ATM Testimony to the Committees on Finance and Consumer Affairs, New York City Council

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Testimony submitted by Stacy Mitchell to the Committees on Finance and Consumer Affairs, New York City Council, for the December 6, 2000 hearing on Int. No. 680, a measure to prohibit surcharge fees on automated teller machine transactions:

Thank you for the opportunity to comment on the proposed ordinance to prohibit surcharges on automated teller machine (ATM) transactions within the city of New York. My name is Stacy Mitchell. I am a Research Associate for the Institute for Local Self-Reliance, a national nonprofit public policy research organization based in Minneapolis and Washington, DC.

I strongly support local and state legislation to ban ATM surcharges. These fees are not only an unnecessary and excessive burden on consumers, but they are anti-competitive and undermine the ability of small banks and credit unions to compete.

Under normal, healthy free market competition, a company's interest in raising prices or imposing new fees is tempered by the fact that, if the price is too high, consumers will take their business elsewhere. This basic market principle does not operate in the case of surcharges. For large banks that own a dominant share of the ATMs in a local market, there is no downside to imposing a surcharge. Because their own customers are not required to pay these fees, there is no risk of losing depositors.

Rather than being penalized by the market for imposing a surcharge (or raising the rate of the surcharge), large banks are actually rewarded. Raising prices becomes a win-win situation for these dominant companies: either they generate additional fee income or, better yet, they induce customers of smaller financial institutions, which own few ATMs, to move their account to one of the dominant banks in order to avoid the fees. The higher the surcharge, the greater the incentive for consumers to switch to a large bank. This amounts to an inverted form of price competition, under which large banks are actually gaining new customers by raising their prices. Surcharges undermine free market competition and pose a substantial threat to small banks and credit unions. They enable big banks to gain market share, not because they are more efficient or provide better service, but simply because they can use their size and market power to disadvantage their competitors.

As a result, the market for banking services is becoming increasingly less competitive and more expensive. Several studies by the Federal Reserve and consumer groups have found that large banks charge higher account fees and offer lower interest rates on deposits compared to small banks. According to the Federal Reserve's latest annual survey, the average minimum balance required to maintain a no-interest, no-fee checking account at a large bank was $664 in 1999, compared to an average of $440 at small banks. The average monthly fee for failing to maintain the minimum balance was 46 percent higher at large banks than at small banks. Likewise, stop-payment, bounced check, and overdraft fees were more than 40 percent higher at large

banks.(1) Yet, large banks continue to gain market share, in part because they control the ATM infrastructure and are using it to unfairly disadvantage their smaller, lower cost rivals.
No one disputes the fact that banks that deploy ATMs have every right to recover their costs and earn a profit on their investment. ATM owners, however, are already compensated through another fee, known as the interchange fee. This fee is paid by a customer's bank whenever he or she uses an ATM owned or operated by another financial institution. Interchange fees for withdrawals are typically around 50-60 cents. This covers the ATM owner's costs (which average 27 cents per transaction according to the Office of Thrift Supervision) and provides a profit. Surcharges are a second, and unnecessary, fee for the same transaction.

Without fair and equitable access to the infrastructure of electronic banking, small financial institutions will have an increasingly difficult time surviving. In order to maintain a competitive market for banking services, the ATM infrastructure ought to be governed by the same rules that currently apply to other types of common carriers. In industries such as electric power or long distance telephone service, where one competitor often owns the transmission infrastructure that other companies must access in order to compete, lawmakers have mandated fair access. The company that owns the infrastructure must charge its competitors' customers the same rate for access as it charges its own customers. AT&T, for example, may not charge MCI's customers excessive fees for making calls transmitted on AT&T's telephone wires. Such a scenario would distort competition and MCI would undoubtedly lose market share. Eliminating ATM surcharges would apply the same principle of fair competition and fair access to the banking industry.

Prohibiting ATM surcharges is well within the authority of local and state officials. The United States has long maintained a dual federal-state regulatory system governing the banking industry. Congress extended this dual system to electronic banking in 1978, when it enacted the Electronic Funds Transfer Act (EFTA). According to its statement of Congressional purpose, the EFTA was designed to provide a "basic framework" for regulating electronic transfers of funds, including ATM transactions. Congress intended this basic framework to be augmented by state law, particularly in the area of consumer protection. The EFTA expressly authorizes states, and by extension cities, to enact laws that provide greater consumer protection than afforded by federal statute.

Local and state surcharge bans have recently been the subject of lawsuits by several large banks and their trade associations. Although preliminary injunctions against the bans have been handed down in two cases, it is unlikely, as many legal scholars and state attorneys general agree, that the banks will ultimately prevail in court, given the clear Congressional intent evident in the EFTA.

The lawsuits have had the intended consequence of chilling efforts in other cities and states to ban surcharges. This is all the more reason, I believe, for the New York City Council to act now, not only to protect consumers and competition, but to preserve the democratic process and the authority of local and state officials to act on behalf of their constituents.

Finally, I'd like to briefly address two of the arguments frequently made against legislation to ban ATM surcharges. First, surcharge supporters often contend that consumers have other options, such as visiting their bank office during business hours. This is akin to suggesting that writing a letter will substitute for making a telephone call. Certainly the post once was our only option, but no consumer today would consider this a legitimate alternative to the telephone. Moreover, banks have encouraged consumers to rely on ATMs. These machines cost far less than operating branch offices and employing human tellers. And, indeed, as banks have expanded their ATM networks, most have also reduced their investment in opening and maintaining branch offices. Many consumers, especially those with long working hours, parental responsibilities, or limited transportation options, have difficulty visiting a bank branch during business hours. Low-income consumers, on whom the burden of surcharges most heavily falls, are least likely to have a bank branch operating in their neighborhood.

Second, there is no evidence to support the notion that eliminating surcharges would lead to a substantial decline in the number of ATMs. Iowa, a state that has never allowed surcharging, has the same number of ATMs per capita as the national average.(2) Nationally, more than 125,000 ATMs were deployed prior to the advent of surcharging in 1996. Even in the absence of surcharges, banks are eager to install ATMs, because they generate income through interchange fees and reduce the need for more expensive human tellers.(3)

I appreciate the opportunity to testify on this important issue. ATM surcharges are not only a major concern to consumers, but they also distort the market for financial services and undermine the ability of smaller banks and credit unions to compete. Unless policymakers take steps now to eliminate these fees, we are likely to experience even greater concentration in the banking industry, as well as rising costs for basic banking services.

Thank you.

(1) Board of Governors of the Federal Reserve System, "Annual Report to the Congress on Retail Fees and Services of Depository Institutions," July 2000.

(2) "Will Banning Surcharges Mean Fewer ATMs, Less Convenience?" ATM Surcharge Bulletin, July 1999.

(3) According to the Office of Thrift Supervision, the average human teller transaction costs $2.93.