted to those owners (that is, while shares can be traded between current owners, other organisations can not buy shares in the company). Furthermore, the 22 owners then appoint an Executive Committee to run the infrastructure. This inability of outside companies to buy into the company, and also be represented on the board, may lead to a disincentive for the company to seek new opportunities and innovate, although no evidence was adduced to show that this has been a problem in the past. While the company’s directors all come from financial institutions, the company itself is essentially a technology company and is very different from a financial institution. The company may, then, benefit from having board directors who are not solely from financial institutions, although it was noted that there are broad pools of expertise and talent within major banks. Such directors may bring vision, expertise and experience which would allow the company to become more innovative. This may be increasingly important for the company to be successful in a European context following the introduction of the Single Euro Payments Area (SEPA).

C.103 The Combined Code on Corporate Governance (Section 1, A.3.2) promotes the use of independent directors to company boards in order to increase the accountability of the board, although some members of the Working Group questioned the relevance of the combined code to a company with LINK’s shareholding structure. Five respondents to the OFT’s questionnaire suggested that independent directors would contribute to the board by adding to the skills and perspectives already on the board, including better external perspective, ability to stimulate debate, and better accountability, transparency and effectiveness. Five other respondents considered that independent directors would add nothing to the board.
Potential solutions to membership and governance issues

C.104  The Working Group discussed a number of potential solutions put forward by the LINK company to this issue. The Working Group generally agreed that additional board input from outside the current ownership may provide benefit, and therefore discussed the best way to approach this.

Opening up ownership of the LINK company

C.105  The Working Group considered proposals already under consideration by the company that it would benefit from opening up its ownership. Some Working Group members said that new owners would contribute to innovation of the company by providing a different perspective than that of the banks and building societies. No respondents to the OFT questionnaire considered that ownership should not be opened up to other bodies.

Independent directors

C.106  Unlike with the NMC, it was considered that independent directors on the 22 seat company board, which deals with largely strategic issues, may bring some benefits. Independent directors might also be able to add their expertise to the Executive Committee, which currently deals with operational issues.

C.107  It was also felt that a small number of independent directors representing shareholders not present on a smaller company board would be able to provide new perspectives to the governance of the company, and also perhaps different skills. It may be, for instance, that the company might wish to appoint an independent director with skills different from those already on the board. The Working Group felt there was a crucial difference between the benefits independent delegates could bring to the NMC, and those independent directors could bring to the LINK company board. It was felt that the LINK card scheme was in
place to set rules and monitor compliance, whereas the company board was better placed to suggest innovations and new products.

Alternative voting procedures

C.108 Shares in the processing company were fixed in 2003 based on the transaction volumes of shareholders at the time. Since 2003 the owners have been able to buy and sell shares among themselves on a ‘matched bargain’ basis (although no transactions have, in fact, taken place). Although there is no limit on the amount of shares held, no shareholder can exercise more than 15 per cent of the vote. A simple majority is needed to pass most motions, but for some matters a ‘super majority’ of 80 per cent is needed. This has led to concerns that a small majority of the company owners could dominate the decision making process (see CPSS Core Principles for Systemically Important Payment Systems 2001 (Core Principle X)).

C.109 The LINK company has pointed out that in practice decisions are usually made by consensus or by an informal show of hands. A greater number of decisions have been delegated to the Executive Committee, which operates on a one-man, one-vote system.

C.110 There was, however, some support at the Working Group for a change to the voting arrangements at the company. It was agreed that the LINK company, as part of an on-going review into its governance arrangements, would consider moving from a system of votes based on shares owned (with the current cap on ownership that prevents dominance by a single party, while still allowing effective pre-emption rights). This may also make the introduction of independent directors easier, as there would be no need to allocate the independent director(s) a proportion of the vote.
Conclusions to membership and governance issues

C.111 The Working Group recommends that the company reviews voting arrangements for the board, including consideration of a one–director, one-vote system based on powers delegated to them by shareholders at the AGM. While no evidence was presented to the Working Group of a small number of owners with a large shareholding dominating voting, a different voting system would eliminate this as a potential concern. The Working Group also considers that the addition of independent directors to represent smaller shareholders (following the introduction of a smaller board) would be of value to the company.

C.112 Lastly the Working Group considers that the ownership of the company could be opened up more widely. Companies who want to invest in the company should be welcomed, as they may be able to provide funding for new innovations. New members may bring new ideas and initiatives to the table. These changes have not yet, however, been approved by the company board, but that these and other changes were under active consideration.

Issue: The relationship between the LINK company and Avantra

C.113 The LINK company owns Avantra (formerly ATMOS), which forms a separate legal entity. Avantra provides outsourcing services to some LINK card scheme Members (it will run their ATM services for them). It competes in this market with other processing companies which are not owned by the company. Avantra buys transaction processing services from the company on a commercial basis.

C.114 Five questionnaire respondents considered that the relationship between the company and Avantra was not conducive to fair competition, because of the company’s ownership of Avantra. The proximity of Avantra to LINK in both corporate terms and in physical terms (they share the same building), for instance, makes it possible that Avantra has better communications to the company than competing processors.
Although no evidence was provided, some questionnaire respondents were concerned that competing processors would have to make formal requests to the company for information, whereas Avantra could make information requests easily and immediately from colleagues in the same building.

**Potential solutions to the relationship between the company and Avantra**

Retain the current position

C.115 Eight other respondents to the questionnaire considered that there were, in fact, no benefits to be gained by Avantra through being owned by the company. In fact, several pointed out that competitors to Avantra had joined the market recently, showing that barriers to entry were not significant. Some questionnaire respondents pointed to the benefits of a joined up’ service between the company and Avantra, for reasons of efficiency.

A full split

C.116 Some questionnaire correspondents considered that a full split between the company and Avantra would be beneficial to competition. A point made in the questionnaire responses was that a full split between the two would prevent any concerns over favouritism shown by the company to Avantra. Despite some strong views being made in the OFT questionnaire responses, there was little support for a full split among Working Group members.

A clearer division between the company and Avantra

C.117 A third option considered was to make the line drawn between the company and Avantra clearer. This would require no change to the ownership arrangements of Avantra, but would involve a clearer division of roles and responsibilities, a clearer division of personnel and
transparency on the pricing of services so there could be no claim that Avantra was accessing a better priced service. As part of this potential solution the company suggested moving Avantra to separate offices to reinforce the logical split between the two.

**Conclusion on the relationship between the company and Avantra**

C.118 The Working Group concluded that a clearer division between the company and Avantra would ensure a level playing field for Avantra’s competitors without having to go through the expense of a full legal separation.

**Issue: Relationship between LINK card scheme and company**

C.119 One issue was raised regarding the relationship between the LINK card scheme and the company. The relationship between a payment scheme and the company that runs the infrastructure is important in introducing competition to the market. As there is very little competition between payment schemes, there is a little incentive to innovate. This can be somewhat mitigated by splitting the scheme from the company that runs the infrastructure, and making that company bid to run the infrastructure at regular intervals. If the LINK company was forced to bid against other infrastructure competitors, it would need to offer a better deal to the Members of the LINK card scheme than its competitors. This proposition could include a more efficient service, more products and services that consumers want, and lower costs. If a competitor offered a better deal, it would take over the running of the infrastructure. The BACS scheme uses this model of competition for the market, with Voca currently running the infrastructure.

C.120 In the case of LINK, there is nothing to prohibit scheme Members from either collectively or individually seeking an alternative infrastructure provider to the LINK company. The contractual structure between scheme Members and LINK explicitly allows any Member to use an alternative processor (or CSB) to process, switch and settle their
transactions. In this case, while remaining within the LINK card scheme and subject to its rules, transactions between two Members using the same CSB would not pass the LINK company switch. Some Members already use a CSB (TNS) in this way.

C.121 There are also potential conflicts of interest if the payment scheme members are also the owners of the company. There may, for instance, be a reduced incentive for the scheme to seek alternative suppliers, as the current supplier is owned by the scheme members. If company representatives attend scheme meetings, they may have advantages over potential competitors, as they will be party to the scheme’s decisions. This concern was raised in a response to the OFT questionnaire.

C.122 The same points apply to the LINK card scheme and the company, and the Working Group considered to what extent these concerns could and should be addressed by splitting the two.

Potential solutions to the relationship between the LINK card scheme and the company

The current arrangements

C.123 Some respondents to the LINK questionnaire supported the current arrangements, explaining that there was a logical split between the LINK card scheme and company already. There were distinct governing bodies for each entity. Objectives for the LINK card scheme were set by the Members at the NMC, and the company played no part in this. Some banks and building societies were members of the NMC and also owners of the company: they were asked not to send the same representative to both. From 1 January 2006 banks and building societies who own the company no longer have additional votes on the NMC. Perhaps most importantly, the LINK company has no power over the rules of the LINK card scheme.
C.124 Despite the logical split between the two, there are still benefits to the closeness of the relationship. For instance, LINK card scheme executive staff are employed by the company to help the establishment of other schemes, potentially leading to wider products or greater innovation. The purpose of having a schemes unit within the company negates the need for multiple separate scheme companies to be set up by Members of these schemes. There are also other efficiency arguments in favour of not widening the gap between the LINK card scheme and the LINK company, including the flexible allocation of staff and other resources as necessary. Good communication links are also fostered. There are also considerable costs associated with such a split, including legal costs, relocation costs, and staffing costs.

A full split between LINK card scheme and company

C.125 Some questionnaire respondents felt that there should be a clear split between the two, as a split would allow a conventional relationship between a purchaser and supplier of services. As stated above, if this increased the ability of the card scheme or its members to ask for competitive bids from companies to provide processing services to the scheme, this in turn may lead to innovative bids and efficiency gains as bidders seek to improve on each others' bids.

C.126 Others pointed out that it was Members of the LINK card scheme, not the scheme itself (essentially a set of rules), that purchased services from the company, and that this would remain the case. There was nothing in the contractual arrangements that prevented Members of the LINK card scheme from collectively looking for an alternative processing provider, and scheme Members were also permitted to use different CSBs, so that ATM transactions between members using the same CSB, despite being subject to the scheme rules, did not pass the LINK switch.

C.127 A full split between the LINK card scheme and company would also solve any potential conflicts of interest between the staff of the scheme/company. Presently the LINK card scheme executive answers in theory at least to the company Chief Executive. This leads to a potential
conflict if the interests of scheme and company differ. For example, the LINK card scheme may wish to look for services from the LINK company at a price which the company could not offer, leading to LINK card scheme Members wishing to consider other processors.

A further degree of separation

C.128 A compromise solution would be to introduce a further degree of separation between the LINK card scheme and the company. This would seek to ensure that communication and efficiency links between the two were kept strong, but that there would be changes made to resolve conflicts of interest, ensure that pressure on the company to provide ever-improving services to the card scheme was maximised, while also safeguarding the ability to develop innovative products in which only a minority of card scheme members might initially be interested.

C.129 A key step in further separating the two would be to introduce strict reporting lines for the LINK card scheme executive. The objectives of the LINK card scheme executive would be set by the NMC (or in the case of any other scheme which the executive supported, by the relevant governing body for that scheme), rather than the company. This would go some way to addressing the requirements of the CPSS Core Principles for Systemically Important Payment Systems (Core Principle X) which states that scheme and company governance arrangements should avoid conflicts of interest.

C.130 At present, the LINK company Chief Executive normally attends the NMC. Instead, the ability of the NMC to invite to its meetings any interested parties (including, perhaps, the LINK company Chief Executive, or potential competitors to the company) in order to brief them on developments, and also a right to exclude LINK company representatives, could be formalised.

C.131 Most importantly, a Service Level Agreement would be introduced between the LINK card scheme Members and the company, to ensure the contractual service commitments of the company to Members could
be more easily assessed and benchmarked against those provided by others. The Service Level Agreement would be agreed between each NMC Member and the company.

Conclusion on relationship between the LINK card scheme and the LINK company

C.132 The Working Group concluded that the best approach would be to increase the degree of separation between the scheme and the company. This is because it was felt that the benefits of the scheme and company being linked (good communication links and efficiency) would be lost if the two were legally split. At the same time, the further degree of separation would provide benefits in terms of separating the reporting line of the LINK card scheme executive from the company, and formalising the ability of the NMC to open its meetings to potential competitors to the LINK card scheme, without involving the expense of legal separation. Most importantly the Service Level Agreement between LINK card scheme Members and company would ensure Members enjoyed contractual protections with regard to service levels provided by the company, and could more easily benchmark services provided by the company against those provided by competitors.

C.133 This issue could be revisited by the Task Force if Working Group members considered that, despite the logical separation, there remained unresolved competition, innovation or efficiency issues.
D LIST OF BODIES CONSULTED

LINK Interchange Network Ltd

SIBS

Interac

Alterna Savings Bank

Recipients of the LINK Working Group questionnaire:

Abbey

AIB Group (UK) Plc

Airdrie Savings Bank

Alliance & Leicester Plc

American Express Europe Ltd

Bank Machine Ltd

Bank of Ireland

Barclays Bank Plc

Bradford & Bingley Building Society

Bristol & West Plc

Britannia Building Society
Calypso Europe Ltd
Cardpoint Plc
Cashbox ATM Systems Ltd
Chelsea Building Society
Citibank International Plc
Co-operative Bank Plc
Coventry Building Society
Creation Financial Services Ltd
Cumberland Building Society
Derbyshire Building Society
Diners Club UK Ltd
Dunfermline Building Society
EDS
E-Funds International Ltd
First Data
G E Capital Bank Ltd
Hanco ATM Systems Ltd
HBOS plc
HFC
HSBC
IBM
Infocash Ltd
Lloyds TSB
Moneybox Corporation Ltd
National Savings and Investments
National Australia Group
Nationwide Building Society
NCR
LINK Network Members Council Chairman (NMC)
Northern Rock plc
Norwich & Peterborough
Omnicash
Paypoint Service Ltd
RBS Group

Sainsburys

Scott Tod Developments

Securicor Cash Services Ltd

Tesco Personal Finance

Travelex UK Ltd

Triton UK

TRM Corporation

Wincor Nixdorf

Yorkshire Building Society
# GLOSSARY

The following glossary of terms is not intended to provide precise legal definitions but to assist in reading the report.

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
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<tbody>
<tr>
<td><strong>ACH</strong></td>
<td>Automated Clearing House. An electronic clearing system in which payment orders are exchanged among financial institutions, in the United Kingdom using telecommunications networks, via a data-processing centre. The processing centre may also support settlement processes.</td>
</tr>
<tr>
<td><strong>Acquirer</strong></td>
<td>A bank having a business relationship with merchants, retailers and other service providers to process their plastic card transactions.</td>
</tr>
<tr>
<td><strong>APACS</strong></td>
<td>APACS, UK Payments Association</td>
</tr>
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</table>
| **APCA** | Australian Payments Clearing Association  
www.apca.com.au |
| **ATM** | **(Automatic Teller Machine)**  
Also known as a cash machine or cash dispenser. A computerised self-service device permitting the holders of an appropriate card and personal identification number (PIN) to withdraw cash from their account and access other banking services. |
| **Avantra** | ATM management service provider, formerly known as ATMOS, which provides authorisation and ATM technology allowing members to outsource the running of their ATMs. |
| **BACS** | Bankers’ Automated Clearing Services. An automated clearing house (ACH), the system used for |
bulk clearing of electronic payments between bank accounts in the United Kingdom. It handles all direct debits and direct credits, as well as interbank standing orders and remote banking payments. BACS Ltd was the clearing company for BACS prior to being split into BPSL for the payment scheme and Voca Ltd for payment infrastructure.

| **BPSL** | BACS Payment Schemes Limited. A membership based industry body whose role is to own, develop, enhance and preserve the integrity of automated payment and payment-related services. It is the scheme company for the BACS payment system. BPSL sets the business rules that govern the operation of the direct debit and direct credit payment schemes. It also manages and has responsibility for the operation of these schemes. |
| **Combined Code on Corporate Governance (2001, revised 2005)** | The Combined Code on Corporate Governance sets out standards of good practice in relation to issues such as board composition and development, remuneration, accountability and audit and relations with shareholders |
| **CPA** | Canadian Payments Association. Responsible for establishing and operating systems for the clearing and settlement of payments in Canada. www.cdnpay.ca |
| **IADs** | A non-financial institution independent of a bank or building society which owns and installs ATMs. |
| **Interac** | Interac Association is a national organisation in Canada linking enterprises that have proprietary networks so that they may communicate with each other for the purpose of exchanging electronic |
| **LINK** | LINK Interchange Network Ltd is the transaction management company whose primary focus of attention is switching and settling shared transactions for LINK, the United Kingdom’s ATM network. |
| **MIF** | Multilateral Interchange Fee |
| **NMC** | Network Member Council (NMC) is the governing body of the LINK card scheme. Each Member of the LINK card scheme is represented on this body. |
| **OFT** | Office of Fair Trading |
| **Payment system** | An arrangement which allows the users of that system to transfer money. It facilitates funds transfer between the members of the system and consists of the network which links them, the switches for routing payment messages and the rules and procedures for the use of this infrastructure. |
| **Payment Systems Task Force** | The OFT announced the creation of the Task Force in March 2004. This followed an announcement by the Chancellor of the Exchequer that the OFT would play an enhanced role in payment systems for a period of four years. The Task Force aims to identify, consider and seek to resolve competition, efficiency and incentive issues relating to payment systems over four years, particularly looking at network effects of the existing payment mechanisms. Where appropriate, issues affecting consumers which derive from, or are associated with, features of payments systems are also considered. |
| **SEPA** | Single Euro Payment Area. The European Commission and European Central Bank have launched an intention to create a single payment area within the EU. |
| **SIBS** | The Interbanking network in Portugal [www.sibs.pt/](http://www.sibs.pt/) |
| **The LINK card scheme** | Determines the Operating Rules and procedures that define the terms on which card issuers and ATM operators may participate in the network, as well as the fees payable from issuers to acquirers for transactions where the cardholder does not pay the acquirer. |
| **The LINK processing company** | The LINK processing company (which is explicitly ‘for profit’) provides the technical, commercial and financial infrastructure that supports the LINK card scheme. |
| **The Standing Committee** | A Committee to be established by the LINK card scheme Network Members Council (NMC) to represent the interests of consumers and advise the NMC on consumer issues that relate to the LINK ATM network and LINK card scheme rules. |
| **Voca** | Voca Limited (known as BACS Limited prior to 12 October 2004). A company which provides processing and related services in the United Kingdom for direct debit, direct credit and standing order transactions, originated either by Settlement Members of BPSL or by others sponsored by them to use the service. |
F  LINK CARD SCHEME STRUCTURE

Chart F.2 Link card scheme structure
G ATM MARKET FROM 1995-2004

Chart G.3 – G.5 ATM market information 1995 – 2004
TERMS OF REFERENCE FOR STANDING COMMITTEE ON CONSUMER ISSUES

13 December 2005

1. PURPOSE:

The Standing Committee on Consumer Issues (‘the Committee’) has been established by the LINK Card Scheme Network Members Council (NMC) to represent the interests of consumers and advise the NMC on consumer issues that relate to the LINK ATM network and LINK Card Scheme rules.

The Standing Committee is independent of the NMC, although a number of NMC Members will be represented on the Committee. The NMC has accepted an obligation to respond formally to any recommendations or questions put to it by the Committee.

2. COMPOSITION:

The Committee will be chaired by the Independent Non-Executive Chairman of the NMC and will consist of:

- Four or more independent members, who will represent the views of consumers. These members will be invited to join the Committee by the Independent Non-Executive Chairman of the NMC, following advice and input from the Card Scheme Executive.

- Four representatives of NMC Members elected by the NMC providing that at least two shall be from NMC Members that issue cards used in the LINK ATM network, and at least two shall be from acquirer-only NMC Members. In the event that there are more than two nominations either for the two positions of issuer-representative or for the two positions of acquirer-representative, each Member (whether issuer or acquirer) will be asked to identify their first and second choice candidates from the relevant list of nominations. Each Member’s full weighted vote will be counted towards each of their first and second choices. Neither the vote for their first choice
nor the vote for their second choice candidate may be split between candidates. Votes will be cast by secret ballot. Those candidates with the highest and second highest total of votes shall be elected as the Member representatives. The Chairman will announce the successful candidates.

Representatives of NMC Members will not form a majority of the Committee. In addition to the views of their own institution, the issuer and acquirer representatives undertake to represent the views of those other issuer and acquirer representatives that are not directly represented.

The LINK Card Scheme Executive will attend meetings of the Standing Committee, and provide secretariat support to the Committee, but will have no voting rights.

Members of the Committee shall be appointed for a three-year term, subject to the Chairman’s confirmation of each appointment after the first year.

Only NMC members who attend at least one half of the NMC meetings in the calendar year during which they are on the Standing Committee will be able to retain their seat.

The Committee will meet not less than twice a year. The LINK Card Scheme Executive will provide administrative support for up to six meetings per year.

The Card Scheme Executive will approve any expenditure by and on behalf of the Committee in accordance with established spending limits.

3. TERMS OF REFERENCE:

The main purpose of the Committee is to provide advice to the NMC. Standing Committee members do not have executive responsibility for the running of the Card Scheme.

The Committee will not be responsible for individual consumer complaints, which should continue to be addressed to relevant card issuer or acquirer-Members of the NMC. The Committee may, however,
choose to raise with the NMC concerns evident from consumer complaints.

The Committee will consider from a consumer perspective issues in the LINK Card Scheme that relate to consumers. This will include, but will not be restricted to, signage rules relating to cash machine charges. Whilst the Committee can discuss and comment on any issue related to consumers’ use of ATMs, there are some issues, such as the level of charges that Members apply to customers and the siting of ATMs, whether free or charging, that Competition Law prevents the NMC from discussing. The Committee’s views on these matters will be passed on to the Members of the NMC for their individual consideration and will not be discussed by the NMC.

The emphasis of the Committee’s work is on activities that are under the control of the NMC, although it may also look at the impact on consumers of activities outside of the NMC’s control but related to ATMs.

The Committee will have regard to the interests of all groups of consumers including those who may be considered disadvantaged in relation to access to financial services.

The Committee will:

(i) represent the interests of consumers by advising, commenting and making recommendations on existing and developing LINK Card Scheme policy and practices that affect cardholders;

(ii) speak on behalf of consumers by reviewing, monitoring and reporting to the NMC on the effectiveness of the LINK Card Scheme’s policies and practices;

(iii) assess the effectiveness with which the NMC has delivered its objectives with respect to cardholders, namely:

- to listen to and take account of the interests of cardholders;
- to provide universal acceptance of cards in ATMs in the United Kingdom (and potentially Europe);
• to provide transparency on direct charging at ATMs;

• to ensure clarity of branding so that Customers know who is responsible for each ATM that they use and;

• to ensure that Customers have secure, reliable, access to their cash at ATMs;

The Committee will report their conclusions and any recommendations to the NMC and the NMC will respond to any questions or recommendations made by the Committee.

4. CONFIDENTIALITY AND PUBLIC ACCOUNTABILITY

Discussions within the Committee will be confidential, and all Members agree to respect the confidentiality of discussions. A breach of confidentiality may result in loss of Membership should the Chairman or a majority of other Members consider this appropriate.

The Committee will publish an annual report summarising its findings, providing that a majority of Committee members approve the report. Minority members will be allowed to express their views in an appendix to the report if they are not in agreement with the majority report. The Card Scheme Executive will assist in the preparation of the report, which will be given space on the LINK website.

The Committee may at any other time choose by majority agreement to make a public announcement, with minority Members allowed to append their own views to that announcement. Such announcements will also be given space on the LINK website.

5. REVIEW OF TERMS OF REFERENCE

These Terms of Reference will be reviewed at the first meeting of the Standing Committee and again after a full year of operation, with any changes agreed by both the Standing Committee and NMC.
I INTERNATIONAL COMPARISON TABLE

The table is divided into four sections:

- background
- access and governance
- services supported by the network
- wider stakeholder participation

Key

United Kingdom (LINK)
LINK is the United Kingdom’s national cash machine (ATM) interchange network. The LINK company provides the physical switch for these transactions while the LINK card scheme sets the rules, practices and procedures. The LINK card scheme is open to every ATM operator and card issuer in the United Kingdom. The LINK card scheme ensures universal, reliable and secure access to cash and maintains and enforces fair rules for technical standards, interchange, charging and signage. There are currently 49 members of LINK.

Portugal (SIBS)
SIBS is a collaboration of the Portuguese banks. SIBS’ services include a debit card scheme and an ATM and a point of sale network, all under the brand Multibanco. Furthermore, SIBS acts also as the ACH for the Portuguese financial system, clearing all the transactions arising from card payments, debit and credit transfers, cheques, drafts and RTGS. Although all of the banks operating ATMs in Portugal are connected to SIBS, some (few) banks have small proprietary ATM networks. Most of the Portuguese point of sale terminals are connected to SIBS, but a new POS network – owned by a local bank, member of SIBS – has started to operate. Furthermore, a few POS terminals, not connected to SIBS, also operate in merchants that have cross border acquiring contracts with foreign banks. SIBS is considered to be one of the most innovative ATM schemes in the world, and offers a wide variety of services from its ATMs. There are currently 28 shareholder members of SIBS and 2 non-shareholder members.

Canada (Interac)
Interac Association is a national organisation linking enterprises that have proprietary ATM networks. Interac itself is decentralized, with direct members joined by bilateral links, rather than through a central infrastructure. The bilateral links constitute an Inter-Member Network that is a totally redundant, closed and private network connecting the Direct Connectors to one another. Interac Association is responsible for managing the network and ensuring its availability, reliability and security 24 hours a day. As of January 2006 there are 88 Members. Interac Association is the organisation responsible for the development of a national network of two shared electronic financial services:

- Shared Cash Dispensing (SCD): cash withdrawals from any ATM not belonging to a cardholder’s financial institution
- Interac Direct Payment (IDP): Canada’s national debit card service
<table>
<thead>
<tr>
<th>Key Feature</th>
<th>United Kingdom (Link)</th>
<th>Portugal (SIBS)</th>
<th>Canada (Interac)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>BACKGROUND</strong></td>
<td><strong>Number of scheme members</strong> 49</td>
<td>28 shareholder members and recently 2 non-shareholder members.</td>
<td>88</td>
</tr>
<tr>
<td><strong>Scheme members</strong></td>
<td>35 financial institutions which deploy ATM cards (and also ATMs) and 14 non-financial institutions that deploy ATMs, but do not issue cards.</td>
<td>All members of SIBS are financial institutions.</td>
<td>Direct Connectors: 15 who have bilateral links with other direct connectors to form the Inter-Member Network.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Includes 6 non-financial institutions</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Indirect Connectors: 73 who access the system through a direct connector</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Includes 9 non-financial institutions</td>
</tr>
<tr>
<td><strong>Number of ATMs connected to scheme</strong></td>
<td>57,900</td>
<td>10,550</td>
<td>47,000</td>
</tr>
<tr>
<td><strong>Infrastructure</strong></td>
<td>Central switch, operated by LINK Interchange Network Ltd (the LINK company)</td>
<td>Central switch operated by SIBS as well as most processing carried out by the individual banks in other countries. SIBS believes that it is the efficiency generated by this business model which gives rise to the significant innovations introduced through SIBS.</td>
<td>Decentralised (based on a totally redundant, closed and private network connecting the Direct Connectors to one another).</td>
</tr>
<tr>
<td>Key feature</td>
<td>United Kingdom (LINK)</td>
<td>Portugal (SIBS)</td>
<td>Canada (Interac)</td>
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<tr>
<td><strong>ACCESS AND GOVERNANCE</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scheme governing body</td>
<td>Network Member Council (NMC) made up of one representative from each Member</td>
<td>Managed by a Board of 9 Directors (5 representing the 5 largest banks and 1 representing a small savings bank). An Executive Committee made up of three Executives runs the day-to-day operations. There is also an annual meeting of all shareholders.</td>
<td>14-member Board. Two seats are reserved for non-financial institution Direct Connectors, and three for Indirect Connectors. A maximum of 9 Direct Connector Financial Institutions can sit on the Board.</td>
</tr>
<tr>
<td>Description of scheme voting</td>
<td>25 per cent of votes are apportioned equally among members. The remaining 75 per cent is apportioned according to transaction volumes (with a 15 per cent cap for any Member)</td>
<td>New banks that want to become shareholders can buy a minimum number of shares. At least three banks' support is necessary to support a motion as there has been a cap of 22 per cent put on voting rights, which reflect the original allocation of shares to each bank (at inception or at later adherence) and the cumulative result of consolidation in the banking sector, through time. However SIBS stresses the cooperative nature of the scheme and search for consensual approaches</td>
<td>One-member, one-vote.</td>
</tr>
<tr>
<td>Votes required to pass a motion</td>
<td>50 per cent for most matters. 60 per cent for rule changes, and 80 per cent to agree the interchange fee</td>
<td>50+ per cent for most matters. (See above)</td>
<td>Majority for most issues, two-thirds majority for fundamental changes including changes to the Memorandum of Association and the Security Regulations.</td>
</tr>
<tr>
<td>Key feature</td>
<td>United Kingdom (LINK)</td>
<td>Portugal (SIBS)</td>
<td>Canada (Interac)</td>
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<tr>
<td>Access to the scheme</td>
<td>Members must either deploy LINK-enabled cards or operate ATMs attached to the LINK network. Other criteria, such as financial robustness apply.</td>
<td>The scheme has recently allowed access to non-shareholder members which pay an access rental fee.</td>
<td>Members must carry out at least one of these functions: card issuer (financial institutions only); acquirer (ATM or POS terminals); connection service provider (providing links for indirect connectors); settlement agent.</td>
</tr>
<tr>
<td>Key feature</td>
<td>United Kingdom (LINK)</td>
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<tr>
<td>SERVICES SUPPORTED BY THE NETWORK (INCLUDING SERVICES GOVERNED BY SCHEME RULES AND INFRASTRUCTURE)</td>
<td>Cash withdrawals, balance enquiries, mobile phone top ups, mobile phone based services such as balance enquiries, gateway services to Visa and MasterCard networks, bank and building society branch sharing services, and transaction processing service to support a free cash withdrawal service over the Post Office Ltd’s counters</td>
<td>Cash withdrawals, balance enquiries, transaction enquiries, request for chequebook, change PIN request, gateway services to Visa and MasterCard networks, subscription services, concert and theatre ticket sales, tax payments, paying utility bills, direct credit payment initiation, road toll and parking toll payment, conditional direct debit authorisations, payment of lottery prizes, cable TV channel subscription, travel pass sales</td>
<td>From ATMs cash withdrawals only, although a point-of-sale network is also operated, as is an online payment service and an e-mail money transfer scheme</td>
</tr>
<tr>
<td>Key feature</td>
<td>United Kingdom (LINK)</td>
<td>Portugal (SIBS)</td>
<td>Canada (Interac)</td>
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<tr>
<td><strong>WIDER STAKEHOLDER PARTICIPATION</strong></td>
<td>Standing Committee on Consumer Issues. Represents the interests of consumers and advises the NMC on consumer issues. Made up of NMC Members and consumer representatives. Also, regular consultations with consumer groups.</td>
<td>There is no explicit involvement in SIBS governing structure by organisations representing consumer, business or government issues.</td>
<td>Members voluntarily abides by the Federal Provincial Government code of practice for Debit Card services, which includes consumer protection policies. Also, informal consultations with consumer and other user groups.</td>
</tr>
</tbody>
</table>