



Domus Building , 57 Kasteel Road
1st Floor Suite 103, Lynnwood Glen
Pretoria 0081, South Africa
Tel: +27 (12) 348 0809 Fax: +27 (12) 348 0811
E-mail: ceo@mfsa.net www.mfsa.net

**The DTI Campus
Mulayo (Block C)
77 Meintjies Street
Sunnyside
Pretoria**

**ATT: CHARLES FRANK
Enquiry Manager**

Friday, 27 October 2006

Dear Sir

RE: ENQUIRY INTO COMPETITION IN BANKING

1. As South Africa's largest representative body of registered microfinanciers, we welcome the enquiry into competition in banking, specifically as it relates to the National Payment System (NPS). We are willing to participate at whatever level you deem appropriate and look forward to hearing the outcome of the process in due course.
2. For more than a decade, MicroFinance South Africa (MFSa) has vigorously campaigned for a levelling of the NPS playing field. This included commissioning scientific research dating back to 1995, litigation, and consultation with the Trade & Industry portfolio committee, the South African Reserve Bank (SARB) and other relevant Regulatory structures.
3. We never sought 'special favours' and always worked within the parameters available to us. However, based on the rules governing access and the big banks' dominance of the space, our members and their customers were seriously marginalised as a result of preferential debits, skewed pricing, restricted interface and an operational structure that clearly favoured big (banks) over small (lenders).



4. In 2006, EDO (Early Debit Order System) was launched. Although the new system is currently being tested in the market, and practical difficulties are being identified and resolved on an ongoing basis, we believe we have managed to establish a means by which many of the legacy issues can be addressed. However, **EDO will only be successful if the process to betterment is an ongoing one that engages all the parties.**

5. However, while EDO facilitates access to the NPS and takes care of some of the very real and practical challenges that microfinanciers experience in collecting money and complying with the provisions of the National Credit Act, the service perpetuates and strengthens the position of the banks vis-à-vis the NPS:
 - 5.1 The banks determine the cost of EDO independently of the users, i.e. microfinanciers. Since EDO is designed to facilitate payments across the banking network, the banks – under the guise of the NPS – set the price and are not required to disclose the structure. Since **microfinanciers and the banks compete in the small loans category, this price-setting capacity is anti-competitive and gives the banks a distinct advantage.** It is also our view that such behaviour contravenes corporate governance rules, especially since the NPS is considered to be a national asset, which must serve **all** South Africans.

 - 5.2 The launch of EDO is by all accounts an achievement, despite the challenges of initial implementation. However, after three years of ongoing work and six weeks after the launch on 18 September 2006, pricing remains unclear.

In the financial services sector, where money is a commodity, the cost of services is a key factor and the lack of certainty about how much EDO will cost is causing havoc among microfinanciers, whose business models are already under pressure as a result of the new compliance criteria brought about by the introduction of the National

Credit Act. (The MFSA played an active part in developing the said legislation, even though it brings new compliance requirements with severe cost implications.)



For whatever reason, the banks are withholding price. In the event that the roles were reversed, the banks would claim potential systemic risk. *Why should microlenders and small players in general not be treated with the same sense of urgency and respect?*

- 5.3 Added to the above dynamic and the fact that there are few checks and balances in the system, the banks' pervasiveness in the NPS environment provides them with unrestricted access to highly sensitive and competitive information regarding microfinanciers, e.g. sight of transaction values and volume flows. Such information has the potential to be used by the big banks in an anti-competitive manner, i.e. in product design and marketing. Closing the gap must be one of the enquiry's most pressing imperatives.
- 5.4 Furthermore, microfinanciers provide loans to consumers who have difficulty accessing mainstream financial services.

The National Credit Act and accompanying Regulations, which take full effect on 1 June 2007, cap how much is charged in terms of interest and administrative fees. For microfinanciers to compete in the new regulatory era, operational efficiencies are going to become increasingly important and the cost attached to collections has the potential to be the 'make or break' for many businesses.

The cost of collecting a loan via the NPS mandated service providers can be as much as 20% of the cost of administering a successful loan.

Example:

Consumer A borrows R750 from a microfinancier. He repays R975 in total (the loan amount, plus interest and charges). Of the R225 that is the difference between the loan and what is repaid, R173 is the cost of placing the loan on the microfinancier's books; 16% of that R173 (i.e. R27.80) goes directly to facilitating payment via the NPS, assuming the transaction was successful the first time round. Where the transaction is rejected and multiple attempts are made to reclaim the loan, the charges add up very quickly.

This dynamic increases the overall cost of credit for poorer borrowers, stimulates loan-sharking practices, counters the consumer protection policy underpinning the National Credit Act, and is – by its very nature – anti-competitive.

6. It is clear that the NPS does not serve all South Africans equally, especially given the diverse needs of smaller operators and poorer consumers. To correct this distortion, the MFSA believes the following principles are imperative:

- 6.1 Governance

All parties who have the need to facilitate payments via the NPS should be entitled to participate in the governance of the system, specifically in the areas of policy, strategy, oversight and conduct.

- 6.2 Trust

Given the historic and legacy issues, processes and channels should be established, which build trust among non-banks for what the NPS does. The system's decisions and behaviours should be regarded as having integrity and legitimacy, while viewed as being beyond reproach. This will offset some of the debate, and engender a spirit of cooperation and a sense of fairness.

- 6.3 Neutrality

The neutrality of the NPS is undermined by the fact that the space is dominated by the big banks who compete with microfinanciers for the same consumer base; and at the same time, determine the price that smaller lenders must pay to access the system.

The NPS should be neutral. This could be achieved by a separation of powers (i.e. rule makers, operators, policy and oversight), which give microfinanciers a fair chance of having their voices heard with due regard attached to what they are saying.

7. What the NPS can do for the banks in terms of efficiency and consumer service, it should do for all legitimate smaller players, without in any way jeopardising the risk management aspects of the NPS.
8. Small credit providers have unique needs in legitimately accessing the NPS, and to date considerable work has been committed to the process. It has, however, not been possible to fully complete the expression of our needs as further research and technical inputs are still required, and we request the opportunity to make a later submission, if deemed appropriate by the Commission.
9. As previously indicated, the MFSA is willing to engage on any of the above points should the Competition Commission require us to do so.
10. For any further information or to establish contact with the MFSA, please contact the undersigned directly on (012) 348 0809/083 572 1214 or by e-mail ceo@mfsa.net.

Yours sincerely



Hennie Ferreira
Chief Executive Officer