

# **Response of The Standard Bank of South Africa Limited (“Standard Bank”) to the request for a submission on the reliability of the Falkena Report<sup>1</sup> as a body knowledge for the Competition Commission’s “Enquiry into Competition in Banking” (“the Enquiry”)**

## **1. Introduction and scope**

In the meeting between Standard Bank and Enquiry Technical Task Team (“Task Team”) (on 24 August 2006), the Task Team stated that for the purposes of the Enquiry, the Panel would prefer to be able to assume that the Falkena Report contains a body of knowledge upon which the Panel can rely. The Task Team has requested Standard Bank to point out any areas of the Falkena Report that in Standard Bank’s view cannot be relied upon in the Enquiry.

## **2. Standard Bank’s approach to the request**

For the purposes of responding to the Task Team’s request, Standard Bank has assumed that the “body of knowledge” upon which the Panel would like to rely consists of:

1. The underlying data contained in the Falkena Report;
2. The conclusions of the Falkena Report, as specified in chapter 12 of the report; and
3. The recommendations of the Falkena Report, as specified in chapter 12 of the report.

In this document, Standard Bank will address each of these components in turn, as well as address a number of methodological issues that it feels undermines the general reliability of the Falkena Report as a usable/reliable body of knowledge. Given the very broad scope of the Enquiry as specified in paragraph 5 of the terms of reference of the Enquiry, Standard Bank assumes here that all of the data, conclusions and recommendations of the Falkena Report may be deemed by the Panel to fall within the scope of the Enquiry, and have therefore not confined its comments to any sub-set of those conclusions and recommendations.

This document is not intended to provide a detailed response to the conclusions and recommendations of the Falkena Report; its purpose is limited to identifying the material components of the Falkena Report that it believes cannot be assumed to be reliable for the purposes of the Enquiry, with summary reasoning for Standard Bank’s view.

### 3. Standard Bank’s view on the reliability of the Falkena Report

#### Summary

Standard Bank believes that the Falkena Report as a whole should not be viewed as a reliable body of knowledge by the Panel for the purposes of this Enquiry. Although it is unlikely that most of the underlying “facts and figures” of the report are fundamentally false, Standard Bank contends that few of the conclusions and recommendations proposed by the report are properly substantiated. Therefore, although Standard Bank welcomes and looks forward to engaging with the Panel on these conclusions and recommendations over the course of the Enquiry, it can not at this stage accept that any composite part of the Falkena Report is a reliable item of knowledge for purposes of the Enquiry.

#### View on the data used in the Falkena Report

In respect of the **underlying data** used in the Falkena Report, it is clearly impractical at this stage to comment on every fact and figure used. It is also worth noting the report’s own warning on page ix that *‘this investigation is no more than a pilot study, (since) a lot of the required data was not readily at hand’*.

Standard Bank expects that most of the facts and figures used in the report would be accurate, even where it disputes several of the arguments and conclusions of the report based on that data. Standard Bank does however have concerns about the use of the data in many instances (i.e. ROE’s potentially not adjusted appropriately for tax and inflation; comparisons not done on a like-for-like basis etc.). Given that it is not practical to review and assess every item of data in the report at this stage, Standard Bank deems it not appropriate or useful to propose that all the facts and figures be regarded as a reliable body of knowledge. It is more appropriate to scrutinise in detail that sub-set of the data which relates directly to the substantive issues of the Enquiry, and Standard Bank would on that basis prefer to reserve judgement on the underlying data until the substantive issues become clearer.

#### View on the Falkena Report conclusions

There are very few of the Falkena Report conclusions that Standard Bank accepts as “reliable knowledge” at this stage. Standard Bank’s views and reasoning are set out in the tables below. The tables also contain developments that have taken place since the publication of the report, which have a bearing on the conclusions reached.

**Table: General conclusions**

	<b>Falkena report conclusion</b>	<b>Standard Bank’s summary view</b>	<b>Developments since the report</b>
1	<i>The entry requirements for banks in South Africa are high by international standards, particularly because there is no provision made for the establishment of second-and</i>	We do not believe that this conclusion is fully substantiated. Greater definition of what is meant by “high entry requirements” is required, as we have not found a complete link in the analysis to support the above conclusion. Consequently, we have assumed that high entry requirements refer to legislation and regulatory requirements	Government had published the Dedicated Banks Bill and later withdrew it. It has now published the Co-operatives Banks Bill, and intends to finalise the Bill and promulgate it as an Act.

	<p><i>third-tier banking institutions.</i></p>	<p>imposed on local banks, and have used the analysis in Chapter 11 of the Task Group Report to support this view.</p> <p>Footnote 11 of Chapter 11 indicates that “<i>a detailed comparison of the compliance cost with other dispensations is outside of the scope of the Task Group</i>”. Furthermore, we find no evidence of a comparison of capital requirements across international markets in the Task Group Report. Consequently, we believe the aforementioned conclusion in its current form is unsubstantiated.</p>	
2	<p><i>Disclosure of the cost of banking services is weak, as is the disclosure of the return on savings accounts, both of which undermine consumers’ ability to compare the products of different institutions and thus competition. Poor disclosure is the result of weaknesses in the relevant banking legislation, consumer credit legislation and advertising rules.</i></p> <p><i>Under current regulatory arrangements, the banking code of conduct is administered by the Banking Council. There is no independent oversight of disclosure of interest rates or charges on savings accounts and transactions. Ideally disclosure rules should make it possible to compare bank and non-bank products (e.g.</i></p>	<p>Standard Bank does not agree that disclosure of banking charges is weak. Two primary reasons support this view: The facts of current Standard Bank pricing disclosure; and the analysis in the Task Group Report does not adequately support this conclusion.</p> <p>Standard Bank discloses charges to customers in a number of ways. Pricing disclosure on products is most easily accessible through product brochures that explain the pricing structures for various products. The Standard Bank website contains a schedule of all pricing on products, including a calculator that allows customers to simulate their banking behaviour and then compare costs of various products. These options are available directly to customers in branches, through Standard Bank staff in branches, using our online website or contact centre. Furthermore, Standard Bank has undergone a product and charges rationalisation and standardisation exercise to make it easier for customers to understand the product options and make appropriate choices with respect to their specific needs. With respect to lending products, the rate applicable is included in the contractual agreement with a customer. Any price changes to fees are communicated to the customer before they are implemented.</p> <p>However, while we feel that we are not weak on disclosing</p>	<p>The National Credit Act has been published/promulgated since the release of the Falkena Report, strengthening consumer credit legislation. Disclosure requirements have also been significantly strengthened in the NCA.</p> <p>The need for customers to be able to price and compare offerings has been recognised by the banks. The Banking Association will host a service on its website where a consumer can identify what he/she needs in terms of banking services, and the various banks will contact that consumer and tender their best offering and price to meet that consumer’s needs. This will better enable customers to decide which bank and product to use.</p>

	<i>deposits versus money-market funds).</i>	<p>pricing, and while we undertake numerous activities to disclose pricing, we would still welcome discussion on possible improvements to pricing disclosure to customers.</p> <p>We agree that no independent oversight of disclosure has been formalised. However, it should be noted that the financial media performs reviews of banking charges that are made available to enable price comparisons. Furthermore, a number of independent financial services websites publish detailed charges on all banking products and services to enable price comparisons e.g. <a href="http://www.bankmonitor.co.za">www.bankmonitor.co.za</a></p>	
3	<i>The ownership of and control over the National Payment Systems, which constitutes essential infrastructure, is concentrated in the hands of the four biggest banks. It is possible that a complex monopoly exists, but a detailed investigation of this issue was not within the remit of the Task Group.</i>	<p>Firstly, we believe that it is incorrect to conclude that the NPS is an essential infrastructure concentrated in the hands of the four biggest banks. The four biggest banks are, as described in the SARB website, only some of numerous participants in the NPS that is regulated (and therefore controlled) by SARB.</p> <p>Secondly, the concept of “complex monopoly” does not form part of South African competition law. Even if “complex monopoly” had meaning in South African law, we find no analysis or conclusions reached in the detailed chapters of the Task Group Report that supports this conclusion. We are also unable to find any causal link in the Task Group Report that could infer the above conclusion. Furthermore, we are uncomfortable with the apparent contradiction between this conclusion and a previous statement in the report that “...a detailed investigation of this issue was not within the remit of the Task Group”.</p>	
4	<i>There are a number of mechanisms in the payment-processing procedures through which preferences are</i>	This recommendation is consistent with current SARB policy.	Preferential payments have been done away with in the National Credit Act (NCA) and by the introduction of AEDOS and NAEDOS.

	<p><i>created in favour of account-holding banks and related parties. These mechanisms undermine competition and create disincentives for both bank and non-bank competitors to enter into aggressive competition with the account-holding banks.</i></p>		
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**Table: Conclusions on competitiveness**

	<b>Falkena report conclusion</b>	<b>Standard Bank's view</b>	<b>Developments since the report</b>
1	<p><i>The market share of the four biggest South African banks is high, and while the Task Group could not find any evidence of any one bank acting as a monopoly, a detailed examination of their behaviour is such that it leads the Task Group to conclude that collectively they behave as a complex monopoly (as defined in Appendix 1.2).</i></p>	<p>As stated above, we believe that the concept of complex monopoly does not form part of South African competition law. Furthermore, we are uncomfortable with the apparent contradiction between this conclusion and Conclusion 1.3 in the previous Section 4.1.1. (Regulatory and Structural weaknesses), which states that "...a detailed investigation of this issue (complex monopoly) was not within the remit of the Task Group".</p>	
2	<p><i>The Task Group concurs with the conclusion of the Wallis Report in Australia that a large number of suppliers is not a prerequisite for a competitive market, and that a competitive</i></p>	<p>Standard Bank does not believe that there is a lack of diversity in the banking sector. In addition, we welcome the introduction of more competition, as well as 2<sup>nd</sup> and 3<sup>rd</sup> tier banks.</p>	<p>Since the publishing of this report in April 2004, the sector has seen the introduction of many new competitors that are not banks, including for example: Teba Bank A-Card (UIF beneficiary debit card); WesBank Islamic Finance launched; Discovery credit card; Wizzit Maestro-branded debit card &amp; cellphone</p>

	<p><i>market may well be characterised by vigorous competition between a small number of suppliers.</i></p> <p><i>However, the lack of diversity in the banking sector is a matter of concern, and in particular the absence of second- and third-tier banking institutions. These sub-sectors appear to play a very important role in service delivery to low- and middle-income groups and SMEs in many developing countries as well as in most OECD countries.</i></p>		<p>banking; SHESHA taxi recharge card; JD Group &amp; Absa JV form Maravedi in-store credit &amp; financial services; DaimlerChrysler Dream Drive (VAF Stokvel model); EasyPay brand re-launch; Edgars credit card; MTN Banking launched; Pick 'n Pay Go Banking MasterCard credit cards; Shoprite Checkers money transfers; Virgin Money credit card; Postbank pilots Internet banking; Capitec pilots Internet banking in 5 languages; SAA Voyager credit card launched; Kulula.com credit card launched</p> <p>Arguably, the relative number of banks facilitated adoption and will facilitate implementation of the Financial Sector Charter that seeks to address the concerns raised.</p>
3	<p><i>The returns on equity earned by the primary banks are high by international standards.</i></p> <p><i>However, this is not the central focus of concern; indeed the Task Group finds that the sound and comfortable position in which banks find themselves provides an opportunity to introduce measures that will enhance accessibility and make competition more effective in the market.</i></p>	<p>Standard Bank regards the first part of this conclusion to be inaccurate and incomplete. We disagree with the statement that ROE earned by primary banks are high by international standards, for both theoretical and methodological reasons.</p> <p>Any financial analysis of returns across markets, and subsequent conclusions of profitability within a market, needs to include (amongst other adjustments):</p> <ul style="list-style-type: none"> <li>• an analysis of the structural differences between markets,</li> <li>• an analysis that reflects the economic cycle,</li> <li>• an appropriate cost of capital analysis that takes into account risk-return, and</li> <li>• a computation of returns that allows comparison with the cost of capital.</li> </ul> <p>Specific difficulties we have with the report's use of ROE are</p>	

	<p>the following:</p> <ul style="list-style-type: none"> <li>▪ ROE at group level (as analysed in the Falkena Report) has no direct connection to ROE at the sub-market level for which the report is drawing conclusions. The overhead cost allocations required to calculate ROE for the relevant sub-market are non-trivial, and have not been attempted in the report;</li> <li>▪ It is unclear that appropriate adjustments have been made for factors like inflation, interest rate environment, exchange rate and country risk in the ROE comparisons.</li> <li>▪ We have not been able to reconcile the report's results for ROE to the components of the calculation. In particular, it is not clear that the report has used correct average capital figures in its calculations.</li> </ul> <p>Furthermore, Standard Bank believes that a single profitability metric (at an industry level, compared across different markets) is insufficient in order to develop any meaningful conclusions.</p> <p>The Report has drawn heavily on ROEs of South African banks extracted from "The Banker" to reach the conclusion that South African banks are amongst the most profitable in the world, and implicitly, that they are earning excess profits and so there must be weaknesses in the market. We believe that the reported ROEs may be overstated because The Banker used pre-tax profits as the basis for a world-wide comparison to remove the effect of numerous differences on the results of banks being compared (including different tax regimes, reporting dates, and inflation and exchange rates).</p> <p>The Banker states that, wherever possible, consolidated figures have been taken for the banking group (unless it is a</p>	
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		bank assurance group, in which case the figure reflects ROE of the banking business only). In the annual financial statements of the South African banks, ROE figures are expressed for the entire group. This can lead to significant distortions, especially where the business lines of different banking groups differ markedly. For example, certain business lines require less/more capital which in turn affects relative ROE's.	
4	<p><i>The leading banks' ability to maintain stable returns on equity over the business cycle does appear to indicate that the banks wield considerable market power.</i></p> <p><i>In particular, there are strong indications that the leading banks have considerable market power in maintaining a desired level of earnings from bank fees and that the banks have been able to increase bank fees at will in response to any downward pressure on net interest income.</i></p>	<p>We assume that the analysis contained in Table 2.5.1 has been used to support the first part of this conclusion. Standard Bank has not found evidence in the Task Group Report to support the conclusions reached and believes the conclusions to be invalid.</p> <p>A number of reasons explain the relatively lower level of volatility in profitability in Banking vis-à-vis other industries (Table 2.5.1). The ability of banks to "...<i>maintain stable returns on equity over the business cycle...</i>" is a function of many factors, including the financial performance of the economy and its sound underlying economic growth, the diversified nature of banking businesses, the natural hedge in banking businesses and earnings and decisions taken by management over the business cycle.</p>	

**Table: Conclusions: Access and costs of banking services**

	<b>Falkena report conclusion</b>	<b>Standard Bank's summary view</b>
1	<i>The high-income clients have a fair level of choice, partly owing to the availability of savings, loan and transmission substitutes,</i>	Standard Bank concurs with this conclusion; this is consistent with the majority of other banking markets globally. While all segments of the consumer banking market have the same core financial services needs, the level of sophistication in how needs are met tends to differ. The usage of product ranges is partially

	<i>both from niche banks and from financial institutions outside the banking sector. For instance, insurance and unit trust products play a particularly important role in creating savings substitutes for the high-income population.</i>	correlated with level of financial sophistication, level of financial literacy and levels of disposable income.
2	<i>Low- and middle-income earners face exceptionally high bank charges, low (and often negative) returns on savings accounts, and limited access to banking services. It is only in micro-lending that there are significant non-bank substitutes. The interest on these is often crippling high and the choice in terms is limited. Regulatory barriers and cost of payment processing are major factors in the high cost of these non-bank substitutes.</i>	Standard Bank does not agree with the general statement that low and middle income earners face exceptionally high bank charges, low and often negative returns of savings accounts, and limited access to banking services. We dispute this conclusion on the following basis: a significant portion of the underlying analysis and assumptions supporting the Task Group conclusions (contained in Chapters 7 & 8) is inaccurate, and a number of the expressed views in Chapter 8 conflict with what Standard Bank observes in practice in underlying customer behaviour by its low- and middle-income customers
3	<i>The situation in respect of small- and micro-enterprises appears least satisfactory of all, with very limited access and very high costs.</i>	Standard Bank disputes this view. While it appears this conclusion is applicable in the United Kingdom (see Cruikshank Report), Standard Bank's experience is that the same does not apply in the South African market.
4	<i>There is a substantial segment of the population that has no access to banking services. This segment may be divided into those who are ineligible for such services such as the informally employed or the unemployed and those who qualify by virtue of their low- to middle- income status. It is tempting to conclude that inadequate product design, weak service levels and high fees contribute to low- and middle-income consumers choosing to remain</i>	Standard Bank agrees with the first part of the conclusion but disagrees with the second part.  The Financial Sector Charter describes access to the financial system as one of the challenges facing the financial sector. The large South African Banks have set objectives and targets contained within the Financial Sector Charter, and are currently executing on these in order to address the challenges facing the sector. This includes providing access to financial services to unbanked customers.  Further clarification is required with respect to the definition of the term " <i>tempting to conclude</i> " in order for us to respond in more detail. We have assumed this to mean an implied anecdotal conclusion. We find no evidence in the analysis contained within the Task Group Report to support views of " <i>...inadequate product design...</i> " and " <i>...weak service levels...</i> ". We do not agree with the view regarding 'high fees'.

<p><i>partially or fully unbanked, and the entry of second-tier banks, (operating under different business model) may more adequately (and profitably) serve the needs of this group than do the big retail banks.</i></p>	<p>Furthermore, we find no analysis in the Task Group Report supporting a causal relationship between being unbanked and the aforementioned reasons. To the contrary, a Finmark Trust survey indicates reasons for customers not banking. The sample of customers consists of those who were previously banked, but that are now currently unbanked. Only 7% of the previously banked sample suggested that “it’s expensive to have an account”, with the remainder of reasons being unrelated to the cost of ownership of a banking account or any of the other reasons suggested in this conclusion. The main reasons for being unbanked are not being employed (54%), no regular income (46%) and they earn too little (15%).</p>
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### ***View on the Falkena Report recommendations***

There are few of the Falkena Report recommendations that we would be prepared to accept as properly motivated and therefore “reliable” at this stage

**Table: Recommendations of the Task Group**

	<b>Falkena report recommendations</b>	<b>Standard Bank’s summary view</b>	<b>Developments since the Falkena Report</b>
I	<p><i>Government should introduce improved disclosure requirements in banking services.<sup>1</sup></i></p> <p><i>Government should introduce improved disclosure requirements on banking services, which should cover savings services, transmission services and credit services, and which should encompass point-of-sale disclosure as well as disclosure in marketing and</i></p>	<p>Standard Bank does not believe that there is ‘weak disclosure’. We try to ensure that our pricing and services charges are comprehensive, transparent and well communicated. (Detail in this regard is given above).</p> <p>It is fair to say that the information from various banks is not given in the same form, so it is difficult to make comparisons. We believe that the initiative proposed by Standard Bank, and adopted by the other banks, to have ‘competitive tendering’ for individual clients via the Banking Association web site will address concerns regarding comparability (see details in column on the right).</p>	<p>The National Credit Bill obliges disclosure of information.</p> <p>On the proposed Banking Association website, customers will be able to enter a few basic details (age, income, transaction profile i.e. number and value of cash withdrawals, etc.). This information will be sent to the various banks, which will use the information to calculate the monthly cost of banking for that customer. The calculator will only look at entry level accounts (Mzansi and E Plan), and will return the option with the lowest cost back to the Banking Association website. The customer will be able to compare the costs between banks. At this stage the proposal does not cover current accounts.</p>

<sup>1</sup> The text in blue is the abbreviated recommendation, as set out by the Falkena Report. The text in black is the full recommendation as set out in the Falkena Report.

	<p><i>advertising material.</i></p>	<p>We agree with the proposal regarding 'point-of-sale disclosure' if it means disclosure at the point at which the product is first sold to the client. However, if the reference is intended to relate to every point at which a service is provided, then we feel that the recommendation is unworkable. For example, when a client uses the ATM of another bank (the "ATM provider"), the ATM provider does not know what charge will be levied by the client's own bank. And even if the ATM provider did, it would be totally impractical to suggest that the ATM provider should disclose the charges of all the different banks.</p> <p>We are sensitive to the issue of disclosure, and welcome suggestions on how to improve pricing disclosure to customers.</p>	
ii	<p><i>Government should introduce legislation that would compel banks to offer existing and potential customers unbundled service and pricing options.</i></p> <p><i>Government should introduce legislation that would compel banks to offer existing and potential customers unbundled pricing options. Each component of the service being offered should be separately priced and any discount on a bundle of services clearly indicated. This unbundling will facilitate price comparisons between</i></p>	<p>It is not completely clear what the report means by "bundled" and "unbundled" options. On the assumption that "price bundling" is referred to, then with respect to single transactional products, Standard Bank currently offers customers both bundled and unbundled options. This is in order to best serve the underlying customers needs. Furthermore, Standard Bank does not seek to influence this decision other than to inform customers of the option that would best suit their specific needs. Standard Bank product brochures and year end pricing communication clearly indicates customer choices; these can be changed by simply phoning the call centre or visiting a branch.</p> <p>Standard Bank believes that demand for bundled products or services is primarily driven by the customer's need. Standard Bank does not insist on an exclusive relationship, nor that customers purchase a specific pricing option. We offer customers bundled and</p>	

	<p><i>service providers and allow consumers to make informed choices. Further, consumers will be charged only for the service or transaction used and not for a package that may be inappropriate for their needs.</i></p>	<p>unbundled pricing options on current accounts.</p> <p>Standard Bank does not believe that legislation is required to compel banks to offer customers unbundled pricing options as these options are already in place. Furthermore, we believe that any current product bundling options do not limit disclosure to clients or comparison across suppliers and, arguably, compulsory unbundled options may inhibit competition based on product and pricing differentials. Standard Bank would welcome suggestions for possible improvement to unbundled pricing options provided to any sub-market in which it serves.</p>	
iii	<p><i>Penalty fees, charges for essential services or charges for services not open to competition should be on a cost-plus basis and open to regulatory oversight.</i></p> <p><i>Government should introduce legislation that regulates the charging of penalty fees, charges for essential services and charges for services not open to competition. Only fees that are related to actual costs or quantifiable risks should be charged to customers.</i></p>	<p>Further clarification is required from the Task Group as to what is defined by the terms “<i>penalty fees</i>”, “<i>charges for essential services</i>” and “<i>charges for services not open to competition</i>”. We know of no bank charges not open to competition, and we do not find any specific analysis in the Task Group Report that addresses the specific types of fees highlighted in this recommendation, but assume that the analysis on pricing in Chapter 8 has been used as a basis.</p>	<p>Newly introduced transparent transaction processing rules will minimise the occurrence of returned debit orders. This should provide significant relief to low income earners, who through no fault of their own, would not have funds to cover debit orders (for example their salaries not being paid on time), and whose accounts are debited on numerous occasions by holders of debit orders trying to ‘chase’ the credit.</p>
iv	<p><i>Compliance by banks of the pricing disclosure requirements should be</i></p>	<p>Standard Bank currently offers customers both bundled and unbundled options. This is in order to best serve the underlying customers needs.</p>	

	<p><i>monitored.</i></p> <p><i>Government should monitor the compliance by banks of the unbundled pricing disclosure requirements and undertake periodic evaluations of the impact of disclosure requirements on the effective functioning of the banking system.</i></p>	<p>We propose that the Code of Banking Practice ('the Code) should be amended to include disclosure requirements and this should be monitored or fall within the terms of reference of the Ombudsman for Banking Services.</p>	
v	<p><i>Sharing of client information (with client consent) should be common practice, to lower information barriers to entry into banking and switching between banks.</i></p> <p><i>Government should introduce legislation that will enable sharing of client information (with client consent) so that if consumers choose to switch their accounts, information barriers to switching will be reduced.</i></p>	<p>Standard Bank believes that information disclosure levels are adequate in all sub-markets in which it operates. We agree that standard factual information, regarding SMEs should always be available to the acquiring bank. The client is entitled to the information, and can instruct the losing bank to deliver it to the acquiring bank. The following standard reports can be obtained from the losing bank:</p> <ul style="list-style-type: none"> <li>• So-called 'coded interbank reports' on how the client has been handling his or her cheque account.</li> <li>• So-called 'full and general' reports on the banks' understanding of the client's financial status;</li> <li>• Audited (or certified) annual financial statements;</li> <li>• Any client wishing to shop for alternative credit or banking services is entitled to obtain a full record of his or her dealings with the current bank.</li> </ul> <p>We do not believe that it is valid to release proprietary information developed by the bank for its own purposes.</p>	<p>Since the report had been published a large amount of work has been undertaken to facilitate transferring bank accounts and actively assisting customers in moving debit and stop orders to new banks.</p>

vi	<p><i>Government should pass enabling legislation for second-and-third-tier banks.</i></p> <p><i>Government should move away from the current monolithic bank legislation and should introduce a multi-tiered banking system, with second-and-third-tier banks, at the earliest opportunity. The current requirements of the Banks Act are too onerous for specialised retail banks and undermine competition. The legislation that will enable the formation of 2<sup>nd</sup> and 3<sup>d</sup> tier banks should be implemented as a top priority.</i></p>	<p>Standard Bank is not aware of any bank having opposed the facilitation of second-and-third tier banks.</p>	<p>Developments have overtaken this recommendation – government introduced and then withdrew the Designated Banks Bill. Government has also introduced the Co-operatives Banks Bill.</p>
vii	<p><i>While greater access to financial services is to be welcomed, a National Bank Account defined in terms of price-fixing and collusion or a subsidy to one or more of the big banks is likely to have anti-competitive implications and should be avoided.</i></p> <p><i>A National Bank Account defined in terms of price-fixing or collusion and/or a subsidy to one or more of the</i></p>	<p>Standard Bank aims to avoid building any anti-competitive features into any of its products. Standard Bank, together with other banks, proposed the Mzansi initiative. Our understanding is that the Falkena report gave its support to the Mzansi initiative.</p>	<p>Developments have overtaken this recommendation, with the launching of Mzansi.</p>

	<p><i>big banks will pre-empt competition and should be avoided. In addition, if such a National Bank Account is defined without electronic transmission facilities for payments and/or if it excludes small business, it is likely to be inappropriate</i></p>		
viii	<p><i>Government should investigate the feasibility of transforming the Postbank into a state-owned bank that can effectively provide deposit taking and electronic transmission facilities to the lowest-income groups and the unemployed.</i></p> <p><i>Government should investigate the feasibility of transforming the Postbank into a state-owned bank that can effectively provide deposit taking and electronic transmission facilities, with a mandate that is limited to the lowest-income groups and the unemployed. The success of such an initiative is dependent upon a fundamental reorganisation of the Postbank, the transfer of accountability for the Postbank to National</i></p>	<p>We recognise the important role that the Postbank can and does play, and so support this recommendation.</p> <p>Standard Bank has sponsored Postbank / SAPO in the ATM / Saswitch environment for several years. We currently sponsor Postbank in Electronic Funds Transfer (EFT) and are currently in discussions with them regarding Debit Card. This current role performed by Standard Bank includes providing mentorship and technical capability.</p>	

	<i>Treasury, and the introduction of a leadership group with a proven track record in the management of an institution such as the Postbank.</i>		
ix	<i>Government should promote entry of and competition by foreign banks, potentially by adopting the EU approach in respect of home-country capitalisation for host-country branches as opposed to current arrangements, which require foreign banks to establish a subsidiary or be separately capitalised.</i>	We welcome the entry of foreign banks, but are not convinced that foreign banks require an incentive to enter the South African market by offering home-country capitalisation; the nature of the underlying market in itself needs to be attractive for broad market entry by a foreign bank. Attractiveness includes, amongst others, the ability to generate returns that meet shareholder expectations given the risk profile of an investment, and the ability to generate growth over a sustained period. Any entry by foreign banks needs to be on a “level playing fields” basis, so any home-country capitalisation would need to be reciprocal.	Standard Bank had hoped that foreign banks would enter the South African market and would specifically contribute to addressing challenges facing low income consumers. Since the Falkena report was published Standard Chartered came into South Africa, but later withdrew from its 20/20 initiative. Barclays also entered the South African market though purchasing Absa.
x	<i>The Task Group supports and wishes to see extended the principle of interoperability in the National Payments System and transparency of access currently being promoted by the National Payments System Department of the SA Reserve Bank. In addition, it would like to see full access of second-tier banks and the Postbank to the payments system on competitive terms.</i>	Standard Bank believes that access to the National Payment System (NPS) is transparent. We do not oppose access to the NPS provided the new participant falls within the existing participation criteria. Continued interoperability depends heavily on the confidence of counter parties and the appropriate management of counterparty risk  Access to the NPS is overseen by the South African Reserve Bank (SARB), and is in the public domain managed by Payments Association of South Africa (PASA) under a mandate granted by the South African Reserve Bank. PASA membership is available to all approved banks in accordance with the Banks Act and	Standard Bank supports the extension of access to the NPS Act, taking due account of any risk to the system and the need to maintain a stable and strong banking sector. Currently the banks support such extensions through sponsorship arrangements.

		upon fulfilling predominantly operational conditions. Entry criteria for participation in the NPS are clearly defined and available in the public domain.	
xi	<i>Government should investigate the feasibility of implementing a narrow e-money directive that would allow suitably regulated non-banks to take part in electronic transmission facilities. This will not necessarily impose a new regulatory burden on the authorities, as the definition of e-money can be restricted to small amounts, defined as pre-paid, carry insurance in the form of a percentage amount held in collateral and not paying interest. Such a definition of e-money would not necessarily carry systemic risk and would facilitate access to the benefits of formalised electronic transmission facilities for many consumers currently not served by the banks.</i>	<p>We have used the limited analysis contained in the Task Group Report in Chapters 6.1 and 11.3 to comment on this recommendation. Further clarification and detail would be required in order to provide a more detailed comment, including target sub-markets, float holding, types of transactions supported, and transaction exclusions.</p> <p>The South African Reserve Bank (SARB) released a Position Paper on Electronic Money - April 1999 (NPS 11/99). Recent changes in the NPS Act allow SARB to issue directives to regulate participation in the NPS, one of these directives is currently in the draft phase addressing the above recommendation.</p> <p>This directive will help facilitate the further entry of non-banks in the e-money and more common payment mechanism arenas. A brief summary of the directive, which Standard Bank supports, is as follows: Non-banks will be able to continue to issue payments mechanisms within a closed loop environment e.g. an in company e-money type purse to facilitate payments sundry (e.g. canteen) within the company, without regulatory intervention.</p> <p>Non-banks will be able to issue payment mechanisms within defined markets in conjunction with a bank. This will assist the regulators to ease the ability of non banks to provide payment mechanisms, whilst utilising existing regulatory obligations on banks to assist in monitoring risk, etc</p> <p>Standard Bank supports this recommendation through</p>	<p>Standard Bank has launched two money transmission products:</p> <ol style="list-style-type: none"> <li>1. Mzansi Money transfer: This is an industry initiative, whereby customers can transfer funds between any participating SA banks at a fee.</li> <li>2. Standard Bank has also launched a cross-border money transfer product know as Moneygram which allows funds to be transferred across the border to affiliated institutions.</li> </ol> <p>For both products, neither the payer nor payee has to hold a bank account.</p> <p>We think there is considerable potential to use e-money (as opposed to smart card and e-purse) to address the needs of low income communities. We also support the recommendation that non-banks should participate in the system.</p>

		the draft directive, with the proviso that the systemic risk to the financial system is not compromised.	
xii	<i>The concept of complex monopoly should become part of the general remit of the Competition Commission. (A complex monopoly occurs when firms, whether voluntarily or not and with or without agreement between them, so conduct their business that it prevents, restricts or distorts competition. This would give the Competition Commission scope to investigate anti-competitive behaviour even where it does not involve proven collusion.)</i>	Standard Bank believes that the view that a complex monopoly operates in the banking sector in South Africa is incorrect and unsubstantiated.  We do not at this stage have a firm view as to whether the concept of “complex monopoly” should become part of the general remit of the Competition Commission.	
xiii	<i>The Competition Commission should investigate the possibility of a complex monopoly in the operation of the payments system.</i>	“Complex monopoly” has no meaning in South African competition law.	The Competition Commission is currently investigating competition in the banking sector. As Standard Bank, we believe that the industry is competitive, and will co-operate with the Competition Commission in its enquiry.
xiv	<i>Government should prohibit any preferential processing mechanism for payments.</i>  <i>Government should prohibit any payment processing mechanism that results in favouring any institution. The</i>	This is consistent with current SARB policy.	This has been done as in the National Credit Act (NCA) and the introduction of AEDO and NAEDO.

	<i>rules of the National Payment System regarding the processing order of payment instructions should be transparent. Accordingly, the rules should disallow any preferential treatment of payment instructions in favour of an account-holding bank.</i>		
xv	<p><i>Government should establish a deposit-insurance scheme for all banks.</i></p> <p><i>Government should establish a deposit-insurance scheme, which will enable smaller banks to compete on a more level playing field with the large banks in the field of retail deposit taking, and that may assist in preventing second- and third-tier failures leading to contagion. The successful introduction of a second- and third-tier banking component is dependent upon the simultaneous introduction of a comprehensive deposit-guarantee scheme.</i></p>		<p>Government accepted that a deposit insurance scheme should be introduced, and the Policy Board for Financial Services submitted a first report on the possible design parameters of such a scheme to the Minister of Finance in 2002. The intent of the report was to facilitate certain detailed policy decisions by government so that the scheme could be developed.</p> <p>Standard Bank worked with government to do this and was on the SARB committee which refereed proposals 4 years ago.</p>
xvi	<i>All bank and payment regulators should be required</i>	The Report highlights the potential impact of regulation on competition, and the balance that is required between	

	<p><i>to consider the competitive impact of their regulation.</i></p> <p><i>Regulation has the capacity (whether intended or not) to impair competition. To guard against this, all bank and payment regulators should be required to consider the competitive impact of regulation. In addition, regulators might consider the impact on competition of existing legislation.</i></p>	<p>stability, efficiency, effectiveness and consumer protection. Onerous regulation increases the costs of compliance, and raises the barriers to competition. We therefore welcome this recommendation.</p> <p>Standard Bank will continue to welcome the opportunity to engage with regulators as and when changes to legislation are proposed.</p>	
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### **Methodological concerns with the Falkena Report**

	<b>Methodological concern</b>	<b>Standard Bank's summary view</b>
1	The Falkena Report makes heavy use of two primary sources, both resulting from enquiries into competition in the UK Banking market <sup>2</sup>	Standard Bank believes that these enquiries are amongst the most comprehensive studies conducted globally into competition in banking. Standard Bank welcomes the use of these reports as a basis to provide a framework for an enquiry of this nature. However, Standard Bank notes that both enquiries, particularly the latter enquiry, had a significant focus on the small and medium enterprise (SME) sub-market, and were conducted in the context of a developed and mature banking market. Hence, while Standard Bank acknowledges that these conclusions for other sub-markets may be applicable in the particular South African sub-market, we would be uncomfortable accepting them as valid without the detailed underlying supporting analysis for the South African sub-market. In line with the report's own characterisation of itself as a pilot study, we do not believe the required level of analysis has been conducted to properly establish the report's conclusions.
2	The <b>definition of excess returns</b> is	Standard Bank believes this test of excessive returns and the inference that effective competition is

<sup>2</sup> The primary sources were 'Competition in UK Banking' by Don Cruickshank; and 'The supply of banking services by clearing banks to small and medium sized enterprises' by members of the Competition Commission.

<p>outlined in Chapter 1.4 of the Task Group Report as “... <i>a rate of return on equity in excess of the cost of capital...</i>”. The concept of profitability and excess returns is again elaborated on in Chapter 1.9. It is stated that “...<i>if most or all suppliers have a return on capital greater than the cost of capital on a basis adjusted to represent long-term profitability, there is likely to be excess profits and an absence of fully effective competition.</i>”</p>	<p>absent, to be flawed. Firstly, calculating an accurate cost of capital and return on capital requires a wide range of subtleties to be dealt with, including amongst many other factors, appropriate adjustments for country risk, market risk, target capital structure etc. We find no evidence that a sophisticated calculation of costs and returns has been carried out. Secondly, a differential between cost of capital and return on capital is not a sufficient condition for the absence of fully effective competition.</p>
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