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Centre for Competition, Regulation
and Economic Development

Review of the Competition Commission Banking Enquiry

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Abbreviations and Acronyms

AEDO	Authenticated early debit orders
ATM	Automated teller machine
BASA	Banking Association of South Africa
CCSA	Competition Commission of South Africa
EDO	Early debit order
EFT	Electronic funds transfer
FICA	Financial Intelligence Centre Act
FSR	Financial Sector Regulation bill
NAEDO	Non-authenticated early debit orders
NPSD	National payment system department, SARB
NT	National Treasury
PASA	Payments Association of South Africa
POS	Point of sale (usually found at a retail outlet)
SAMOS	South African Multiple Option Settlement
SARB	South African Reserve Bank

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1. Executive Summary

The regulatory entities capacity building project, run by the Centre for Competition, Regulation and Economic Development (CCRED) at the University of Johannesburg has commissioned a series of four case studies to explore the impact of regulatory decisions related to a specific market, product or service or examine particular issues and/ or regulators in the sector. This paper, a review of the Competition Commission Banking Enquiry (the Banking Enquiry), forms part of this case study series. The Banking Enquiry was the Competition Commission's first market enquiry and was intended to deal with complaints about high bank charges and competition in the national payments system, among other issues. A significant amount of time has passed since the enquiry was concluded which allows for reflection on the impact of the enquiry. For example, the market appears to be more competitive with the successful entry of Capitec but what impact has this had on pricing for transactional banking accounts? The timing for this review is particularly appropriate as the Competition Commission embarks on another market enquiry into the healthcare sector.

The Banking Enquiry, though established by the Competition Commission, was conducted by an independent panel (the Panel).The subject matter of the enquiry was firstly the level and structure of bank charges and secondly the feasibility of improving access to the national payment system (NPS) for non-banks to allow them to compete more effectively in payment services. In addition, they were empowered to investigate other aspects related to the payment system and bank charges that could be regarded as anti-competitive.

The banking enquiry culminated in a set of concrete proposals and recommendations aimed at improving the competitiveness of the banking sector. Some of these were implemented by the banks themselves or through their industry association, the Banking Association of South Africa (BASA), while others were implemented by the National Treasury (NT), the South African Reserve Bank (SARB) or the Payments Association of South Africa (PASA).

The key questions that this paper will address are:

- Have the banking enquiry panel recommendations had a positive impact on consumers and the financial system, and were the recommendations capable of being implemented?
- Which of the banking enquiry panel recommendations were implemented, and why?
- How have bank charges evolved overall since the enquiry panel recommendations were published?
- Did the enquiry panel's recommendations result in lower barriers to entry and the introduction of new payments tools and mechanisms, such as Paypal and cell-phone payments, in South Africa?
- What institutional and regulatory changes have been effected, such as regarding inter-change determination?
- Was the enquiry process the optimal approach for reform and what are the reasons for the lack of progress, where applicable?
- What are the possible next steps?

A review of the literature on financial services regulation following the Banking Enquiry shows that the Enquiry has been an impetus for various changes, particularly in those areas in which the banks were key respondents. However, there are several aspects of the recommendations that have been interpreted differently and which have not been implemented due to competing concerns from other regulators.

Key areas in which the Enquiry has caused changes in the industry and its regulation include the following:

- Changes to the Code of Banking Practice to incorporate a variety of pro-consumer commitments.
- Improved transparency around ATM charges. This has the potential to improve further with the pilot of the interchange determination project which is focused on the ATM stream, though the mechanism is different to that envisaged by the Panel.
- Changes to the NPS Act, PASA documents and other SARB papers to allow for designation of non-banks and allow non-banks to be members of PASA.
- Increased regulatory oversight and interaction with non-bank participants in the National Payment System.
- An interchange determination project has been embarked on, although it is in a slightly different form from that suggested by the Panel.

Recommendations of the Enquiry that have not been implemented or have been implemented differently to the approach suggested by the Panel after being deliberated by the NT, SARB and the Competition Commission include the following:

- Recommendations that seek to improve comparability across bank products such as the centralised fee calculator and the establishment of generic profiles have not been implemented by any regulatory body. Fee calculators are nonetheless available from private sector websites.
- The change from interchange pricing on ATMs to a direct charging model (DCM) was not implemented. Instead, NT undertook to monitor the international implementation of the DCM.
- Non-bank participants will not be given access to the settlement system. This is to ensure system stability in the payments system.
- Non-bank participants will be allowed to clear only when sponsored by a settlement bank.
- The governance of the PASA Council has not been made more independent through the inclusion of qualified non-bank participants. Nonetheless, an independent chairperson is currently being appointed to the PASA council.

Since the banking enquiry smaller new entrant banks have increased their market shares but their share of total deposits remains relatively small. As a result of the expansion of new entrants, access to financial services has grown considerably. The financial sector charter of 2004 also played an important role in the expansion of access to financial services. While prices for mass market banking accounts have declined, prices for other transaction banking services did not decline significantly.

Going forward it is possible that the anticipated introduction of a twin peaks model of regulation with a prudential regulator and a market conduct regulator could improve the regulation of the sector and further the objectives and recommendations of the Enquiry by enhancing oversight over competitiveness, transparency and the consumer experience.

There is considerable scope for reforms that will facilitate more competition and better outcomes for consumers, including greater access to the payments system in a risk-based prudential regulatory framework and better governance of PASA, as well as changes to approaches on interchange.

The first recommendation for reform is that the SARB's (or its successor body, the Prudential Authority's) regulatory **mandate** should be explicitly expanded to allow for the consideration of **competition issues**. While the Competition Commission will continue to oversee conduct on an *ex-post* basis the SARB (or, in future, the Prudential Authority) will continue to set rules for the sector on an *ex-ante* basis, including on access to the payments system and oversight of rulemaking for the payments system, both of which have a competition dimension. The Financial Sector Regulation bill mandates the Market Conduct Regulator to take into account 'contestability' and allows the Competition Commission to participate in the Council of Financial Regulators. However, this does not go far enough in ensuring an explicit trade-off between competition and prudential regulation, at least for the proposed Prudential Authority.

Second, **switching bank accounts** in South Africa could be made easier and could be more tightly regulated. For example, there are no regulated timeframes within which an account transfer must be completed, as there are in regulations governing number portability in the telecommunications sector, for example. The ISO 20022 messaging standard that the banks in South Africa are in the process of implementing allows for automated debit order and incoming (salary) payment switching. This will require further system development by the banks. A process that allows for account switching within seven days without significant effort from consumers has recently been implemented by the Payment's Council in the United Kingdom. The SARB and PASA could consider the merits of this system for South Africa. Furthermore, consumers should be indemnified from interest, penalty fees and other charges incurred as a result of delays in switching bank accounts. The National Treasury appears to be considering measures for improving the efficiency of the 'Know Your Customer' (KYC) process under FICA, which in addition to expanding access to the financial system should ease account switching and ideally facilitate competition. In relation to account switching, the proposed Market Conduct Regulator should consider developing tools for consumers to be able to understand bank accounts, compare prices and choose a suitable banking product to the extent that this is not already available through private sector online comparison websites. This will improve price and product transparency, which will foster greater competition.

Thirdly, the **interchange setting process** as it is implemented currently is opaque, contrary to the transparency recommended by the banking enquiry panel. While the banks' detailed costs and transaction information need not be released publicly, the principles and methodology for arriving at interchange rates should be publically available. Currently, the principles and methodology are effectively not open to scrutiny and public debate is therefore limited. For example, it is difficult for the authors of this report to comment on the effectiveness or suitability of the SARB's interchange setting methodology because the latter is confidential. If PASA were more independent from the banks (discussed below), they might also have a role to play in reviewing the interchange setting process in future, given their access to data and resources to undertake the analysis required. While PASA's role can be enhanced in this process, a separate authority, whether it be the Market Conduct Regulator or the Prudential Authority (depending on how their roles are defined in the payments system) would need to oversee the process and make the final decision. This is in line with the current process in which the SARB makes the final decision on interchange rates. Whether PASA plays a greater role or not, greater transparency on the principles and methodology used is needed in order to ensure that the interchange determination process is as effective as possible.

Fourth, **a risk based prudential regulatory framework for current non-banks**, and for mobile providers and retailers particularly, should be considered in order to balance competition and prudential regulatory concerns. This framework should enable non-banks to become limited activity banks. This is not simply a matter of providing greater access to the payments system for non-banks but involves creating a risk based prudential regulatory framework that would support South Africa's highly stable financial system while at the same time ensuring that new entry and innovation is fostered within the system. The Dedicated Banks Bill, which is currently under development within the National Treasury (though it has been under development for some time), might provide a useful framework for this. In the interim, it would be useful for the SARB and PASA to widen PASA membership, with increasingly progressive levels of regulation and oversight the more significant in terms of volume, value and risk that the payments provider or system operator is in the clearing and settlement system. This second tier banking framework could be explored with the private sector to determine their appetite for a simplified banking license that is linked to limited financial activities and has proportionate compliance requirements.

Fifth, **PASA should be made more independent of the banks**. The PASA Constitution currently provides for banks to appoint all of the members of the PASA Council. PASA is currently in the process of making itself more independent, and is planning to appoint an independent non-executive chairman as a result of a King III corporate governance review and benchmarking study, which is a welcome reform. Nonetheless, PASA could be made more independent of the banks. For example, the UK Payments Council Board has 15 voting directors and a voting independent chairman as well as an observer from the central bank (the Bank of England). Four of the voting members are independent, and any two independent voting members have veto powers. While the PASA council does include an independent observer from the SARB and is in the process of appointing an independent Chairman, South Africa could consider the UK arrangement, with an even greater role for independent members of the PASA Council. Finally, PASA's decisions and debates could be made more transparent. For example, the UK's Payments Council Board meeting agendas and minutes are publicly available on their website.

Sixth, **future enquiry processes could be more inclusive of sector specific policymakers and regulators to ensure buy-in and ease of implementation of recommendations**. Key to the success of the banking enquiry process was the implementation of the recommendations, which was outside the ambit of competition law investigations. However, there were significant delays in implementing the recommendations. For example, the first changes to interchange rates are only happening in 2014, more than five years after the conclusion of the banking enquiry process. While the Competition Act has been amended to allow for the Minister of Economic Development to consult with other Ministers when engaging in an enquiry process, more could be done to ensure greater co-operation with sector specific policymakers and regulators. This includes requiring that such entities participate in hearings and respond formally to recommendations. The latter is a requirement, for example, in the UK.

Information gathering ought to be better planned. The information that was obtained was not provided in a consistent, comparable format, which created difficulties for the assessment of the costs of individual services. Furthermore, care should be taken with confidential information in order to avoid the release of sensitive data.

Finally, co-operation among banks is required in order for an inter-operable payments system to function. This applies to many parts of South Africa's financial infrastructure and is the case in many countries. This is an important area for the **Competition Commission to set out guidelines or a practice note**, so as to ensure that co-operation that leads to progress is allowed for, while ensuring that the co-operation involved does not harm consumers.

2. Introduction

The regulatory entities capacity building project, run by the Centre for Competition, Regulation and Economic Development (CCRED) at the University of Johannesburg has commissioned a series of four case studies to explore the impact of regulatory decisions related to a specific market, product or service or examine particular issues and / or regulators in the sector. This paper, a review of the Competition Commission Banking Enquiry (the Banking Enquiry), forms part of this case study series. The Banking Enquiry was the Competition Commission's first market enquiry and was intended to deal with complaints about high bank charges and competition in the national payments system, among other issues. A significant amount of time has passed since the enquiry was concluded which allows for reflection on the impact of the enquiry. For example, the market appears to be more competitive with the successful entry of Capitec but what impact has this had on pricing for transactional banking accounts? The timing for this review is particularly appropriate as the Competition Commission embarks on another market enquiry into the healthcare sector.

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- What are the possible next steps?

The enquiry panel recommendations are assessed in three parts:

- Recommendations relating to consumer protection (including penalty fees);
- Recommendations on interchange (including ATM, EFT and payment card interchange); and
- Recommendations on access to the national payments system.

Conclusions and recommendations for next steps are provided after this. The Panel's recommendations relating to consumer protection are discussed next.

3. Consumer protection recommendations (relating to penalty fees, transparency and related matters)

One of the key concerns focused on during the banking enquiry was the experience of consumers who access banking services for personal transaction accounts. During the course of the enquiry the panel found that various factors combined to create market power for banks in the market for personal transaction accounts (PTAs) and that this was likely to remain in the face of high fixed costs and scale economies. The factors that enhanced market power included the complexity in the provision of products and the fee structure, a lack of transparency on charges and fee structures, the fact that consumers failed to question fees and charges on PTAs, the difficulties and costs of switching and general oligopolistic conditions. However, the Panel felt strongly that there were various changes that could be made to enhance competitive conditions in the market for PTAs. This subsection focuses on those changes that could be made primarily by the banks and banking association to improve competitiveness in this market.

3.1. Panel recommendations

3.1.1. Comparisons and switching

The Panel raised concerns regarding the complexity and lack of price transparency of banking products, which resulted in ineffective competition in the banking sector. Accordingly, the first set of recommendations focused on enhancing consumers' ability to compare product offerings and prices, and to switch between banks if there was a more competitive offering.

The enquiry recommendations therefore called for a minimum set of standards required for the disclosure of product and price information. These were aimed at improving the ease of comparison for consumers and included five practical provisions that the Panel felt should be included in the Code of Banking Practice. These provisions included the standardisation of terminology, a requirement to communicate in "plain language", the provision of minimum information on bank statements and information on charges on every account, advanced notice of new and altered charges and a regular rights reminder.

The Panel also recommended the establishment of processes to facilitate comparisons between products and prices. These included generic customer profiles published by the Banking Association that could be used by customers as a basis for comparison of products and prices across banks, the establishment of a centralised banking fee calculator, and the lifting of comparative advertising restrictions.

In order to facilitate the account switching process, the Panel also suggested that Codes of Switching Practice be developed and added to the Code of Banking Practice (CoBP). This would include criteria on the provision of information and documentation, a schedule in terms of which banks were to provide each other with documentation and in terms of which transfers were to take place, and provisions to exempt customers from paying fees incurred as a result of failures in the switching process. A second suggestion related to switching was the establishment of a central FICA hub to allow for easier switching.

In tandem the panel suggested the expansion of the mandate of the Ombudsman for banking services to include monitoring and enforcement of compliance with the abovementioned codes.

3.1.2. Costing and pricing

The Panel felt that there were insufficient initiatives to lower fees aimed at lower income customers. They therefore suggested that the Banking Association encouraged better fee options to entry level accounts.

3.1.3. Penalty fees

Penalty fees for rejected debit orders were found to be high and to bear little relation to costs. The Panel felt that this was especially marked for more basic accounts (typically those used by lower income customers). This was of concern to the Panel, particularly as penalty fees could create a spiral of rejected debit orders for those who did not have large funds. The report suggests capping the penalty at R5 through regulation (through the powers of the SARB or other legislation). In addition, the Panel recommended that systems be put in place to allow customers to more easily cancel debit orders by telephone, through the internet and at bank branches.

3.2. Interpretation of recommendation and agreed approach

In discussions between the Treasury and the banking industry the banks agreed to a large part of the recommendations relating to transparency and facilitating switching. In a press release published by the National Treasury following discussions they committed to the following (NT, 2010):

i. “Creating standards for disclosure, effective communication, easier-to-read bank statements with summary breakdowns of monthly fees, and using standardised terminology, which will be incorporated into the CoBP.

ii. The development of a set of criteria for a switching code “to facilitate a quick, seamless and efficient transfer of accounts between banks, when requested by the customer”. This code will form part of the CoBP.

iii. Participate in discussions to create a cost effective way to FICA clients as this forms one of the major barriers to easy switching.

iv. Banks may also individually undertake to:
   a. Provide banded and bundled options for low income customers.
   b. Disclose prices, benefits and costs of their products to allow customers to exercise informed choices.
   c. Provide a fee calculator, or other support, in branches and via other channels to reduce search costs.”

The banks also committed to reducing debit order abuses. Measures agreed upon included improving the financial literacy of customers and denying access to providers who abuse the system. Further measures included the specific, practical commitment to creating a system in which there are unique contract and debit order numbers in order to facilitate cancellation (NT, 2012).

However, what is notably absent from these points is an implementation plan for the recommendations related to increasing product information and comparability. Neither the establishment of generic profiles nor the centralised fee calculator has been taken forward. Furthermore, “disclosing prices, benefits and costs of their products to allow customers to exercise informed choice” is at the discretion of each bank and is not enshrined in any code, other than at a very basic level in terms of disclosure of fees. Treasury focused on what it termed the “spirit of the recommendations” noting that some could be implemented differently” and that the banking sector is “innovative enough” to do this. In particular the NT provides the example of the centralised calculator, which they believe may be better implemented by independent consumer groups and the media. They therefore only require each bank to have an individual calculator for its own fees that is accessible to more than 90% of customers (NT, 2010). In addition, the Treasury took an opposing view to the panel with regards to generic profiles stating that “it could be viewed as collusion” (NT, 2010). The Competition Commission agreed with the NT’s approach. As a result of this, customer profiles and a centralised calculator were not implemented.

The Treasury agreed with the notion that penalty fees should be reduced but they explicitly disagreed with the premise that the fee had to be regulated. The Treasury argued that they preferred to achieve downward pricing pressure through greater disclosure of pricing and more competition. A Treasury press release notes that the Competition Commission’s view was that product and pricing comparability may not restrain penalty fee abuses. The Competition Commission was also of the view that penalty fees were not a substantive point of competition. However, this does not seem to have swayed the Treasury position on the regulation of prices. They noted that banks unilaterally lowered penalty fees to between zero and R9.50 on lower income accounts and had taken other measures to improve customer education including sending SMS’s to notify customers when there were insufficient funds and educating consumers (NT, 2010).

It is noted that the monitoring of pricing and transparency will continue, conducted both by the Treasury and the Market Conduct Regulator under the Twin Peaks framework (discussed below).

3.3. Implementation

The Code of Banking Practice was revised in 2012 to address many of the recommendations of the Banking Enquiry as well as to comply with the Consumer Protection Act (BASA, 2012). It incorporates those components agreed upon with Treasury as follows:

- Communication: The banks commit to providing clear information on a range of areas including the types of products and accounts available, opening an account, closing an account, and on how debit orders and stop orders work. They further commit to providing information on electronic banking services, cards and withdrawals. They also commit to improving the accessibility of information.

- Charges and Fees: In terms of charges and fees a commitment is made to providing relevant information on fees and charges at bank branches and through other channels as well as a commitment to informing the customer of additional charges outside of the standard fees and penalty charges.

- Calculator: Calculation tools will be made available on the bank website, in branches and through the call centres to assist with understanding product and bank specific costs. As reflected by the Treasury discussion it does not provide for a central calculator but highlights that there are independent calculators available on the internet and through the media and that specific costs for an individual's transaction pattern can be calculated by banks.

- Switching: The code of banking practice includes a lengthy commitment to smoothing the switching process including transferring debit and stop orders. It also lays out the specifics of what you can expect from your old and new bank, including information such as a switching guide, loading of stop orders and beneficiaries and closing of accounts within set timeframes. However, the code does not indemnify consumers from interest costs, penalty fees or other charges incurred during the course of switching.

The Code also states that banks will provide information when requested on how debit and stop orders work and how to stop or cancel them. The Code further outlines the dispute resolution mechanisms. *Appendix A* tabulates the specific sections of the Code that correspond to each recommendation.

Banks have also agreed to work together to reduce debit order abuses. A system for providing unique contract and debit order codes was to be completed in the last quarter of 2012 (NT, 2012).PASA has now imposed a unique user code for each debit order that reflects the end merchant so that that the beneficiary is on consumers' bank statements. Furthermore, PASA has implemented rules whereby if more than 10% of a merchant's debit orders are rejected that merchant undergoes a review process and is entered on a review list, during the course of which the merchant may not change banks.

Going forward, in addition to the self-regulation by the Banking Association through the Code of Banking Practice, there is likely to be a greater role for regulatory oversight under the new Twin Peaks Framework (discussed in more detail below) with a new "Market Conduct

Regulator" targeting the fair treatment of customers as one of their explicit mandates. A "Prudential Authority" (the other peak) would regulate financial services from a risk management perspective. It is hoped that the market conduct regulator will mitigate the risk of exploitation of customers, and Treasury specifically notes that it must be sufficiently strong to complement prudential legislation, "particularly in the banking sector" (NT, 2013). The Treasury envisions the market conduct regulator looking at the following six outcomes (NT, 2013):

- "Customers are confident they are dealing with firms that put fair treatment of customers at the centre of their culture.
- Products and services marketed and sold in the retail market are designed to meet the needs of identified customer groups and are targeted accordingly.
- Customers are given clear information and are kept appropriately informed before, during and after the time of contracting.
- Where customers receive advice, the advice is suitable and takes account of their circumstances.
- Customers are provided with products that perform as firms have led them to expect. The associated service is of an acceptable standard and in accordance with what customers have been led to expect.
- Customers do not face unreasonable post-sale barriers to changing product, switching provider, submitting a claim or making a complaint."

As such, there is potential for the market conduct regulator to take forward the recommendations of the banking enquiry by monitoring the aspects that are currently being self-regulated. In particular they could strongly monitor the provision of information and advice, and the barriers to switching. It is anticipated that this will be done through a mix of tools including site visits, reporting and information requests as well as various new tools. These are likely to include "mystery shopper" techniques[1], the sourcing of information from third parties, surveys and enhanced regulatory reporting (NT, 2013).

A new messaging system for the payments system is currently being introduced. The new system will bring South Africa into compliance with ISO 20022. Currently, there is a paper based mandate from merchants for debit orders. The new system will create an electronic mandate, similar to swiping a debit card and entering a PIN. Consumers will be able to authorise a debit order on a cell-phone, for example. The current, dated message type allows for 180 characters, which has very limited space for information. The new message standard will help to integrate the South African national payments system with that of SADC and will facilitate overseas transactions. It will also facilitate consumer switching between banks,

[1]These are informal bank branch visits by regulatory officials who ostensibly wish to buy or use a banking product but whose true purpose is to assess the actual experience of customers and compliance by banks with regulatory requirements.

simulating account number portability, though this will require additional systems development by the banks. A similar system has recently been introduced by the UK Payments Council (Payments Council, 2013).

It has not been possible to set up the FICA information hub, which was proposed in order to facilitate account switching. The key barrier to the implementation of this proposal is that it is not clear whether the original bank or the new bank would be responsible in the event that FICA was not complied with. If there was a risk that the new bank would be liable for non-compliance, the information from the previous bank could not be used. An alternative to the current KYC process, which includes providing proof of address, is to use biometric verification of account holders. This might be feasible in the future, particularly once the HANIS card rollout is complete.[2] The Treasury is considering putting in place a means by which banks can electronically search for customer contact details on databases operated by a variety of entities, including municipalities, the post office, mobile network operators, etc. This should reduce the time and effort required to open a new bank account and should improve consumers' ability to switch bank accounts. There is some support for this from the Department of Home Affairs and from the Financial Intelligence Centre. However, the Protection of Personal Information Act, no. 4 of 2013 (POPI), imposes protections on consumer information that might limit the sharing of address and identity details with banks. Further research is needed in order to assess whether sharing of KYC related information with banks will be possible under POPI.

3.4. Evaluation

The Enquiry spurred a variety of changes in the area of consumer protection. In particular it caused the industry to change the Code of Banking Practice to incorporate a variety of pro-consumer commitments. It is likely that this has had a direct impact on the transparency of fee structures and the ease of switching. However, there appears to have been less of an impact on initiatives that would make direct comparisons and comparative shopping with recommendations easier. For example, the centralised fee calculator and the establishment of generic profiles were excluded from the final implementation programme. Concerns that the centralised fee calculator and customer profiles would lead to collusion are not well-founded: the banks are capable of searching for their rivals' pricing online. Prices are therefore already sufficiently transparent to banks who are thus already in a position to collude, tacitly or explicitly. Consumers, however, do not have the same incentive to understand bank products and prices. Greater transparency would aid consumers in choosing a bank account. The proposed Market Conduct Regulator should therefore consider developing tools to aid consumers to choose a banking product and facilitate price and product comparisons to the extent that these are not already provided by private sector price and product comparison websites.

Furthermore, more could be done to facilitate account switching. This includes system developments to ease debit order and credit push systems to simulate account number portability during the course of the implementation of the ISO20022 messaging standard. The

[2] The HANIS card is the biometric Identification Document developed by the Department of Home Affairs.

banks should also indemnify consumers from interest, penalty fees and other charges incurred as a result of delays in switching bank accounts. State-owned entities that serve consumers directly, such as Eskom, and organs of state, such as municipalities and the Department of Home Affairs, should support the NT's initiatives on integrating information systems operated by such entities with those of the banks in order to enable address verification for FICA purposes. There is scope for greater monitoring and intervention in this arena going forward that could be undertaken by the market conduct regulator under the new twin peaks model of regulation.

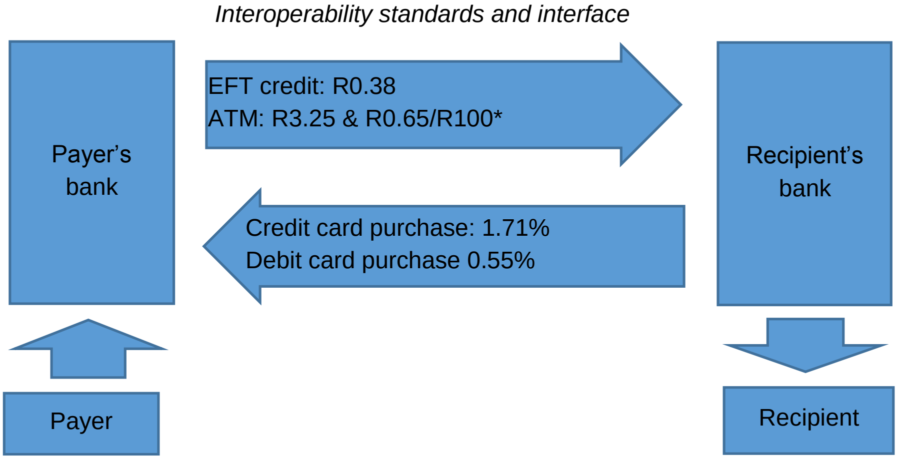
4. Interchange (including ATMs, payment cards, EFTs)

4.1. Introduction and background

The Reserve Bank defines interchange in the context of payment systems to be "the process whereby banks, through their devices, systems and procedures, facilitate the acceptance, collection, exchange, clearance and settlement of payment instruments utilised by their customers within the National Payment System" (SARB, 2012). Interchange most commonly arises where payments for goods or services are made by payment cards as per the four party payments system model, described in Figure 1 below. For example, where a consumer wishes to buy groceries for R100, they would present their credit card to the grocery merchant, who swipes the card through a Point of Sale (POS) device provided by or connected to the merchant's bank. The merchant's bank then sends a message to the payer's bank to deduct R100 from the payer's account. The payer's bank then pays R100 less 1.71% to the merchant's bank, which then deducts a further fee before depositing the funds into the merchant's account.

Interchange does not always flow in the same direction: interchange flows from payers to receivers in the case of credit electronic fund transfers (EFTs) while interchange flows from receivers to payers in the case of interchange for payment cards.

Figure 1: Four party payments system model and interchange



Source: Volker, 2013
**Note: ATM interchange will be increased to R3.48 plus R0.53 / R100 from April, 2014*

Interchange rates vary considerably between different payment streams and include bi-lateral agreements between banks (see Table 1). The credit card interchange rate appears to be very high, at 1.71% of the value of transactions, which would be of concern if the banks set the rate collectively. While bilateral agreements for interchange rates might reduce concerns regarding horizontal co-ordination among the banks, they raise barriers to new entry and are therefore not necessarily desirable. The banks have opted for bi-lateral agreements for newer payments streams, such as AEDO and NAEDO, as concerns regarding interchange setting amounting to a possible contravention of the Competition Act increased.

Table 1: Interchange rates

Payment system	Interchange rate	Direction
EFT credits	R0.38	Sponsoring bank to receiving or homing bank
Real Time Clearing	Bi-lateral agreements	Sponsoring bank to receiving or homing bank
EFT debits	28 cents	Sponsoring bank to paying or homing bank
Authenticated Early Debit Orders	Bi-lateral agreements	Sponsoring bank to paying or homing bank
Non-authenticated early debit orders	Bi-lateral agreements	Sponsoring bank to paying or homing bank
Credit Card purchase	1.71%	Acquiring bank to issuing bank
Debit Card purchase	0.55%	Acquiring bank to issuing bank
Purchase transaction with a dual message debit card; electronic only credit card, etc.	1.09%	Acquiring bank to issuing bank
Garage or petrol card transaction	R1.70	Issuing bank to acquiring bank
Debit card cash back at POS	Bi-lateral agreements	Issuing bank to acquiring bank
ATM cash withdrawals	R3.25 and R0.65 per R100 (until December 2013), revised to R3.48 and 0.53% of amount withdrawn, from December 2013	Issuing bank to acquiring bank
SSD cash withdrawals	Bi-lateral agreements	Issuing bank to acquiring bank
Cheque transaction	Zero	Not applicable

Source: Volker, 2013

The Panel's recommendations on interchange setting in each of the payment streams and their implementation are discussed next.

4.2. ATM services and direct charging

ATM transactions are a common form of activity for bank customers. However, the Panel was concerned over the level of price competition for ATM services. They felt that there was market power in the provision of ATM cash dispensing services that stemmed from two causes. Firstly, due to the interbank pricing arrangements that inhibited price competition, and secondly, due to the restriction of the acquiring of these services to registered banks.

4.2.1. Panel recommendations

The Panel made various recommendations related to ATM services. In particular they noted that the current system restricted competition due to a lack of transparency in fees and undue restrictions that prevent non-banks from being ATM providers and prevent consumers from shopping around. There was a lack of clarity in how the carriage (interchange) feeswere set, and a concern that there was a contravention of section 4 of the Competition Act.

In particular the Panel was concerned that carriage:

- Involves customer allocation, preventing competition between banks for the provision of ATM services to each other's cardholders;
- Precludes the development of a cash dispensing market for non-bank providers; and
- Entrenches each bank's hold over its own customers in respect of its own ATM services, thus providing a shelter for uncompetitive on-us ATM pricing as well.

Accordingly, the Panel made the following recommendations:

- Firstly, that there is a move to a *direct charging model* instead of the current model of carriage fees (agreed upon between banks). The ATM provider would then recover costs from the customer rather than their bank. This would stimulate competition through enhanced transparency. This would be together with a regulatory prohibition on discrimination between customers of the ATM provider and those of cards issued by other firms.
- Secondly, direct charging on mini ATMs and point of service cash withdrawals should be reassessed once there is enough experience of direct charging at ATM level.

4.2.2. Interpretation of recommendation and agreed approach

The Treasury departed from the Panel in their assessment of the benefits of a direct charging model. Their research, which was supported by that of the Competition Commission subsequent to the enquiry, showed that the benefits of a direct charging model vs. an interchange model were not clear (NT, 2012). In particular, smaller new entrants might have been harmed through a direct charging system if banks with large ATM networks charged high direct charge fees for 'off-us' transactions.[3] While the Panel recommended a ban on

[3] An 'off-us' transaction refers to a transaction, such as a cash withdrawal, made by a customer of Bank A from Bank B's ATMs.

discrimination between on-us and off-us ATM transactions to prevent this, banks might have engaged in such discrimination in other ways through bundling of ATM transactions with a number of other transactions. Direct charging would also lead to uncertainty for consumers, who would not be sure of the costs of belonging to an individual bank due to the variability in direct ATM charges. Furthermore, in some countries where direct charging was implemented, such as in Australia, costs to consumers increased. In fact, direct charging was implemented there with objectives other than improving competition in mind. The Australians, for example, were concerned about the lack of ATM networks in rural areas and wanted to allow for higher prices in rural areas through direct charges in order to compensate for higher costs there and drive the rollout of ATMs (Alves, 2011).Finally, the outcome of the hybrid implementation of DCM and carriage based ATMs in the UK has been that there is no definitive answer as to which model is best.

As such, the Treasury and the Commission focused on other aspects of competition. In particular they focused on the need for transparency in ATM fees. In this regard they believed that the most important elements were to provide the consumer with information at the time of the transaction and the opportunity to choose a cheaper alternative. They stated that the improved transparency should include:

- Disclosure of all charges associated with “off-us” transactions in monthly statements; and

- A message on the ATM that there may be an additional charge for the transaction made (though it was decided that the charge itself need not be displayed due to associated complexities).

4.2.3. Implementation

Banks agreed to three commitments with respect to improving ATM transparency (NT, 2012). Firstly, they agreed to provide a detailed breakdown of fees and charges in their statements. While ATM fees are not specifically mentioned in the revised Code of Banking Practice, the wider provisions of the Code relating to charges and fees will cover this.

Secondly, they committed to displaying a message on screen indicating where they would be charged an additional fee by the customer’s bank for use of the ATM. They also specify it to be an “amount not exceeding a maximum amount in the case of off us transactions”.

Thirdly, they committed to reviewing the policy of cash back at POS. This rule was revised and a range of retailers and banks offer this option including Standard Bank, Nedbank, First National Bank, Absa and Capitec who have partnered with the big retailers such as Pick n Pay, Spar and Shoprite to offer this service (Independent Online, 2010).NT and PASA were instrumental in getting the payment card associations to change their global rules to accommodate this change in South Africa. Furthermore, the SASSA roll-out would not have been possible without this change.

While various steps have been undertaken to increase transparency it is not clear that the Panel's concerns relating to price competitiveness, the setting of the carriage price and customer allocation have been fully addressed.

These concerns may be addressed using a different mechanism in the interchange determination project being undertaken by the Reserve Bank (discussed in more detail in the section on interchange). The current phase of the project aims to "develop a methodology to determine realistic interchange rates based on justifiable costs of providing a service applicable for the various payment streams, and to make the process of determining these interchange rates more transparent". They have piloted this with the interchange rate determination for ATMs. It therefore appears likely that the setting of the carriage price will be addressed within a regulated environment. While the Panel had considered the setting of interchange for ATMs by a third party they had dismissed it on the basis that there was no justification for carriage for ATMs. However, this will at least address concerns related to the collusive nature of the setting of ATM carriage fees.

4.2.4. Evaluation

The recommendation of the Panel to move to a direct charging model was rejected by the Competition Commission and the National Treasury. This position was ultimately proved to be correct, in that the experience with the DCM was that ATM charges increased in Australia, and the outcome of the UK's hybrid DCM and carriage model was mixed. The Panel's competition concerns with the setting of ATM interchange are being dealt with using alternate mechanisms. Steps have been taken to increase transparency and it is likely that the core concerns with the setting of ATM carriage will be resolved if the interchange determination project develops a suitable process for determining ATM interchange.

4.3. Payment card and EFT interchange

4.3.1. Panel recommendations

The Enquiry Panel acknowledged the necessity for interchange for payment cards and EFTs but believed that there were issues in the methodologies for determining interchange rates set by the card schemes and banks for payment card transactions. In particular, they felt that it was necessary to ensure that the level set was not excessive and that there was greater transparency and objectivity in how the rate was set.

The Panel stated that the interchange rate should be set at the lowest level possible, but that in practice card schemes and banks have rather assessed the maximum level of interchange that merchants could bear. Their primary recommendation therefore centred on a "new independent, objective and transparent regulatory process for interchange in payment card and payment streams". The Panel set out a detailed recommendation on how this should look and noted that the process should be a participatory process, be independently assessed on the basis of audited data and be overseen by regulators. The resulting levels should be enforced. They also suggested public disclosure of all interchange agreements and the development of an interchange forum open to all stakeholders that would determine the optimal level of interchange for each stream by developing general criteria, and getting information on costing (through a third party costing study) and demand elasticities. Decisions would be made by consensus or by the chairperson with reasons provided. There would also be an appeal procedure.

In addition, they had various additional suggestions related to payment cards and their rules as follows:

- Rules that restrict the participation of institutions in payment schemes should be abolished;
- Restrictive rules including the “honour all products” rule should be abolished;
- There should be a withdrawal of prohibitions on POS cash back; and
- The interchange on EFT debit transactions and Early Debit Orders (EDOs) should be regulated within the process.

4.3.2. Interpretation of recommendation and agreed approach

There was agreement from the various stakeholders including the National Treasury and the SARB that the development of a process to determine interchange was important. It was decided that the SARB should facilitate and oversee a revision of interchange rates for all payment streams (supported by NT and CC). The Treasury set a deadline for the completion of the process as the end of 2010 (NT, 2010).

4.3.3. Implementation of recommendation

In 2009 and 2010 the SARB, Treasury, DTI and Competition Commission were involved in discussions related to the findings of the Banking Enquiry with respect to the determination of interchange fees. The SARB revision of interchange rates for all payment streams was set for completion by the end of 2010 (NT, 2010). However, in reality the process was far slower. Whilst the Reserve Bank launched what they termed the Interchange Determination Project (IDP), this is still in progress.

The project has two phases. The first phase aimed at reviewing interchange rates in all payment streams to see whether they were feasible and justifiable and set at realistic and appropriate levels based on acceptable parameters. Furthermore, the first phase analysis was intended to result in recommendations for a model, mechanism or process by which interchange rates could be reviewed or determined. This would effectively improve transparency.

Dr Philip Tromp was responsible for this research and delivered a report on this to the Bank in December 2011. We understand that he concluded that interchange is necessary to roll out and maintain infrastructure for provider payment services, although it is not clear whether the report concluded that interchange is necessary in all payment streams. The report is not publicly available, which makes commenting on the SARB’s approach to interchange difficult.

Dr.Tromp's findings were communicated to relevant stakeholders in the first half of 2012. Subsequently, the second phase of the IDP has been launched. This is focused on developing a methodology for determining realistic interchange rates based on costs and to make the determination of these rates more transparent. Payment streams identified include:

- ATMs;
- Early debit orders;
- Debit Card at point of sale; and
- EFT transfer debit and credit.

The methodology was piloted with the determination of ATM interchange fees in December 2013. KPMG is assisting with this project. The SARB aims at completing this in terms of their strategy. The Vision 2015 document places as a major challenge "to formalise and implement an interchange determination process in South Africa that is transparent and sustainable. This process should include all payment streams."

4.3.4. Evaluation

The SARB is progressing with its Interchange Determination Project, though it has taken far longer than anticipated. As the SARB's research is not in the public domain it is not possible to analyse whether the process that has been designed is in line with the Panel's recommendations. However, at this stage the process is not being led by an interchange determination forum composed of all stakeholders that are developing the general criteria and guiding the research (as suggested by the panel), but rather is being led by the SARB. Interchange is also not being set in a transparent process, as recommended by the Panel, but is rather being implemented without public scrutiny. Furthermore, it is not clear whether the SARB is taking into account the elasticities of demand for each payment stream. The latter are an important feature of the correct level for interchange to be set and may require interchange rates set above or below costs, depending on the elasticity of demand for various payment streams and uptake by vendors. While the interchange rate does not determine what prices banks ultimately charge consumers and merchants it plays an important role in balancing a two-sided market, by ensuring that consumers, who tend to be more price sensitive than merchants, are subsidised by merchants (see, for example, Rey &Tirole, 2003). Assessing elasticity of demand is particularly important in South Africa which has a large informal sector that might be more likely to join the formal sector and accept electronic payments, if interchange rates were lower.

The delays in the regulation of interchange have been significant and have resulted in no changes to interchange rates for more than five years. This may have led to considerable inefficiencies in the payments system. Mispricing of interchange can have a significant impact on investment incentives (for example for ATMs), on payment card diffusion and usage, on the usage and pricing of other payment streams, and on the development of new payment streams.

PASA supports the NPSD as per the NPS Act and consideration should therefore be given as to whether PASA could play a stronger role in the interchange rate setting process. This would require significantly more independence of the PASA Council from a governance perspective, and would also require that PASA membership be extended to some degree to non-banks, if only on an associate basis, similar to the UK Payments Council (discussed in more detail below).

Finally, greater clarity is needed on whether the interchange determination process will be managed by the proposed Market Conduct Regulator or the Prudential Authority under the 'twin peaks' model. If it is managed by the Prudential Authority, which does not currently have a mandate to evaluate competition concerns under the FSR bill, there is a risk that interchange rate setting may not take into account the competition related concerns highlighted by the Panel.

5. Access to the National Payment System

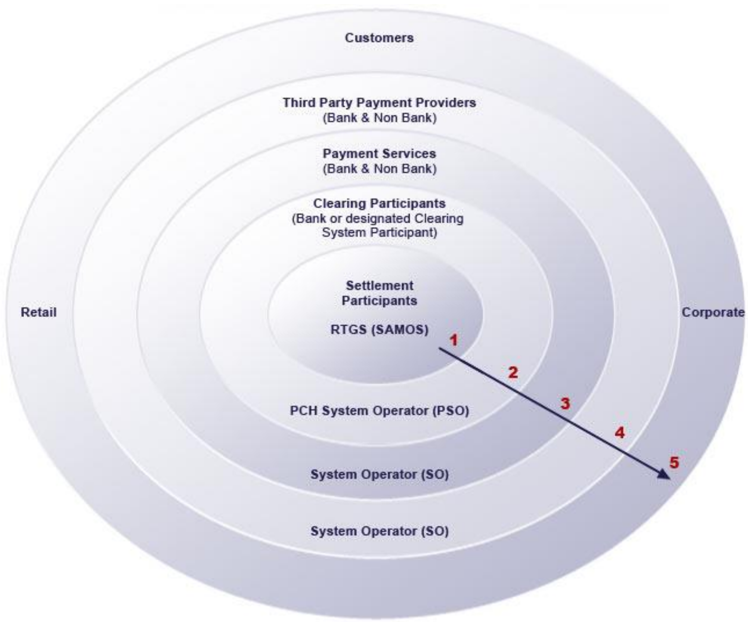
5.1. Introduction to the National Payment System

The National Payment System (NPS) is a system that encompasses the payment process. The Reserve Bank defines it as including the (SARB, 2011):

> '*Systems, mechanisms, institutions, agreements, procedures, rules and laws that come into play from the moment an end-user, using a payment instrument, issues a payment instruction to pay another person or business (the beneficiary), through the final interbank settlement of transactions in the books of the central bank.'*

Role-players in the payment system provide services that include an element of business process and the use of payment system infrastructure (SARB, 2008). The role-players at the heart of the system are settlement participants that make use of the real time gross settlement system, called the South African Multiple Option Settlement (SAMOS) system (see Figure 2 below). In South Africa, settlement participants are registered banks. Clearing participants are able to exchange messages within the payments system, facilitated by Payments Clearing House (PCH) System Operators, including Bankserv Africa, Visa and Mastercard, for example. There are also payments services providers and third party payment providers, who are sometimes supported by system operators. Finally, there are customers, including retailers and corporates.

Figure 2: Payments system participants



Source: PASA, 2014

The NPS is regulated by the Reserve Bank's National Payment System Department (NPSD) under the National Payment System Act, no. 78 of 1998 (NPS Act) and is supported in this function by the Payment Association of South Africa (PASA) which is the payment system management body comprised of banks and designated non-banks as per the NPS Act.

Technical innovation has improved the ability for non-banks to participate in payment services and outsourced payment activities. However, their ability to do so depends on the access allowed by the regulatory regime. At the time of the banking enquiry the NPS was considered to be a fairly restrictive system as access was limited to banks (with particular aspects limited to 'clearing banks'). The enquiry therefore focused on the extent to which barriers to entry prevent competition between providers of payment services to customers, in particular non-banks and would-be banks.

5.2. Panel recommendations

One of the key themes of the Enquiry was access to the NPS. The Enquiry Report shows that the Panel focused on possibilities for enhancing access for both non-banks and banks that are not clearing banks. The Panel found the existing regulatory regime for the NPS to be lacking in its flexibility to allow competitive and technically innovative payment services.

While the Panel noted that non-bank activities were increasingly being acknowledged and considered by the Reserve Bank (with reference to the Vision 2010 document, the directives and some amendments to the NPS Act) they felt that the approach that only clearing banks could participate in clearing and settlement of accounts was not in the interests of South Africa and would negatively impact on innovation.

In particular, they discussed some of the following issues:

- Access to PASA and the system: The Panel was concerned that only banks were able to become PASA members and that this meant that banks supervised their non-bank competitors and potential competitors and acted as gatekeepers. The Panel thus felt strongly that membership and rules should be revised. In addition, they were concerned about the fact that while there were some amendments to the NPS Act there were inconsistencies in the Act and that s6 of the Act meant that non-bank participants were not able to clear.

- Difficulties to becoming a clearing bank: The Panel felt that the development path from being a non-clearing bank to a clearing bank was not set out clearly and that the process was time-consuming.

- Barriers to innovation: The Panel felt that innovation was curtailed by the fact that a non-bank innovator needed to work under the auspices of a clearing bank and PCH. They would need to convince the clearing bank that it would not undermine their own revenues and get the PCH to agree to the innovation and pricing thereof.

- BankservAfrica differential pricing: It was suggested that the Competition Commission observe BankservAfrica pricing practices (particularly the differential pricing) as it is in a dominant position and ownership resides in the incumbent banks.

- Participation in low value streams: The Panel was concerned that the position of the NPSD at the time, namely that only clearing banks could issue electronic money, was problematic in retaining exclusivity for banks in that area.

The Panel therefore motivated for a revised regulatory approach that adequately regulated all those participating in payment activity and included an explicit access policy for banks and non-banks. In particular they made the following four recommendations:

- An access regime that allows for the participation (under effective regulation and supervision) of non-bank providers of payment services in clearing and settlement activities in low value and retail payment streams.

- A revision of the NPS Act and position papers.

- A revision in the membership and governance of PASA to include non-bank participants, to regulate objective entry criteria and to formalise reporting to the NPSD.

- A Payment System Ombud that would assess whether or applications are fairly dealt with and whether participants have been treated fairly in terms of access and pricing.

5.3. Interpretation of recommendation and agreed approach

There was significant pushback from the regulators on a key aspect of these recommendations. Both the Treasury and the SARB stated that they do not support any inclusion of non-bank financial institutions and non-clearing banks in the settlement system due to risks they felt it posed to stability. They felt that competition in retail payments would benefit consumers and merchants in the clearing system (NT, 2010).

The Treasury noted that the SARB had amended the NPS Act of 1998.Treasury also said they would consider further amendments and review governance of PASA to allow membership and representation of non-banks (National Treasury, 2010). However, both the Treasury and the SARB were very opposed to the recommendation that the Chief Executive of PASA have authority over entry rather than the incumbent PCH members as this would place too much authority in the hands of one individual.

In response to the question of an ombud they felt that it was superfluous as SARB could override any decision made by PASA and therefore functioned as an ombud.

5.4. Implementation of recommendation

The SARB has, in theory, committed to improving access to the NPS in its various position papers and documents. One of the main strategic objectives in the SARB's Vision 2010 document published prior to the Enquiry is to "facilitate wider usage by the public and broaden the provision of payment services in the NPS" (SARB, 2010).[4]

The SARB has since released a range of presentations and position papers that elaborate on strategies to increase access. In addition the SARB made certain amendments to the NPS Act during the Enquiry in 2007 under the Cooperative Banks Act and in 2008 under the Financial Services Laws General Amendment Act. The amendments empowered the SARB to designate non-banks as designated clearing system participants. Designated clearing participants were then entitled to participate in the payments system (including becoming members of PASA and gaining access to the clearing system). PASA also made changes in line with this. This directly addressed some of the Panel's concerns in terms of inconsistencies in the legislation.

However, there remain differences in the way the SARB interprets access to the national payment system, and the way that the Panel envisaged access.

Firstly, **settlement remains the domain of registered banks**. While the Panel felt that there should be access to the settlement system the SARB remains opposed to any non-bank entry into the settlement system for reasons of risk. This remains the case even for low value streams. Settlement is therefore restricted to registered South African banks. These banks must meet various statutory and prudential requirements and must also fulfil various requirements to be able to participate in the SAMOS system (SARB, 2011b). There were 22 banks that were registered for settlement and clearing as at September 2013 (SARB, 2013b).

Secondly, in terms of clearing, while participation has widened it is still restricted to qualifying banks and those that are sponsored for settlement. Qualifying non-banks can now be

[4] The SARB's Vision 2010 and Vision 2015 documents set out their long term plans for the payments system in order to give medium to long-term direction to all payments system stakeholders.

designated to be clearing participants as per S6(3)(a) of the NPS Act. In addition, clearing participants can now apply for membership of PASA, which has amended their membership and governance structure to allow for this (NT, 2012). However, non-banks and other banks (such as third person service providers, system operators, those that offer prepaid instruments and those that issue payment instructions) can only be designated <u>if they have a sponsorship arrangement through a qualifying bank</u> (SARB, 2011a). Thus, while development paths exist for designated clearing system participants to become clearing and settlement banks, initial entry is still dependent on sponsorship by a qualifying bank. As at September 2013 there were three participants that were able to clear, but sponsored for settlement, namely VBS Mutual Bank, Diners and Postbank. While the Panel's concerns regarding sponsored access are therefore not fully dealt with, allowing entry into the settlement system could introduce significant risks into the payments system. Without a risk based prudential framework for new entry, such as using a second tier banking licence framework, it is difficult to see how direct access to the settlement system for current non-banks, such as retailers and mobile operators, could be provided. Deposit-taking is also an issue for non-banks.

Various steps have been taken by the SARB to increase participation of non-banks in the NPS. It is not clear that these are a result of the Enquiry, given that some of these predate the Enquiry and are an extension of their Vision 2010 and 2015 documents. These are the **issuing of directives to non-bank participants**, the **creation of a tiered process for participation, participation in forums** and **improved information.**

a) **Directives**: The SARB has published directives to non-banks since 2007. These include system operator and payment to third party service providers (SARB, 2007a and SARB, 2007b). The directives have increased the range of non-bank participants that are subject to regulatory oversight within the NPS. The SARB believes that by regulating non-banks they afford them the "opportunity to discuss payment-related issues with the overseer of the NPS" (SARB, 2011b). However, they do not directly increase participation within the payments system by allowing access to clearing and settlement systems, for example.

b) **Tiered participation:** Ultimately to be able to clear and settle participants need to be clearing and settling banks. However, there are different tiers of participation leading up to that point including sponsored clearing, mentored clearing, and agency clearing.

c) **Participation in forums:** In addition to PASA, a national payment system strategy body and has been established as has the NPS Operational Forum (NPSOF) which will provide strategic input into the NPSSB.

d) **Information on entry:** The SARB has published information to improve transparency around the process of entry (for example, the Starter Pack for Participation within the NPS) which addresses the Panel's concern over the difficulty in information on accessing the system (SARB, 2008).

In terms of the recommendations related to PASA that suggest that admission into the body should reside with the executive rather than members that are made up of banks, the SARB has stated on record that “the Bank would not allow unilateral decisions on membership of PASA and PCH to vest in the executive of PASA”. Nonetheless, admission to PASA does reside with PASA executive office, not in terms of the PASA Constitution but rather in terms of a delegation of authority from the PASA Council to the CEO.

As such, while the Reserve Bank has committed to increasing participation for non-banks they have not acted on some of the recommendations of the Panel. The Reserve Bank, in line with their Vision 2010 and Vision 2015, have maintained restrictions on settlement and have restrictions on clearing. This is consistent with managing risks in the payments system. The focus of access to clearing and settlement has been on developing a growth path for a non-bank to become a proper settling and clearing bank. The participation of non-banks is under a framework that better regulates non-banks that impact on the stability of the NPS without allowing them to be full settlement participants.

Going forward under the twin peaks regulatory system the responsibility for the regulation of the NPS will continue to reside in the SARB as a prudential regulator. However, given the effects that the market conduct of participants will have on customers National Treasury envisions the SARB, PASA and the newly formed market conduct regulator to work closely together to identify and mitigate risks emanating from market conduct (NT, 2013a).

5.5. Evaluation

There is divergence between access to the NPS as discussed by the Panel, which included access to clearing and settlement under appropriate regulation, and that envisaged by the SARB which restricts this access to settlement banks, or banks that are sponsored by settlement banks. However, there is increased regulatory oversight on non-bank participants, and a more clearly established growth path to becoming a settlement and clearing bank. Furthermore, access to the clearing system has been provided to two non-banks: Diner’s Club and the Postbank, a division of the South Africa Post Office (SAPO). Going forward, payments providers could be provided greater access to the payments system under an appropriate prudential regulatory framework, such as the Dedicated Banks Bill, and through a tiered membership approach of PASA. This would ensure that those providers closer to the clearing and settlement system in Figure 2 are regulated more closely than those in the periphery of the payments system. While there is a significant degree of innovation in the South African payments system, particularly among banking agents and payment operators (discussed below), there may be a greater role for the market conduct regulator and the SARB in monitoring and ensuring that innovation is not unnecessarily hampered in the payments environment.

6. Impact of enquiry panel recommendations

6.1. Twin peaks

The 'twin peaks' model for financial sector regulation places greater emphasis on consumer protection in the financial services sector and is an important outcome of the banking enquiry process. For example, the NT explained that (NT, 2011):

> *"The Banking Enquiry identified a major gap in the market conduct regulatory regime: there is no regulator that oversees the market conduct practices of the retail transactional banking sector. While the National Credit Regulator oversees the credit business of banks, it is clear that regulatory oversight needs to be extended to cover the entire banking sector, including retail banking."*

The same document further explained that:

> *"National Treasury strongly supported the sterling efforts of the Competition Commission in highlighting the weakness and opacity in market conduct practices, and is therefore proposing that as part of the shift to a twin-peak model of regulation, the market conduct role of the Financial Services Board (FSB) will be expanded by creating a dedicated banking services market conduct regulator within the FSB, which will work closely with the National Credit Regulator."*

The twin peaks model centres on a separation between prudential and market conduct supervision and is laid out in the policy paper "Implementing a twin peaks model of financial regulation in South Africa" (NT, 2013). The aim of the prudential regulation will be to enhance the safety and soundness of regulated financial institutions and will operate within the SARB. The market conduct regulator will be focused on protecting consumers of financial services and promoting confidence in the South African financial system and will be established from the Financial Services Board.

The draft Financial Sector Regulation Bill (referred to hereafter as FSR) (NT, 2013b) however does not provide for an explicit competition mandate to either the prudential or market conduct regulator. While the FSR provides that the Market Conduct Regulator must take into account "contestability and efficiency" when making its decisions, there is no similar mandate for the proposed Prudential Authority. This means that instead of trading off competition and prudential regulation requirements explicitly, the prudential regulator, for example, is not mandated to consider the competition effects of their decisions. This has significant implications for access to the payments system, for example: the prudential regulator is focused to a large degree on systemic risk and therefore would choose more limited access to the payments system than if it were forced to explicitly consider competition in addition to prudential regulatory imperatives. That is not to say that the SARB should regulate cartels, mergers and abuse of dominance: that should still be left to the competition authorities. Nonetheless, the SARB plays an important role in establishing rules for the sector that ultimately have an impact on competition. It would therefore be useful for the SARB to consider the competitive effects of the rules and regulations that it establishes at the outset. This would avoid having the Competition Commission attempt to remedy the results of anticompetitive behaviour that arises from an environment that encourages it. The FSR Bill does provide for a Council of Financial Regulators, which the Competition Commission is envisaged to be part of. While this provides some scope for the Prudential Authority and the Market Conduct Regulator to consider competition issues, it does not make the trade-off between competition and prudential regulation of the financial system explicit and therefore does not go far enough.

6.2. Prices

The banking enquiry was one of several significant events over the last decade and it is therefore difficult to draw a direct link between the enquiry itself and bank charges. For example, the 2008 / 2009 'credit crunch' had a significant impact on financial markets and the last decade has seen a big expansion of access to banking services to low income consumers.

Pricing trends over the last decade differ somewhat between the banks, although the overall trend is downwards after inflation is taken into account, particularly for package (bundled) accounts. Finweek and Solidarity both produce separate reports, annually, on bank charges (Finweek, 2005-2012; Solidarity, 2010-2013). Finweek assesses the cheapest pay as you transact account as well as the cheapest package accounts (see Figure 3 and Figure 4 below). While there was a sharp rise in the costs of pay as you transact accounts for ABSA and Standard Bank, FNB's prices declined from R415 in 2005 to R376 in 2012 and Nedbank's prices increased somewhat over the same period. FNB, ABSA and Nedbank's prices for package accounts declined between 2005 and 2012, while Standard Bank's prices increased.

Figure 3: Cheapest pay as you transact account (Finweek, Rands per month)

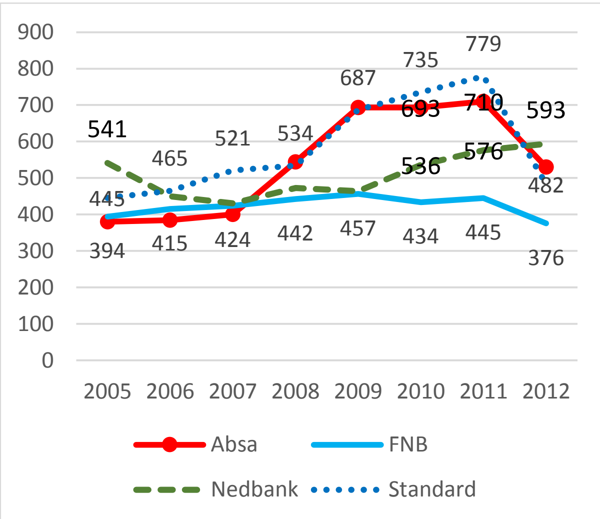
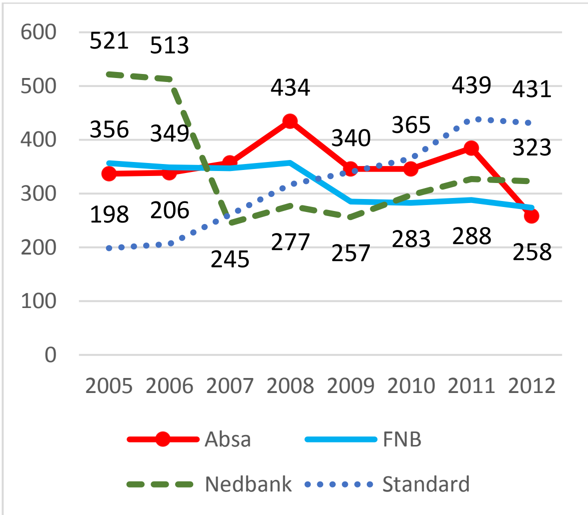


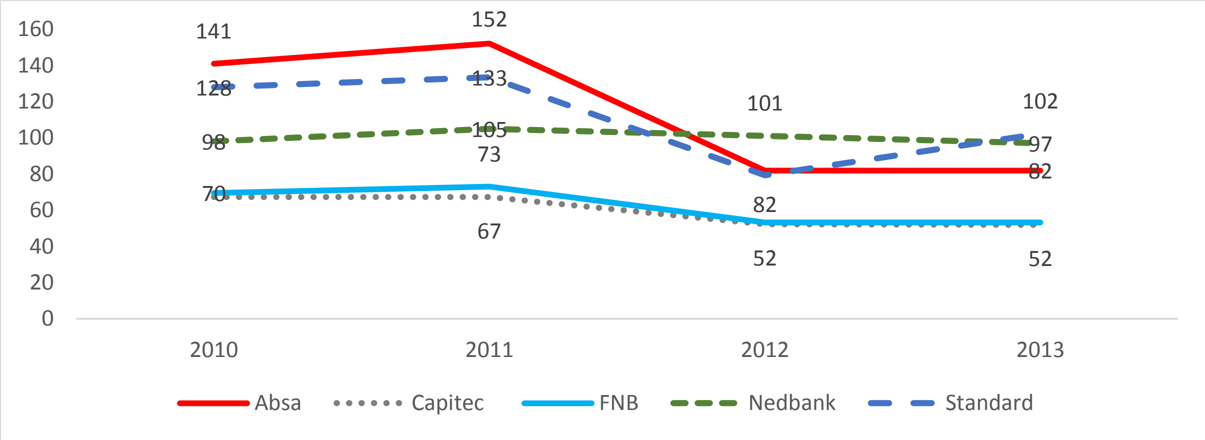
Figure 4: Packages (Finweek, Rands per month)



Source: Finweek, 2005-2012

While the Solidarity research examines the lowest priced bank accounts, their approach changed in 2013 making comparisons over the entire period difficult, it appears as though competition has broken out among the banks, with Capitec and FNB in particular matching each other's prices closely for low-cost bank accounts (see Figure 5 below).

Figure 5: Lowest monthly priced bank accounts (2010 - 2013)



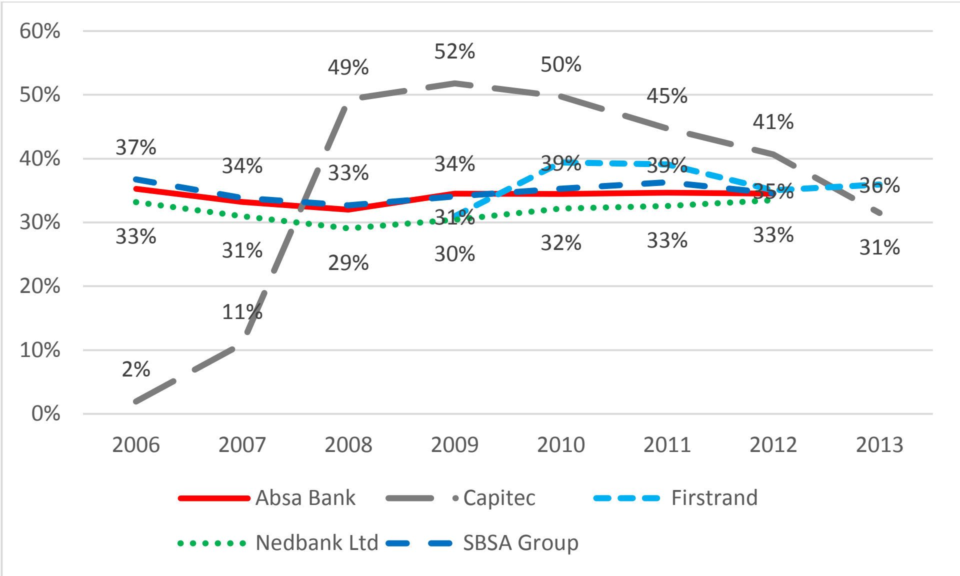
Source: Solidarity, 2010-2013

Note:Note that all figures for 2012 were adjusted in order to be comparable with the figures for 2013, when changes were made to the user profiles for the 2013 report. Figures for 2012 in this table therefore do not exactly correspond with the figures published in the 2012 Bank Charges Report.

6.3. Transaction fee income as a percentage of revenue

The banking enquiry panel aimed to address potential competition concerns and pricing outcomes that were adverse to consumers for transactional banking accounts and payments. One means of assessing whether the enquiry had the effect of causing lower prices for transactional banking accounts is assessing whether transactional banking account revenue declined as a percentage of other bank revenues over time: if the panel recommendations caused greater competition and lower transaction account prices, then transaction account income ought to decline as a percentage of total income. This is a limited measure of assessing whether prices fell, since even if they did, transaction volumes may have increased with an overall neutral or even positive effect on revenue. Most of the banks' transaction related income has been relatively stable at between 30% and 40% of total net income (see Figure 6 below). While Capitec's transactional account and payments related income increased significantly as a proportion of its net revenue, it then fell back to the industry norm, at approximately 31%.

Figure 6: Net fee and commission income as a percentage of net revenue before impairments*



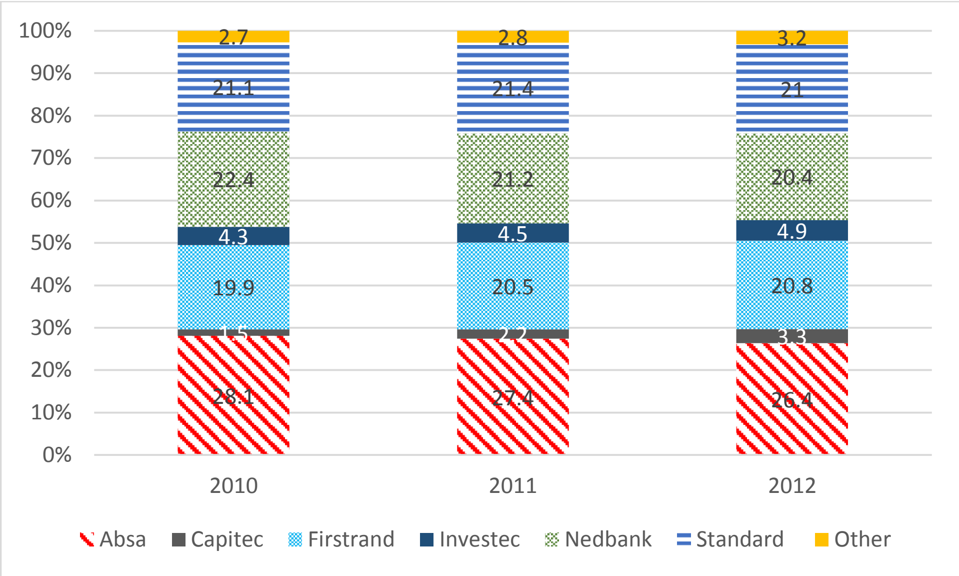
Source: Nedbank, 2006-2013; FNB, 2006-2013; ABSA Bank, 2006-2013; Capitec, 2006-2013; Standard Bank South Africa, 2006-2013

Note: This includes both interest and non-interest revenue, less interest expense but before impairments. The bulk of fee and commission income relates to transactional banking; however, there are small (proportionally) amounts of fee and commission income that are generated from loans and insurance in some instances.

6.4. Competitive rivalry

The banking enquiry made several recommendations that were intended to improve competitive rivalry including improved account switching for consumers and greater transparency that should have eased comparisons between banks (discussed in detail above). While Capitec has had considerable success in the market in terms of number of account holders, bank market shares measured by share of deposits appear to be relatively stable over time (see Figure 7 below). There has been some dynamism in the market: FNB, Capitec and Investec have succeeded in increasing their market share over time, and ABSA and Nedbank have lost market share between 2010 and 2012. It is difficult to attribute FNB, Capitec and Investec's success to the banking enquiry's proposed reforms to ease account switching and improve transparency rather than successful business strategies implemented by those firms. Nonetheless, the Panel's proposed reforms in all likelihood facilitated the increase of the market shares of new entrants at the expense of the larger banks to some extent.

Figure 7: Market shares of banks by retail deposits (%, 2010 - 2012)

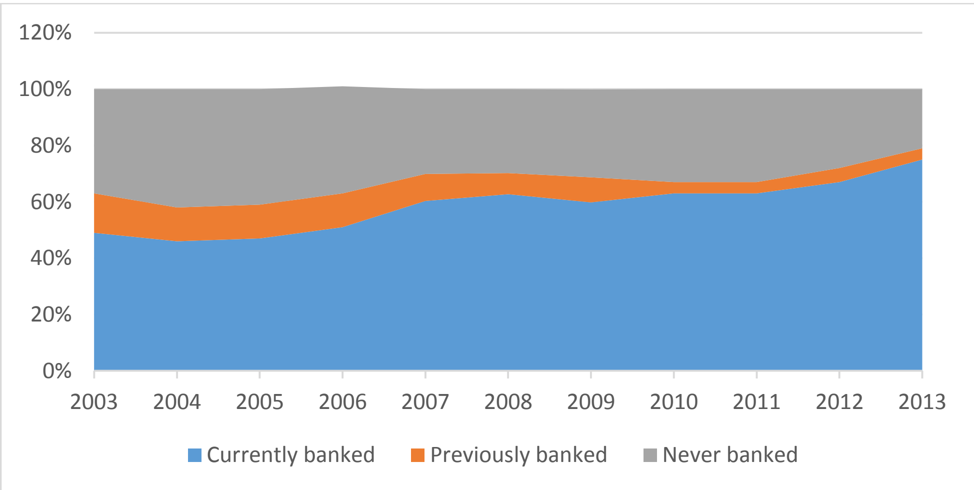


Source: Capitec, 2010-2013

6.5. Access to financial services and usage

Access to bank accounts has improved significantly over the last decade, from less than 50% of the population in 2005 to approximately 75% in 2013 (see Figure 8 below). While this is largely due to an improvement in living standards over time (Finscope, 2013) and the Financial Sector Charter Process in 2004, an increase in competition among banks likely resulted in lower prices and greater inclusion. The rollout of South African Social Security Agency (SASSA) cards has played a particularly important role (discussed in more detail below).

Figure 8: Access to bank accounts

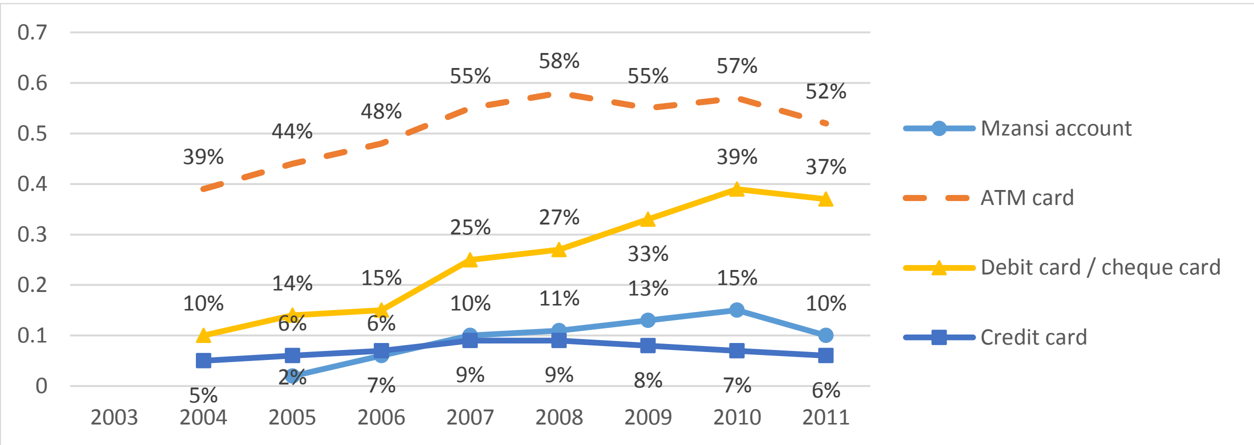


Source: Finscope, 2003-2013

The Mzansi account, an outcome of the Financial Sector Charter process in 2004, also had an important effect on increasing access to banking services. The Mzansi initiative was launched in 2004 in order to improve access to and usage of the financial system and entailed the development of a low cost banking account targeted at low income consumers by each of the large banks. Usage of Mzansi accounts peaked at 15% in 2010 (see Figure 9).

One of the main justifications for interchange rates for payment cards is increased payment card diffusion and usage. The payment of interchange from the merchant's bank (the acquiring bank) to the cardholder's bank(issuing bank)for a purchase means that the cardholder does not have to pay for that transaction, or pays less than the cost of that transaction. This encourages uptake and usage of payment cards. In South Africa, credit card uptake declined from 9% to 6% of adults between 2007 and 2011 (see Figure 9). At the same time, debit / cheque card penetration increased from 10% in 2004 to 37% in 2011. This is despite the fact that interchange for credit cards is 1.71% and is 0.55% for debit cards (see Table 1 above). This outcome may partly be a result of the financial crisis that began in 2008. The National Credit Act, no. 34 of 2005, may also have played a role in reducing credit card uptake and usage. ATM cards, which are payment cards that can be used at an ATM (such as debit cards), are used by more than 50% of adults in South Africa.

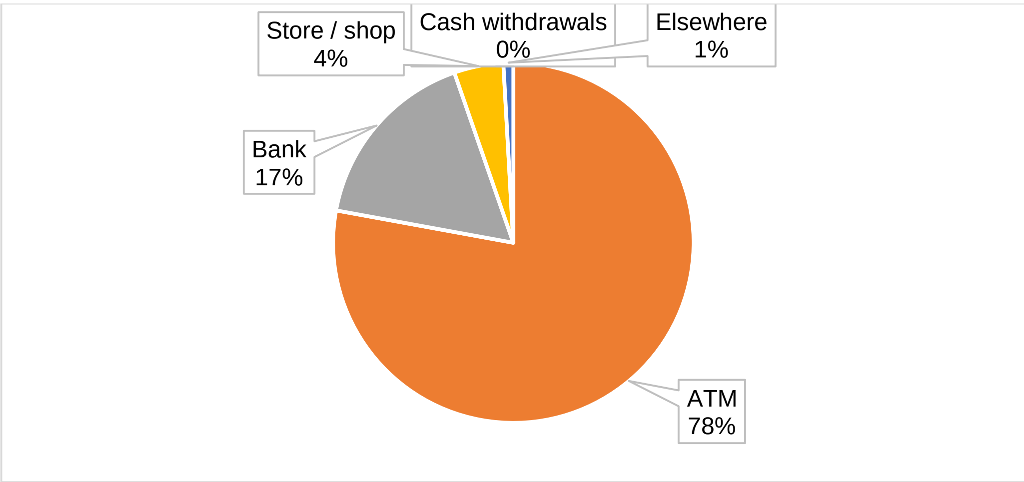
Figure 9: Penetration of payment instruments (2003 - 2011)



Source: Finscope, 2003-2013

The Panel recommended the removal of payment card rules that prevented cash back at point of sale, as discussed above. By 2011, a small but significant number of people reported using a store/shop as the place at which they draw cash (see Figure 10). Nonetheless, a significant proportion of consumers continue to use ATMs.

Figure 10: Where do you draw cash from? (2011)



Source: Finscope, 2003-2013

6.6. Innovation in payments streams

6.6.1. Mobile money

An important concern for the current payment system is the lack of success of mobile payments offered by mobile operators MTN and Vodacom. In 2011, for example, while 26% of South Africans sent or received money, only 42% did so using a bank service including eWallet (i.e. only a small proportion of remittances were sent via mobile payments; Finscope, 2003-2013). While the use of mobile payments is on the rise, a very small proportion of South Africans use these services: 9% of adults used e-Wallet, M-Pesa, Cash Send and Instant Money as measured in December 2012, and usage had increased to 12% in June 2013 (SAARF, 2012-2013). Both MTN and Vodacom have launched mobile money services in partnerships with banks: Vodacom with Nedbank (the M-Pesa product), and MTN with Bank of Athens (previously, Standard Bank), for the Mobile Money product. MTN now offers Mobile Money services in conjunction with Visa in Ghana and many other countries (Techcentral, 2013).

According to one stakeholder, M-Pesa has not been a big success in South Africa because it must be offered in conjunction with a bank in terms of the existing prudential regulatory framework for banking, which entails additional costs and mark-ups. This increases prices paid by the consumer and reduces uptake of the service. Other factors have also played a role, including the well-established banking system that already provides a plethora of banking products and payments offerings. While mobile operators benefit from partnerships with banks which have existing systems, it is possible that mobile payments could be cheaper and therefore have greater uptake if offered directly by mobile operators. In order to facilitate the development of more payments service providers and competition, particularly in the remittance market, a suitable prudential regulatory framework should be researched. This could facilitate the provision of certain financial services that have a financial inclusion focus for non-banks like retailers and mobile operators. Such a framework was considered in the past (the dedicated banks bill) which envisioned a second tier banking licence based on limited functionality and offerings for new entry by non-traditional operators in order to achieve greater financial inclusion. While the NT has been developing a Dedicated Banks bill for some time, the lack of success of the Co-operative Banks Act has meant that there is little pressure to develop and implement a prudential regulatory framework for mobile operators and retailers to offer banking services. Further research is needed to assess whether mobile operators and retailers would use a second tier banking licence, given that they already have partnerships with banks and the business case for a stand-alone second tier banking operation may not exist.

6.6.2. South African Social Security Agency (SASSA) payment system rollout

The South African Social Security Agency has recently rolled out an innovative biometric identification payment system for social grant payments, using both fingerprint and voice biometric identifiers. This has resulted in the elimination of a significant number of 'ghost' grant recipients (up to 370,000 grant recipients, according to Net1, 2013). While the SASSA rollout relies on existing payment system infrastructure in the form of retailer Point of Sale devices and the existing bank ATM networks, the SASSA biometric identification system was developed outside of the National Payments System and relies on a proprietary fingerprint network. This means that Net1, the company rolling out the SASSA payment system, has developed its own proprietary Point of Sale devices for biometric authentication, which retailers are encouraged to make use of in order to attract customers into their stores. The proprietary biometric Net1 system is therefore not inter-operable with the existing payments system. A parallel payments system is thus being developed next to the existing payments system, which reduces the efficiency of payments in South Africa.

Nonetheless, the innovation brought about through the Net1 service has played a role in eliminating ghost recipients from the system, among other factors such as the re-registration of grant recipients. An important question arises as to why this kind of innovation was not possible through the existing payments system. Innovation is seen globally as key to banking the unbanked, reaching rural areas, addressing identification issues and the lack of infrastructure. Innovation has played a particularly important role in Africa and there are several success stories to prove this. The success is often attributed to collaboration between the public sector and private sector, and particularly the openness of the regulator to innovation. The G20 Principles on Financial Inclusion support the "test and see" approach which suggests that the private sector and public sector be open to piloting new innovations, understanding risks and establishing a framework that appropriately manages such identified risks. This will also curb the incentive to bypass the regulated national payment system.

6.6.3. Non-banks including third party payment providers and System operators

There is a profusion of third party payment providers and system operators: there are 88 system operators registered with PASA, and 99 third party payment providers, according to the PASA website. Paypal offers services in South Africa through FNB, whereby merchants can accept payments into Paypal accounts and can transfer funds from their Paypal accounts into an FNB account. There is also a profusion of online payment gateways, driven by the growth in online retail services in South Africa, including PayFast and PayU. Similarly, retailers such as Pick ‘n Pay, Shoprite / Checkers, Pepkor and Woolworths are registered with PASA as Third Party Payment Providers and offer a range of payment services.

While all of this competitive entry suggests a dynamic payments market supportive of innovation, all of these Third Party Payment Providers are sponsored into the system by banks, meaning that they use the banks’ payment systems for account-to-account payments. Both PayU and PayFast, for example, are sponsored into the payments system by ABSA. Shoprite’s money transfer product is offered through Capitec. Further research is required to assess whether these services might be offered more cheaply if TPPPs did not have to work through banks but instead were regulated in terms of a risk-based prudential regulatory framework such as the Dedicated Banks Bill. TPPPs might be getting competitive prices from the banks under existing arrangements and the business case for TPPPs to develop their own information technology systems compliant with national payment system standards might not exist. In other countries, including the UK, third party payments providers are full-fledged members of the payments body. PayPal, for example, is a full member of the UK Payments Council, as opposed to the more peripheral associate membership offered by that body (Payments Council, 2014b).In order to be a full member of the Payments Council, the entity must be a payments provider in the UK and must meet the qualifying criteria in terms of volumes through the payments system. This was implemented in order to reflect the increasingly diverse range of payment providers in the UK. In the same way, the SARB and PASA should consider integrating TPPPs more closely into the regulatory framework for the payments system in order to support innovation and provide a platform for new entry.

6.7. Summary and evaluation of impact

While prices have fallen for transactional banking products, particularly for “mass market” or low income accounts, prices have not fallen significantly. Transaction fee and related income as a percentage of net revenues for the banks has remained more or less stable over time. Nonetheless, there has been significant increases in market shares for the smaller banks, Capitec and Investec, and marginal increases in market share for FNB, largely at the expense of ABSA. While not necessarily directly attributable to the banking enquiry, new entrants appear to be making significant inroads into the market and there has been significant progress in expanding access to the financial system. While there has been considerable progress since the banking enquiry, there is scope for greater competitive intensity and lower prices.

There has been more muted success for mobile money and for retailer remittance products, as well as innovations by non-banks in the payments system. While the mobile operators and retailers have introduced payments solutions, these have been introduced in partnership with banks, which has meant two entities that need to earn additional margins, as opposed to retailers and mobile operators offering payments solutions in their own right. This might be an efficient market outcome, as the banks might compete vigorously for mobile operator and retailer payments volumes and offer very low prices for access to the payments system. Furthermore, the business case for mobile operators, retailers and other third party payments providers to develop their own systems compliant with payments system requirements might not exist. More research is therefore required to assess whether there is scope for reform in allowing a second tier of limited banking licences to allow for greater competition for payments and remittances.

7. Banking enquiry panel processes and policy approaches adopted after the enquiry, and reasons for lack of progress

7.1. Inquisitorial nature of the process

The Competition Commission chose an inquiry process rather than an investigation into the banking sector, which means that the process adopted was less adversarial than an investigation. Stakeholders reported generally that the panel was interactive and was receptive to getting information. Nonetheless, the inquiry process was robust and went against the usually co-operative relationship between the regulator and the banks.

According to one stakeholder:

> *"The banking enquiry process was a bit like a court case, with advocates cross-examining people and trying to catch people out. This was not the best means of gathering evidence and rather than informing the panel's recommendations it made people defensive. The enquiry panel's approach was not a fair process for all parties to make their case and arrive at a good outcome for all; rather the panel was out to punish the banks. The panel appeared to take the side of the non-banks."*

According to the same stakeholder, there was a major financial crisis in 2008, and this was a good opportunity to highlight the risks of allowing non-banks into clearing / settlement.

While the inquisitorial nature of the process was not comfortable for the participants, the approach lent an air of independence to the panel, which almost all stakeholders agreed was an important feature of the inquiry process and should be retained for any future enquiry.

7.2. Relationship between SARB, National Treasury and enquiry panel

Stakeholders largely agreed that it was good to have a certain distance between the regulator and the panel, emphasizing the importance of the independent nature of the enquiry panel. Having a SARB representative on the panel would not have made a significant difference to the delays in the implementation of the enquiry panel's recommendations. Despite the lack of participation in the process by the SARB and the NT, certain recommendations, such as reductions in penalty fees, were implemented by the banks relatively quickly. Progress on reform of the payments system has been very slow, however, and amendments to the banking code of practice also took a long time to implement.

The enquiry panel ought to have done more to include the SARB and the NT in its processes. For example, in order to foster co-operation between the NT, SARB and the enquiry process, it would have been useful for the Panel to have shared their recommendations with the SARB before the results went public in order for the SARB to manage stakeholders and the public, and also in order to inform the Panel's recommendations. According to one stakeholder, this is because the banking sector is sensitive and there are reputational issues if the public engagement around regulatory interventions is not managed.

7.3. The prudential concerns of the SARB were not adequately addressed by the enquiry panel

An important reason for the delays in the implementation of the banking enquiry recommendations is the apparent lack of regard that the banking enquiry panel held for the prudential regulatory mandate that the SARB NPSD was responsible for implementing. There are natural reasons for the SARB to be cautious about admitting non-banks entry into the payments system. Non-banks do not have the prudential requirements imposed on them that banks have but their activities very often involve essentially accepting deposits on behalf of their customers and managing those deposits until the funds are paid out. The classic example is firms that manage payrolls for corporate customers: the payment provider accepts funds from the corporate in question and then pays those funds out to the corporate's employees. The payment provider earns interest on the "float" (deposits) during the period between which the funds are paid into the payment provider's account and the payment provider pays out employees. While it may be desirable for the payment provider in question to clear funds in its own name as opposed to a sponsoring clearing bank, the payment provider in question has not had to put up the necessary guarantees at the SARB to ensure that its commitments can be met.

The Panel ought to have dealt with these questions upfront, particularly in light of the fact that the world experienced a financial crisis towards the end of 2008, when the Panel was finalising its report. Instead of simply recommending greater access, the Panel might have researched prudential regulatory frameworks and recommended changes to relevant banking legislation, such as promoting the Dedicated Banks bill, which would have alleviated the primary risk related concerns that the SARB has regarding the entry of non-banks into the payment system. This was particularly important given the SARB's focus on prudential regulation as set out in its governing legislation.

7.4. Information gathering

The Panel faced significant information asymmetries when commencing with the process. According to one stakeholder, one of the problems with the enquiry panel was that it did not have payments experts on the technical team and that the Panel should have spent more time understanding the payment system. For example, the Panel focused a lot on the Australian payments system but Australia's system of bilateral agreements with no central clearing house is not a good model for a payments system by global standards.

According to stakeholders, the banks submitted a large and very complex set of information. However, each bank followed its own format and provided very large amounts of unstructured information. Any new enquiry should follow a more structured approach with established formats for the information to be provided in a comparable way.

Nonetheless, the information gathering process was co-operative, with the enquiry panel team members often engaging directly with bank staff to obtain information on specific questions, according to stakeholders.

Ultimately, most stakeholders agree that the Panel arrived at a reasonable set of recommendations that were well founded and based on good information obtained from stakeholders. However, the leak of confidential information after the banking enquiry undermines the Commission's credibility with stakeholders that the Commission will keep their information secure. Care should be taken with confidential information in order to avoid the release of sensitive data in the future.

7.5. Cooperation in the payments system

During and subsequent to the banking enquiry there was a reluctance among the banks to co-operate on payment system issues which paralysed the industry, according to several stakeholders. The industry lost at least two years in terms of progress due to this. Over this period there was a lack of development and innovation. The lack of willingness to co-operate in some areas still exists. A further problem has been that the banks have not been willing to engage with the Competition Commission to understand where co-operation is acceptable for fear of being found to request something that is anti-competitive. The Commission should provide more guidance as to what is allowable for the banks to discuss, and what is not. The banking industry views the Competition Commission as a credible enforcer of the rules and the banks are risk averse when assessing their competition law risks. In particular, processes for setting interchange were stalled in the period leading up to the inquiry. For example, the industry has been waiting 11 years for new ATM interchange fees. Another example is that the electronic payments and cash (EPC) forum is unable to develop an exit strategy for cheques.

It is often not clear whether it is genuine fear of contravening competition law that prevents the banks from co-operating or whether they use this as an excuse when co-operation does not suit them. The banks in some cases benefit from closed loop systems, at least initially for a new product, such as is currently the case in mobile payments.

Where payment cards are concerned, competition law fears are not used as often because of the perceived influence of Visa and Mastercard, who are independent of the banks.[5] The card strategy forum is also run by the heads of the card divisions rather than the payments staff from banks, which introduces a different dynamic into decision making and allows for greater co-operation in that payment stream.

It is important for the Competition Commission to set out guidelines or a practice note on co-operation that leads to progress, while ensuring that the co-operation involved does not harm consumers. This should be undertaken in consultation with the sector specific regulators and policy makers involved.

7.6. Using the inquiry process to stimulate change

According to at least one stakeholder, having the enquiry nonetheless pushed the industry into making changes that are desirable from a competition point of view. Regulatory pressure

[5] We note that Visa and Mastercard do not, however, play a regulatory or quasi-regulatory role.

can be helpful in this regard, even if it does not take the form of formal interventions. For example, where regulators put pressure on the industry to make changes, this makes investments in system changes easier since it avoids months of debating the business case for a system change.

The informal nature of the changes brought about by the inquiry process therefore should not be discounted, many of which are implemented without public announcements and credit given to the regulatory intervention.

8. Conclusion

A review of the literature on financial services regulation following the Banking Enquiry shows that the Enquiry has been an impetus for various changes, particularly in those areas in which the banks were key respondents. However, there are several aspects of the recommendations that have been interpreted differently and which have not been implemented due to competing concerns from other regulators.

Key areas in which the Enquiry has caused changes in the industry and its regulation include the following:

- Changes to the Code of Banking Practice to incorporate a variety of pro-consumer commitments.
- Improved transparency around ATM charges. This has the potential to improve further with the pilot of the interchange determination project which is focused on the ATM stream, though the mechanism is different to that envisaged by the Panel.
- Changes to the NPS Act, PASA documents and other SARB papers to allow for designation of non-banks and allow non-banks to be members of PASA.
- Increased regulatory oversight and interaction with non-bank participants in the National Payment System.
- An interchange determination project has been embarked on, although it is in a slightly different form from that suggested by the Panel.

Recommendations of the Enquiry that have not been implemented or have been implemented differently to the approach suggested by the Panel after being deliberated by the NT, SARB and the Competition Commission include the following:

- Recommendations that seek to improve comparability across bank products such as the centralised fee calculator and the establishment of generic profiles have not been implemented by any regulatory body. Fee calculators are nonetheless available from private sector websites.
- The change from interchange pricing on ATMs to a direct charging model (DCM) was not implemented. Instead, NT undertook to monitor the international implementation of the DCM.
- Non-bank participants will not be given access to the settlement system. This is to ensure system stability in the payments system.
- Non-Bank participants will be allowed to clear only when sponsored by a settlement bank.

- The governance of the PASA council has not been made more independent through the inclusion of qualified non-bank participants. Nonetheless, an independent chairperson is currently being appointed to the PASA council.

Since the banking enquiry smaller new entrant banks have increased their market shares but their share of total deposits remains relatively small. As a result of the expansion of new entrants, access to financial services has grown considerably. The financial sector charter of 2004 also played an important role in the expansion of access to financial services. While prices for mass market banking accounts have declined, prices for other transaction banking services did not decline significantly.

Going forward it is possible that the anticipated introduction of a twin peaks model of regulation with a prudential regulator and a market conduct regulator could improve the regulation of the sector and further the objectives and recommendations of the Enquiry by enhancing oversight over competitiveness, transparency and the consumer experience.

There is considerable scope for reforms that will facilitate more competition and better outcomes for consumers, including greater access to the payments system in a risk-based prudential regulatory framework and better governance of PASA, as well as changes to approaches on interchange.

9. Recommendations for next steps

9.1. Overall competition mandate for the SARB and PASA

When deciding on matters of access to the payments system, interchange, and PCH rules the SARB and PASA predominantly take into account prudential (financial stability) concerns, although the SARB also has a safety and 'efficiency' mandate. Competition concerns, including fostering greater entry into the market and innovation, tend to be secondary or are not taken into account at all. As one stakeholder put it: "Financial stability trumps competition". While the SARB has been very successful in regulating a highly stable financial system (South Africa was one of the few countries whose financial system was largely unaffected by the 2008 'credit crunch'), innovation and new entry has been somewhat limited, as discussed above. While the Competition Commission will continue to oversee conduct on an *ex-post* basis the SARB (or, in future, the Prudential Authority) will continue to set rules for the sector on an *ex-ante* basis, including on access to the payments system and oversight of rulemaking for the payments system, both of which have a competition dimension. The SARB's (or its successor body, the Prudential Authority's) regulatory mandate should therefore be explicitly expanded to allow for the consideration of competition issues.

The Financial Sector Regulation bill mandates the Market Conduct Regulator to take into account 'contestability' and allows the Competition Commission to participate in the Council of Financial Regulators. However, this does not go far enough in forcing an explicit trade-off between competition and prudential regulation, at least for the proposed Prudential Authority.

9.2. Consumer protection

Switching bank accounts in South Africa continues to be a manual process that is uncertain for consumers. For example, there are no regulated timeframes within which an account transfer must be completed, as there are in regulations governing number portability in the telecommunications sector, for example (TA, 2006). The ISO 20022 messaging standard that the banks in South Africa are in the process of implementing allows for automated debit order and incoming (salary) payment switching. A process that allows for account switching within seven days without significant effort from consumers has recently been implemented by the Payment's Council in the United Kingdom (Payments Council, 2013), and the SARB and PASA should consider the merits of this system for South Africa. Furthermore, consumers should be indemnified from interest, penalty fees and other charges incurred as a result of delays in switching bank accounts.

The National Treasury appears to be considering measures for improving the efficiency of the 'Know Your Customer' (KYC) process under FICA, which in addition to expanding access to the financial system should ease account switching and thus facilitate competition. The NT's proposal to allow banks greater access to address and identity verification details held at other institutions such as telecommunications operators is innovative but will require support from other regulators and may require legislative changes that will give banks legal clarity around their obligations.

Finally, the proposed Market Conduct Regulator should consider developing tools for consumers to be able to understand bank accounts, compare prices and choose a suitable banking product to the extent that this is not already available through private sector online comparison websites. This will improve price and product transparency, which will foster greater competition.

9.3. Interchange setting

The interchange setting process as it is implemented currently is opaque, contrary to the transparency recommended by the banking enquiry panel. This means that the methodology is effectively not open to scrutiny and public debate is therefore limited. For example, it is difficult for the authors of this report to comment on the effectiveness or suitability of the SARB's interchange setting methodology because the latter is confidential. One of the questions that has arisen during the course of the preparation of this report is whether the SARB is sufficiently taking into account the two-sided nature of the payment card market, which requires that interchange levels also take into account the elasticities of demand for merchants and cardholders.

If PASA were more independent from the banks (discussed below), they might also have a role to play in reviewing the interchange setting process in future, given their access to data and resources to undertake the analysis required. While their role can be enhanced in this process, a separate authority, whether it be the Market Conduct Regulator or the Prudential Authority (depending on how their roles are defined in the payments system) would need to oversee the process and make the final decision. This latter is currently in place, with the

SARB making the final decision on interchange. Greater transparency is needed for the improvement of the interchange determination process. Greater transparency would allow for greater accountability for the regulator that ultimately sets interchange and is in line with best practice for economic regulation (see, for example, Brown *et al*, 2006).

9.4. Access to the payments system

A risk based prudential regulatory framework for current non-banks should be considered to balance competition and prudential regulatory concerns. This is not simply a matter of providing greater access to the payments system but requires a prudential regulatory framework that would support South Africa's highly stable financial system while at the same time ensuring that new entry and innovation is fostered within the system. The Dedicated Banks Bill, which is currently under development within the National Treasury (though it has been under development for some time), might provide a useful framework for this.

In the meantime, it would be useful for the SARB and PASA to widen PASA membership, potentially to a five tier model as set out in Figure 2 above, with greater levels of regulation and oversight performed by PASA and the SARB, the more significant in terms of risk and impact the payments provider or system operator, as the case may be, is in the clearing and settlement system. The UK Payments Council follows a similar model: they offer full membership and associate membership (Payments Council, 2014c). Full membership is associated with shares of transactions passing through the payments system, similar to the PASA governance structure. Associate membership is open to a much wider set of entities and provides access to information, research, and statistics and provides the opportunity to work with full members of the Payments Council (Payments Council, 2014c). As discussed above, there may be a role in the future for the proposed Market Conduct Regulator to regulate disputes regarding PASA membership.

9.5. PASA governance

The PASA Constitution currently provides for banks that have a share or 10% of more of participation in the payments system to each appoint a Councillor, and if there are less than 4 such members, then the four largest participants in the payments system may each appoint a councillor.[6] PASA members that do not qualify for participation as either one of the largest four or having 10% or greater participation in the payments system must choose three members for the Council from among themselves. PASA is currently in the process of searching for and appointing an independent non-executive chairman as a result of a King III corporate governance review and benchmarking study, which is a welcome reform.

By way of comparison, the UK Payments Council Board has 15 voting directors and a voting independent chairman as well as an observer from the central bank (the Bank of England). Four of the voting members are independent, and any two independent voting members have

[6] Participation is measured in terms of a Participation Percentage, defined as a member's percentage, relative to all members, of its throughput in terms of volume (quantity of transactions by way of payment instructions) that have passed through all PCHs multiplied by the member's throughput in terms of value (value of all transactions by way of payment instructions) that have passed through all PCHs multiplied by the number of PCHs in which the member is a participant.

veto powers. While the PASA council does include an independent observer from the SARB and is in the process of appointing an independent Chairman, South Africa should consider the merits of the UK arrangement, with an even greater role for independent members of the payments council.

Finally, PASA's decisions and debates should be made more transparent. For example, the UK's Payments Council Board meeting agendas and minutes are publicly available on their website (Payments Council, 2014d). Greater transparency is particularly important for decisions on rules in individual PCHs which can affect competition, and of course if PASA is ultimately awarded the ability to set interchange (provided that the governance changes are made to ensure that Council is sufficiently independent of the banks), it is important for these decisions to be debated transparently.

9.6. Future inquiry processes

Key to the success of the banking enquiry process was the implementation of the recommendations, which was outside the ambit of competition law investigations. However, there were significant delays in implementing the recommendations. The first changes to interchange rates are only happening this year, for example, more than five years after the conclusion of the banking enquiry process. While the Competition Act has been amended to allow for the Minister of Economic Development to consult with other Ministers when engaging in an enquiry process, more could be done to ensure greater co-operation with sector specific policymakers and regulators, including requiring that such entities participate in hearings and respond formally to recommendations. The latter is a requirement, for example, in the UK.

Nonetheless, the independent nature of the enquiry process lent credibility to its findings, and the inquisitorial nature of the process supported this independence and credibility. Information gathering ought to be better planned, however, as the information that was obtained was not provided in a consistent, comparable format, in order to be able to assess the costs of individual services.

Co-operation among banks is required in order for an inter-operable payments system to function. This is an important area for the Competition Commission to set out guidelines or a practice note, so as to ensure that co-operation that leads to progress is allowed for, while ensuring that the co-operation involved does not harm consumers.

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11. Appendix A: Incorporation of recommendations into Code of Banking Practice

Banking Enquiry Recommendation	**Incorporation into the Code of Banking Practice**
Standardisation of terminology and a "plain language" requirement	3.1 Your Bank will: Provide you with information in a plain and understandable language format. (3.1 Your entitlements) 4.3 Provide information to you in plain and understandable language, using standardised terminology and offer assistance on any aspect which you do not understand;
Communication and provision of information to clients	3.1 Provide you with effective and adequate disclosure of information including terms and conditions of products and services, Provide you with information on relevant fees and charges for the services and products that you have chosen or are enquiring about. 6.5.2 General banking products and services: We will provide you or a potential customer, when requested, with information concerning our banking products and services, including: 6.5.2.1 clear and appropriate information on the different types of products and accounts available from us and their key features, to assist you to make an informed choice appropriate to your needs; 6.5.2.2 information on how to open an account and how an account works as well as recommended safety measures; 6.5.2.3 how debit orders and stop orders work, the difference between the two and how to stop and/or cancel them; 6.5.2.4 information on electronic banking services including the special requirements and precautions which we expect of you if you bank electronically; 6.5.2.5 the different functions of any card(s) issued to you; and 6.5.2.6 when you can withdraw funds after a deposit has been paid into your account and when funds begin to earn interest.
A requirement for at least certain minimum information to be included in bank statements	7.4 Statements of account

Banking Enquiry Recommendation	**Incorporation into the Code of Banking Practice**
	For accounts where statements are provided, those statements will show: 7.4.1 for each transaction since the previous statement i. the amount of the transaction; ii. the date the transaction was made; iii. the cheque number of any cheques paid out of your account; and iv. for card transactions, automatic payments, direct credits, direct debits and other payments, reference to the party who is making or receiving the payment, if such information is available to us; 7.4.2 any fees and charges relating to the operation of the account; 7.4.3 the same opening balance for each successive statement as the closing balance on the previous statement; 7.4.4 the contact details for making enquiries or reporting errors in the statement as soon as you find them; 7.4.5 a summary and breakdown of charges and interest (both debit and credit) on every account, which may assist you to understand the costs of your transactional behavior; and 7.4.6 a periodic reminder of your rights as a bank customer.
A summary and breakdown of charges and interest (both debit and credit) on every account	7.4.5 a summary and breakdown of charges and interest (both debit and credit) on every account, which may assist you to understand the costs of your transactional behavior; and
Advance notice of new charges and altered charges	6.6.6 Notify you at least 20 business days before any changes in fees or charges take effect as well as any change in the basis on which the fees and charges are determined
A regular rights reminder to customers.	7.4.6 statements will show a periodic reminder of your rights as a bank customer
Generic customer profiles for comparability	Not implemented
Centralised fee calculator	Not implemented
DTI comparative advertiising	Not implemented
Codes of switching practice	

Banking Enquiry Recommendation	Incorporation into the Code of Banking Practice
Provision of information and documentation to customers explaining switching process	7.2.1.You may request a "switching guide" from this bank which will provide you with all the necessary information needed to switch banks.
Schedule by which the old bank provides the new bank with info on standing orders and direct debits	7.2.4.Your old bank will assist you, if requested, by providing the following basic transaction account information within 10 business days of receiving your proper instruction to close your account:
Schedule of which balance, standing orders and direct debits are transferred and old account closed	• Up to 3 months' statements; • A list of stop orders loaded; • A list of beneficiaries loaded and • Any supplementary or linked cards or accounts which may be affected by the switching.
Provision to make customers exempt from paying fees or interest charges where switching process failed	Not implemented.

12. Appendix B: List of interviews

Phil Alves, Keith Weeks, formerly of the Enforcement & Exemptions Division, Competition Commission of South Africa
Dirk Ehlers, Capitec Bank
Mark Griffiths, ABSA
Ingrid Goodspeed, National Treasury
Dave Mitchell, formerly head of the National Payments System Division, South African Reserve Bank
Margaret Olivier, National Payments System Division, South African Reserve Bank
Walter Volker, Payments Association of South Africa