

National Treasury: Facilitating the implementation of the Recommendations of the Banking Enquiry Panel

The main purpose of the meeting held yesterday between the National Treasury and the banking sector was to discuss the responses of the retail banks to the recommendations made by the Banking Enquiry Panel (“Panel”) appointed by the Competition Commission (“CC”). The banks present yesterday were the four largest retail banks (ABSA, Standard, FNB and Nedbank), as well as Investec, Capitec, African Bank and the Banking Association of South Africa (BASA).

The Competition Commission launched an independent public enquiry into particular aspects of competition in retail banking and the national payment system in South Africa in 2006. Though this was not a formal investigation by the CC, Treasury has always strongly supported the objectives of the Panel, which was to ensure greater competition in the retail banking sector in South Africa, in order to achieve real benefits for customers through lower costs, better service and greater access of financial services to poor communities whilst at the same time preserving the stability of the banking system.

Treasury wants to thank Judge Thabani Jali who chaired the Panel for the excellent report produced by the members of the Panel. The Panel has raised many important issues with regard to the retail banking industry, and provided

the opportunity for both Treasury and the industry to respond positively to the challenges identified in the retail banking sector.

BACKGROUND

The full technical report of the Panel was released on 12 December 2008, almost six months after the release of the executive summary on 25 June 2008.

After the release of the full technical report, an inter-departmental committee comprising of the National Treasury (“Treasury”), the Department of Trade and Industry (“dti”) and the CC was established. Treasury also worked with the South African Reserve Bank (“SARB”) to assess the recommendations of the Panel, and consult with the banking industry, both at individual bank level and through the Banking Association, to take forward the recommendations made by the Panel.

As Treasury, we recognised that each of the 28 recommendations had to be assessed as to whether the proposed solutions provided an efficient way forward, without undermining other objectives such as financial stability and integrity. Some of the recommendations, if accepted for implementation, would require structural and/or systems changes, involving not just the banks, but regulatory institutions like the SARB and the Payments Association of South Africa (PASA). Further, for the Treasury and SARB, given the global financial crisis which engulfed the world, it is important to ensure that we do not increase systemic risk in our banking and payment systems. Despite this some of the recommendations made by the Panel, particularly those related to the lowering of penalty fees, can be implemented without delay

FACILITATING A RESPONSE FROM THE BANKS

Treasury is pleased to announce that the banks present at the meeting yesterday, representing the bulk of the retail sector, have committed to implementing most of the recommendations made by the Panel. Treasury is also aware that some banks have already implemented some of the recommendations unilaterally.

The meeting yesterday took account of the commitments made by each of the banks as to how they intend implementing the recommendations. The meeting also took account of the facilitation by BASA in creating a platform for implementation of actions in the collaborative space

Treasury is keenly aware that there are many smaller banks that participate in retail banking and the lending market, and which (except for two) were not present yesterday. The Treasury has met many of the smaller banks individually, and will continue to do so to understand their specific challenges including barriers to entry. We will also engage non-bank financial institutions.

This statement reflects the minimum that the banks present at the meeting yesterday agreed to with respect to the recommendations. Each of the banks will be releasing its own press statement to indicate its response in implementing the recommendations, and by when. This statement is therefore not an agreement between Treasury and the banks, but a summary of the commitments made by each bank in its individual capacity.

In addition to the recommendations made by the Panel, the Treasury recognises that there is a need to review the apparent gaps in the market conduct regulation of banks. Treasury is aware that the Financial Services Board (FSB) and National Credit Regulator (NCR) perform this role for certain functions, and that

certain areas are covered on a voluntary basis via the Code of Banking Practice (CoBP).

Treasury notes the need to improve the ease with which consumers compare retail banking products. Such comparisons should preferably be provided free of charge to the public, via websites (some of these already exist) and the media. Treasury will work with BASA to provide a proposal by 31 August 2010 to explore how funding for such consumer groups could be provided by banks, without compromising the independence and integrity of such consumer groups/media.

INDUSTRY AND TREASURY RESPONSE TO SPECIFIC RECOMMENDATIONS

The Enquiry Panel made 28 recommendations. These can be divided into five categories; three categories address market conduct, one category deals with inter-bank arrangements and the last category is on the National Payment System, as follows:

- a) Two recommendations on penalty fees and the management and cancellation of debit orders (Recommendations 1, 2);
- b) Five recommendations (Recommendations 3-7) on ATM pricing reform and transparency;
- c) Eight recommendations (Recommendations 20-28) on general conduct between banks and their customers. (However, banks are encouraged to take recommendations 21, 22, 23 and 24 forward unilaterally.);
- d) Seven recommendations (Recommendations 8-14) that deal with interchange issues; and
- e) Five recommendations that speak to the access into the national payments system (Recommendations 15-19).

As recommendations in the last two categories above on interchange and the national payments system are mainly for the SARB and Treasury to consider,

they did not form part of yesterday's conversation with the banks. This meeting therefore focused on the first three categories, which is what banks can implement (either unilaterally or as an industry).

1. DEBIT ORDERS

1.1 PENALTY: Recommendation 1 on reducing high penalty fees on dishonoured debit orders

The Panel concluded that the penalty fees on dishonoured debit orders were high across the board, with banks overly dependent on such penalty fees as a source of non-interest revenue. The Panel recommended a R5 cap on penalty fees.

Banks response: From the responses given to the Treasury by the banks, their response can be summarised as follows:

- i. All banks have indicated that they have already taken steps to ensure that their low-income account holders face significantly lower penalty fees than the over R80 fee identified by the Panel.
 - a. Most banks have indicated that they have lowered penalty fees for their accounts aimed at low-income customers to below R15;
 - b. Most banks do not impose any penalty fee on the first one to four defaults per month on all their low-income accounts; and
 - c. Most banks also take steps to ensure that low-income customers are not charged higher penalty fees by inappropriately placing them in accounts aimed at higher-income customers.
- ii. All banks still have penalty fees that exceed R80 fee identified by the Panel, but indicate this is only for accounts aimed at the higher income account market.
- iii. Most banks take preventative steps to avoid imposing penalty fees on all customers, by notifying (e.g. via sms) their customers that there are insufficient funds and that a penalty will be incurred if the debit order is

- rejected, providing the customer time to replenish funds. Some banks that are not able to notify such customers in advance will investigate how to improve their systems to provide such advance notice.
- iv. All banks commit to taking reasonable steps to encourage and educate their customers to honour their commitments.

Treasury: Treasury welcomes the steps taken by the major banks to reduce their penalty fees, but would encourage banks to take further steps to reduce the still remaining higher fees on all customers. The Treasury notes the CC's view that greater product and pricing comparability may not restrain penalty fee abuses. It is not clear that penalty fees will ever be a substantive point of competition amongst retail banks, largely because consumers do not often consider these fees when choosing a bank account. High penalty fees are therefore unlikely to disincentivise bad behavior in this respect.

The Treasury does not support the setting of any cap as recommended by the Panel, but prefers the downward pressure on prices through greater competition and more empowered consumers who are better able to compare the prices for services charged by various banks. To facilitate such comparisons, the Treasury supports the role of independent consumer groups to monitor the prices set by the banking sector for various services.

1.2 DEBIT ORDER MANAGEMENT: Recommendations 2 on debit order cancellations

Recommendations 2 of the Panel's report deals with debit order abuses, and requires banks to improve their systems to improve the rights of customers with regard to the contracting and stopping of debit orders.

The Treasury notes that debit orders often involve three parties, with the primary contractual relationship being between the customer and the service provider. Banks are often the third intermediary party as payment facilitator, though often

are also the service provider. To the extent that any debit order is cancelled, the process of cancellation must involve the service provider. The Treasury is concerned that the current system of accepting and stopping debit orders is deficient and allows for unscrupulous players to impose unauthorised debit orders on customers (or even defraud them). The Treasury also recognises that customers should not be incentivised to stop legitimate debit orders, or to renege on their commitments.

Banks response: The seven banks have indicated that they will be responding as follows to the Panel's recommendation on the stopping of debit orders.

1. All banks allow customers to stop or suspend payment on debit orders, giving the customer time to negotiate cancellation or amend the contract with the service provider.
2. All banks are committed to working with PASA (and other regulators like the NCR) as well as BASA (the industry body), to prevent abuses of the debit order system, and to consider steps to set minimum standards/rules on service providers who can access their debit order system. Service providers and banks abusing the system to impose undue burden on customers will be sanctioned by PASA and possibly denied access to the debit order system by SARB. The minimum standards are to be in place by 30 November 2010.
3. All banks have committed to improving their customers' financial literacy, including the management of debit orders, their rights over debit orders and the need to honour commitments and maintain a good credit record.

Treasury:

The overall objective of this recommendation is to ensure that the currently available stop payment service offered by banks actually works in practice. This includes the system changes by PASA, the enforcement of Payment Clearing

House rules and customer education. Treasury will lead a process to improve the overall system of managing debit orders, in the following ways:

- a) By ensuring that the industry sets minimum standards on the conduct of all role-players who want to access the debit order system and to enforcing these standards through effective sanctioning;
- b) Work with other regulators (e.g. NCR), BASA and PASA to ensure that the system for cancelling debit orders will provide advance notice to both customers and service providers, as well as time to resolve any problems;
- c) Explore whether the debit order system should differentiate between collateralised credit and unsecured credit; and
- d) Ensure that all customers are encouraged to honour their commitments.

2. ATM PRICING TRANSPARENCY

Recommendations 3 - 7: Movement from current Indirect Charge Model (ICM) to Direct Charge Model (DCM) and promotion of cash back at point of sale

The Panel concluded that competition in the South African cash dispensing market (via ATMs) was stifled because of lack of transparency in pricing and customer allocation among banks when it comes to off-us cash withdrawal transaction. The Panel therefore recommended a movement to a DCM which eliminates the customer allocation element and at the same time improving transparency. It also recommended that there must be a review of mini-ATMs and cash withdrawals at Point of Sale (POS) machines in the same light.

However, the Treasury (and CC) research indicates that the benefits of moving to a DCM model from the current ICM are not clear, as can be seen in countries like Australia and the UK. The Treasury has therefore focused on the primary objective of greater transparency in off-us ATM transaction fees, and to do so within the framework of the current ICM system. Treasury notes that the most important elements in ATM pricing reform are to provide the consumer with more price information at the time of the transaction, and the option to decline the

transaction and seek a cheaper alternative if so desired. The Treasury also supports promoting cash back at POS is a cheaper option and this may address the lack of infrastructure in the rural areas.

Banks Response: The banks have indicated their support for pricing transparency for ATM convenience (off-us) fees to better inform the consumer, and commits to support this objective as follows:

- i. All Banks will produce a detailed breakdown of fees and charges (minimum format to be agreed via the CoBP protocol) in statements that will reflect clearly the different fees and charges levied in statements.. BASA will also engage the Banking Ombuds to explore the possibility of oversight on this via the CoBP.
- ii. All banks will display a message, either on a screen or by other means in the case of mini ATMs, indicating to the customer that an additional fee may be charged by the customer's bank for the use of the ATM, an amount not exceeding a maximum amount in the case of off-us transactions.
- iii. All banks have committed to review the policy of cash back at POS, taking into account the need to implement appropriate mechanisms to avoid abuse of the customer.

Treasury: The Treasury supports the transparency commitments made by the seven banks, and believes that such measures will improve transparency and the ability of the customer to exercise choice. The dates of these commitments will be finalised with the industry shortly.

3. Bank-Customer Conduct

Recommendations 20 – 28: Standardised terminology, centralised fee calculator, switching code and general transparency:

The Panel concluded that banks possess appreciable market power, and this has significantly hindered competition.

In trying to rectify this, the Panel recommended standardised terminology; development of a switching code and a centralised fee calculator; creation of a FICA hub; extension of product bundling to low-middle income customers; and the promotion of comparative advertising.

The Treasury supports most of the recommendations and has since engaged with the banks to implement the recommendations around customer conduct.

Banks response: The seven banks have agreed to the following:

- 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. All banks commit to 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.
- ii. As part of facilitating switching, the banks have agreed to participate in discussions to create a cost effective way to FICA clients as this forms one of the major barriers to easy switching.
- iii. Banks may also individually undertake to:
 - a. Providing banded and fee option, and bundled options for low income customers.

- b. Disclosing prices, benefits and costs of their products to allow customers to exercise informed choices.
- c. Providing a fee calculator, or other support, in branches and via other channels to reduce search costs.

Treasury: The Treasury believes that the banking sector is innovative enough to implement the spirit of the recommendations on customer conduct. Whilst some recommendations may be implemented differently (e.g. the recommendation on a central calculator) the Treasury believes that this may best be done by independent consumer groups via web sites and the media (see the Treasury proposal on the role of independent consumer groups in Recommendation 1). All banks already have in place calculators in their branches (and websites) to enable customers to determine the bank charges they may be liable for, given their profile. The Banking and Switching code must be finalised by 30 November 2010.

4. Interchange Recommendations 8-14: *Payments card interchange, non-payment card interchange and card scheme rules*

Interchange payments are made between banks when consumers use payment cards for purchases, and when consumers make use of other electronic payments (e.g. debit orders). The Panel concluded that interchange plays a legitimate role in expanding the penetration of payment cards and electronic payments in the South African economy, provided that it is not abused. The Panel recommended the establishment of an *“independent, objective and transparent process of interchange setting”* by way of an Interchange Forum, to be chaired by the SARB. The Panel also recommended the repeal of some anti-competitive rules imposed by Visa and MasterCard on their customer banks.

Treasury: Treasury notes the urgency of this decision and is currently exploring how to improve the interchange setting process, in consultation with the SARB.. Treasury notes that this is not an area that can be led or determined by the banks. It is expected to complete this process by the end of 2010. Concerning

restrictive card scheme rules, Treasury notes the changes made by MasterCard, and Visa should respond equally as soon as possible. The “no surcharge rule“ will be maintained. It is recommended that the Treasury and SARB formalise their position by end 2010 with an explicit framework on interchange issues.

5. Access Recommendations 15 – 19: *Participation of non-bank financial service providers in the clearing and settlement activities, revision of the NPS Act, revision of PASA governance and payment system ombudspersons*

The Panel’s recommendations aim to improve competition and efficiency in retail payments by improving the quality of the access to South Africa’s national payment system currently afforded to non-bank payment companies and smaller banks. The recommendations also aim to broaden access where possible and appropriate. This may require further revisions to the NPS Act, and does require changes to the structure, rules, and governance arrangements of the Payment Association of SA (PASA) to allow non-bank financial institutions and non-clearing banks into the clearing and settlement space in an effort to improve competition and efficiency in the banking industry.

Treasury: The Treasury and SARB, at this stage, do not support the inclusion of non-bank financial institutions and non-clearing banks in the settlement system, given the systemic risks inherent in the settlement system. Greater competition in retail payments will benefit consumers and especially smaller merchants in the clearing system, but not in the settlement system. Treasury notes that the SARB has also made significant progress in creating a framework that allows access of non-banks in the clearing environment, including amending the NPS Act to allow the SARB to designate non-banks into the clearing environment. Treasury will consider further amendments to the extent required; and review the governance of PASA to allow membership and greater representation of non-banks. The SARB also has the power to override any PASA decisions (as any institution denied entry by PASA can appeal to the SARB), so there is no need for a

Payments System Ombudsman. It is recommended that the Treasury and SARB formalise their position by end 2010 with an explicit framework on access issues.

A key issue not covered by the Panel, but strongly recommended by the SARB and Treasury, is to ensure that current legislation requires all companies entering and involved in the payments industry to be regulated on a risk based approach.

CONCLUSION

The Treasury believes that the above steps taken by both Treasury and the industry will improve the quality of banking services to customers, and also remove many existing barriers to retail banking. However, the Treasury is keenly aware that these steps will not go further in dealing with the problem of dominance by a few banks in the retail banking sector – this is a challenge facing banking systems in many countries (eg Canada, Sweden and Australia) and is currently the key focus in the G20 and Financial Stability Forum. Further steps are also been taken in South Africa to improve competition, through the enactment of the Co-operative Banking Act in 2008 and the coming Dedicated Banks Bill.

The Treasury wishes to thank the Competition Commission, SARB and BASA, together with the industry for the collaborative manner in facilitating a response to the recommendations made by the Panel.