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# Submission to the Competition Commission of South Africa Enquiry into Competition in Banking

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## Introduction

The National Payment System as implemented in South Africa and adjusted and refined during the years is absolutely critical to the economy of South Africa. Each economic transaction is ultimately reflected (and influenced) by the functioning of this macro system. Any adjustment or change to this system could lead to a massive impact on the economics of this country (either in the positive sense or also negative). The impact if something were to go wrong can be huge.

The system is a complex collection of rules, business and computer systems, cross checks and interventions, management control and information feedback. Any-one with sufficient knowledge would agree that the system is not operating in an efficient manner and can be adjusted to improve efficiency, which in turn would lead to significant macro economic benefits (and growth).

The only way to effectively achieve this will be a detailed overhaul of first the *Architecture* of the system and then the actual *Implementation*. This will require bold and decisive interventions. In this submission, I make some proposals on *Architectural* issues that can be considered for improvements in the system. Proper analysis rigour have not been applied in these proposals because of lack of time and space.

## Problem description

The National Payment System (NPS) is currently functioning well (albeit inefficiently) because of an equilibrium achieved on a number of key aspects. These equilibrium positions are not ideal and will have to be adjusted to increase efficiency for the economy as a whole. Some of these equilibriums are the following (this is not a comprehensive list)

### Investment in Essential Infrastructure

A big portion (All?) of the investment in infrastructure required to run the NPS, has been (and are being) made by private organisations with the aim of a healthy return. We are therefore confronted by a situation where we have good infrastructure (e.g. electronic switching centres) providing an essential (life critical) service to the industry, yet this investments were made with the intention of making an acceptable return on investment. In some instances (like the case of Bankserv) where the return was not the intention, the controlling shareholders still influence usage of the infrastructure for their own benefit<sup>1</sup>. If the ability to make profits out of this infrastructure were significantly reduced, it may lead to closure (or lower investment) in the infrastructure that could lead to a degradation of an essential service.

### Collaboration between key Role-players

Collaboration between parties in any payment system is essential. It is critical for instance that the originator and the receiver of a payment request share the same understanding of the rules associated with the payment instruction. In South Africa, the establishment of rules for payment clearing and settlement is dominated by the four big banks. Representatives of the four big banks contributing to payment rules inadvertently have to balance the need for stability and collaboration with what is also protecting the interests of their banks. The South African payment associations have

been very successful in creating a stable and predictable payment domain in South Africa. Unfortunately, these rules have been set up in such a way to protect big banks from new entrants.<sup>2</sup>

### Catering for Developing Economy needs in a First World Paradigm

The challenges and realities of the developed world related to payment systems is vastly different to the needs of developing economies (like South Africa). In the past South African banks have invested huge amounts into infrastructure required to conform to standards developed to cater for problems encountered in first world economies.<sup>3</sup> The investment in this infrastructure was often dictated by membership to international organisations (like Credit Card companies and the World Bank). It would have been difficult (if not impossible) for banks not to conform, but having done so, banks have created an environment where new services more suitable for developing markets can only be deployed with difficulty.

### Proposal

It is not advisable to make drastic changes to a core macro system like the national payment system because of the amplification of effect, but in the light of the above (and other factors not described here), the following actions should be considered:

#### Transparency of Pricing

Pricing for payment services should be split in two components and these two components should be made visible to all players in the industry. The first component should be for the clearing of the transaction. The suggestion in this submission is that this component should be equal to or almost zero as all transactions would ultimately net out. This means that the cost of charging for clearing would be more than the benefit of charging for clearing.<sup>4</sup> The second component would be for the usage of infrastructure. (For instance if money is withdrawn from an ATM, people using the ATM should pay for using the ATM infrastructure – this is totally different to payment for the clearing of the transaction). The price for using infrastructure should be visible and transparent and not be different from one client to another.<sup>5</sup>

#### Developing world Payment Associations

The fact that payment rules and prices for members of developing economies are set by the same bodies than is the case for first world solutions will always lead to a situation where the rules are set in such a way as to protect the business with first world (more lucrative) markets.<sup>6</sup> A solution could be to ensure that at least one ACH be established for the delivery of payment solutions for developing economies. Members of existing ACH's will not be allowed membership on the "low cost" ACH. The payment solutions provided for by the "low cost" ACH should operate in a "closed loop" environment and should adhere to other ACH rules when payment transactions outside of this "closed loop" are to be accepted. This approach would lead to more innovative solutions, but focussed on the banked and un-banked market and not influenced by other existing interests.

#### Designation of National Payment Infrastructure

A possible solution to ensuring that the investment in essential payment infrastructure does not decrease, is to establish mechanisms to effectively control key national payment infrastructure. This could possibly be achieved by central government investment in key infrastructure (rather than banks). The management of and access to this infrastructure should then be governed by means of a public commission or similar structure. The similarity to the national road system and other shared (but essential) infrastructure can easily be seen.

## References

1. Many examples can be found in support of this. The evolution of rules related to the so-called non-ATM devices attached to Saswitch is one case in point.
2. The price for the clearing of real-time transactions from one bank to another essentially reduces as a function of the volume of transactions. The argument for this pricing approach is sound, but implies that a new entrant with (initially low volumes) will have lower (no?) margins in offering services to their customers. This is a very effective barrier to entry.
3. The deployment of (for instance) EMV and other similar standards required massive investment by South African banks. The objective of EMV is to reduce credit card based fraud by making use of chip-based security on the credit card. This sophisticated technology (while absolutely sound from a first world perspective) increase the cost to bring to market less-sophisticated, but still sound solutions to a market without access to credit cards.
4. The implementation of such a clearing dispensation in New Zealand and the effect on electronic payments should be investigated.
5. This means that a client would be aware what they are charged for using their own or another bank's ATM for instance.
6. Some of the rules set for the Mzansi account for instance was clearly an attempt to ensure that existing (more lucrative) business is not cannibalised.

## Contact Information

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Fundamo (Pty) Ltd is a South African software company that provides unique transactional payment and banking solutions. Fundamo was established in August 2000 and is located in Bellville. Fundamo contributed to the deployment of many innovative transactional systems that improved banking in payment and currently supports customers utilising the Fundamo technology in more than ten countries on three continents.