



# **Presentation by SBSA to the Competition Commission**

## **Pricing and related issues**

18th June 2007



## SBSA representatives

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- Sim Tshabalala – CEO: Personal & Business Banking
- Peter Schlebusch – Deputy CEO: Personal & Business Banking
- Darrel Orsmond – Director: Retail Projects
- Ian Sinton – Head of Legal: CIB
- Stephan Malherbe – Genesis Analytics
- Jean Meijer – Bowman Gilfillan Inc



## What we hope to demonstrate

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- SBSA is not dominant in any relevant market and does not have market power. Product features do not constitute separate markets
- SBSA's transaction banking products are characterised by falling prices, strong market growth, low switching costs and significant churn. None of this is consistent with dominance or its abuse
- Banking services are by their nature complex, but SBSA has taken steps and has further proposals to reduce complexity and enhance transparency
- Penalty fees are a normal feature of banking and should be set at a level that discourages behaviour that creates risk
- The ATM model in South Africa has resulted in significant competing infrastructure and a strongly expanding market



## Transaction banking: dominance

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- SBSA's market shares are below 35% in all relevant markets
- In the transaction banking space, competition occurs between offerings of transaction accounts – each with a bundle of *features* such as deposits, cash withdrawals and debit order facilities
- Customers decide which transaction account bundle to purchase – they do not, and cannot, purchase individual features separately
- Therefore market power in transaction banking needs to be assessed not per feature, but by probing competition between the transaction account bundles
- Likewise, pricing needs to be assessed in terms of the total amount payable for the bundle of services, not the pricing of individual features



## Transaction banking: intensity of competition

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- The annual churn rates for SBSA's personal banking products range between 11% (homeloans) and 38% (credit cards)
- The annual churn rate for transaction accounts is 20%
- As most costs are fixed, a failure to win a large number of new customers every year would materially impact profitability
- As SBSA does not discriminate against existing customers in order to win new customers, this reality imposes pricing discipline on SBSA with respect to all of its customers



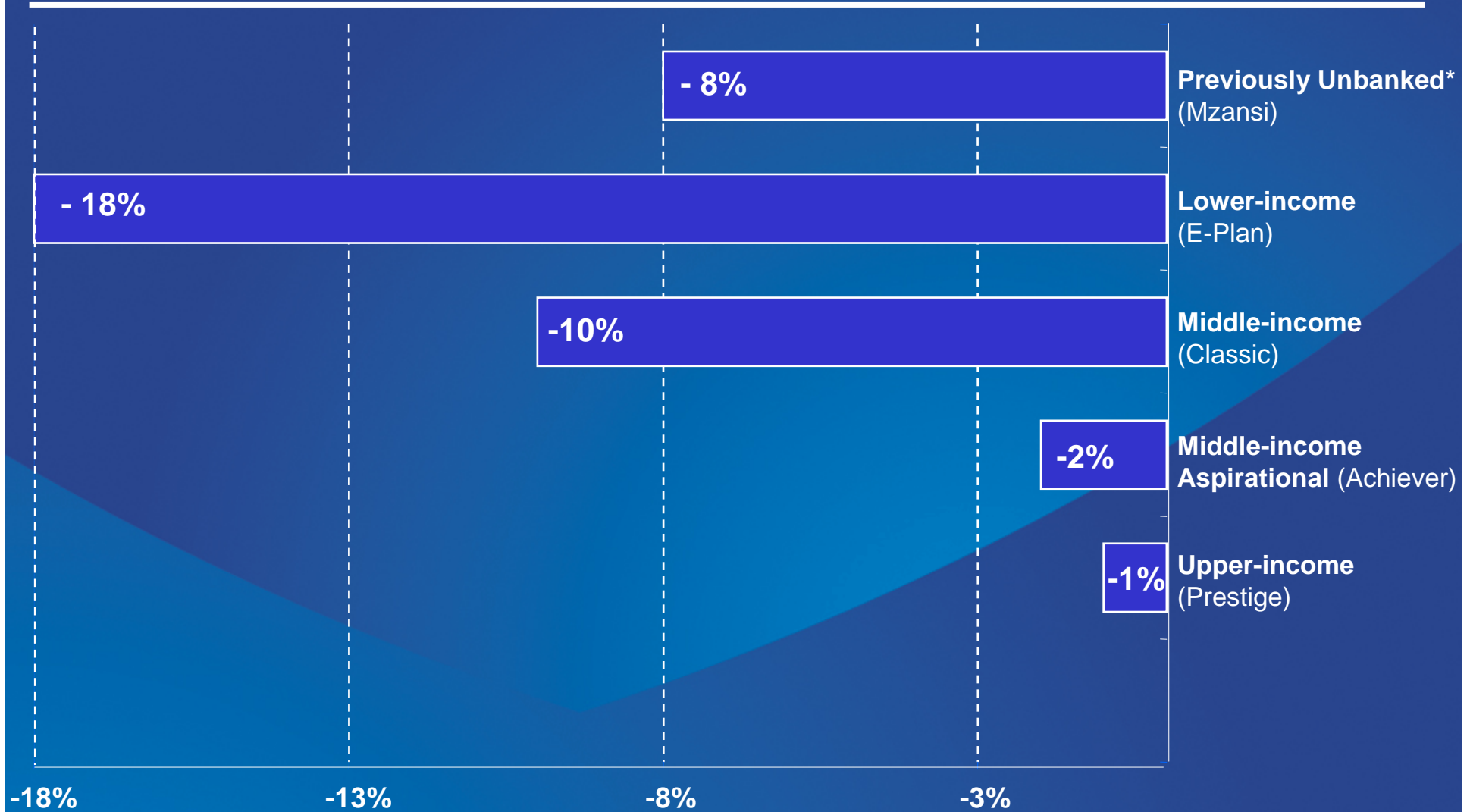
## Transaction banking: switching costs

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- Actual switching costs are low: in the case of transaction banking, 1-3% of costs faced by customers
- Debt is not a barrier to switching. Borrowers are not required to hold transaction accounts with SBSA
- In South Africa today, home loans, vehicle finance and credit card facilities are in any event commonly sourced from banks other than the 'main' transaction bank for that customer
- In the case of current account overdraft facilities, banks readily offer competing facilities on equal or better terms



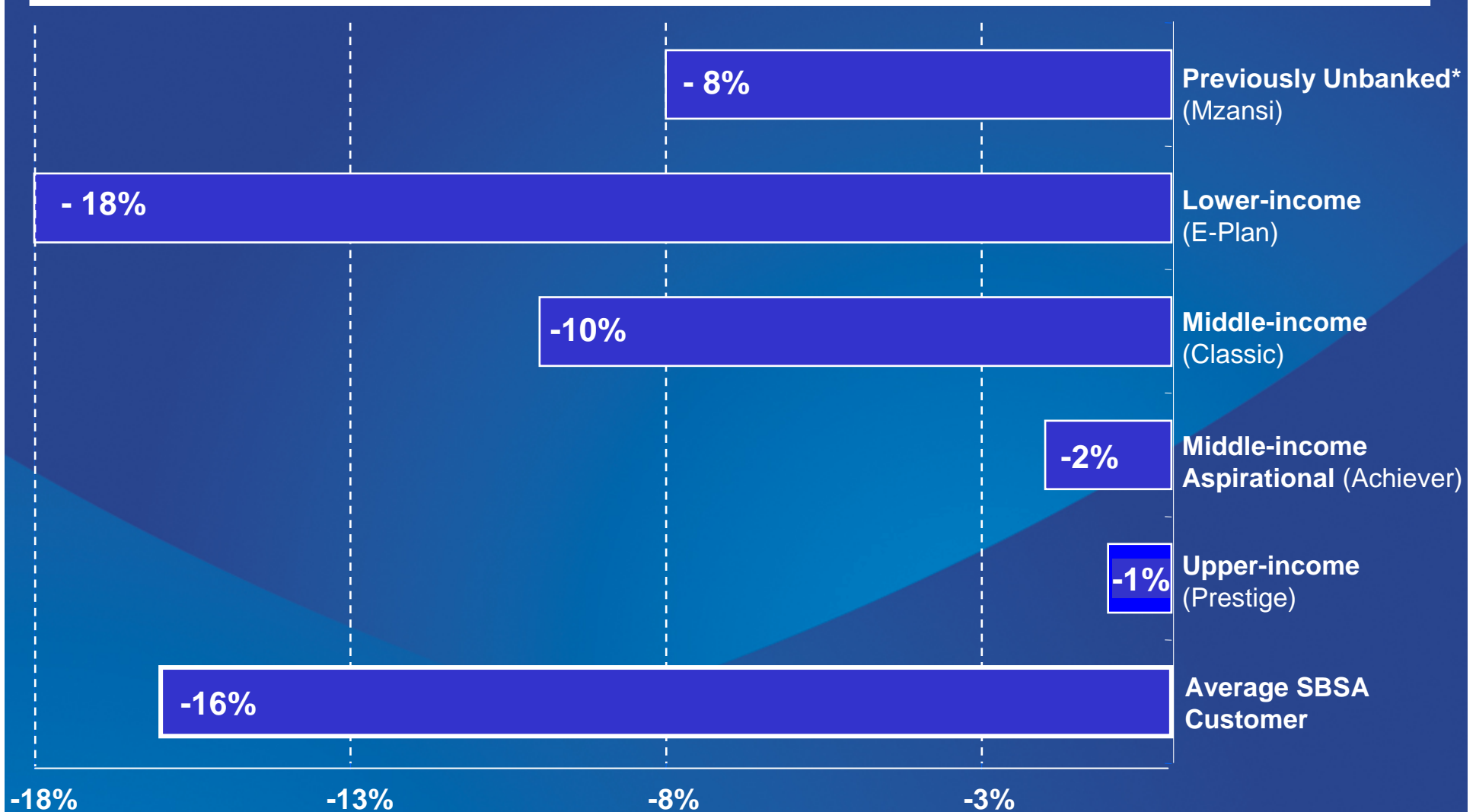
# Change in the real cost of SBSA's transaction offerings over the last 5 years



Calculated over 2002-2007 (\*2004-2007 for Mzansi) using 2006 SBSA median usage profiles for each category deflated by CPIX. 'Average SBSA Customer' calculation excludes Mzansi due to differing time periods



# Change in the real cost of SBSA's transaction offerings over the last 5 years



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## Transaction banking: quality improvements

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We compete in many respects other than price:  
Product mix, service, infrastructure, cost of production, convenience, channel availability and brand

There has been an increase in the quality of banking services over the same period

- Expanded infrastructure
- New channels
- New services and features

Therefore the quality-adjusted price change over the period is better than the numbers suggest



## Transaction banking: SBSA's market growth

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Over the period SBSA's number of transaction banking customers has increased by **45%** – a gain of **two million account-holders**



## Complexity of banking products

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- SBSA's products and the needs that they meet are simple
- The combination of service delivery channels and the way in which customers use products creates complexity
- We offer variety to meet different needs: this enhances competition
- Side-note: the resulting complexity makes co-ordination between the banks on end-user pricing impossible



# Complexity of banking products

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- SBSA's products with a fixed monthly fee are a market-driven response to the perceived problem of complexity
  - This facilitates comparison
  - The Finweek survey found SBSA's fixed-fee products to be significantly cheaper than those of competitors
- A classic current account can be compared directly with other banks' basic current account offerings
- Mzansi is a common banking product (and thus easy to compare) but this is only desirable to achieve social objectives. Mzansi:
  - outsources product development
  - creates rigidity and stifles innovation and competition
  - would be inappropriate in the middle market due to the diversity of needs and customer types



## Proposal for easier comparison and increased customer understanding

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- SBSA is committed to making it easier for customers to compare
- SBSA suggests that there be a common set of six to eight customer profiles – determined by a third party with input from the banks
  - Applicable to transaction accounts for middle-market personal customers
  - A customer will be able to identify which profile is closest to his or her behavioral patterns and will be able to request any bank to provide the solutions for that profile
  - This will make comparison easier while encouraging innovation and competition
  - This approach also deals with the heterogeneous nature of the middle market in a way that a single ‘basic’ product cannot



## Different pricing to different segments

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- We build different packages for different profile customers – taking into account their transactional behaviour
- Our objective is to increase volume – for example by offering banking to low income customers that may not be profitable if fixed costs were fully allocated
- The Mzansi offering is only possible because of the segmentation that prevents wholesale migration of other customers to an account that is unprofitable
- Customers can choose the option that suits them best – our proposal regarding common profiles will facilitate appropriate selection



- A penalty fee is a fee for a breach of contract (cost and value issues do not arise)
- Penalty fees are not a major source of revenue
- Intended to discourage undesirable behaviour (and must be high enough to do so) that may:
  - increase costs
  - cause legal risk
  - compromise brand and reputation
  - attract scrutiny by the regulator



## Self regulation of penalty fees

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- In instances where the customer loses control over the discouraged behaviour, SBSA has:
  - reduced the fee
  - implemented long term changes to give the customer more control
- Example: in the case of direct debits SBSA:
  - decreased the penalty fee before any other bank
  - capped the number of penalty fees possible on a customer's account to two per month
  - implemented AEDO and NAEDO to prevent direct debits running before the salary run or after the full salary has been withdrawn



## Carriage fees: increases in the 1990s

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- SBSA believes that the increases in 1997 and 1998 were motivated by the fact that the existing carriage fee (set more than 10 years earlier) was too low
- This is proven by the behaviour of banks (such as Nedbank) for whom it was cheaper to pay carriage fees than to further develop their own infrastructure
- This implies that the carriage fee did not cover the overall costs of provision of the service



## Carriage fees: increases in the 1990s

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- Persistence of a carriage fee that was too low would be costly to the infrastructure provider, to the economy and the competitive process
  - Commercially - SBSA was not securing an adequate return on its investment and was subsidising a transaction banking competitor
  - Economically - if returns on investment remained artificially depressed, investment would be reduced to sub-optimal levels
  - Competitively - investment by incumbents as well as new entrants in infrastructure would be discouraged
- These effects were reversed when the carriage fees were set at a more appropriate level - After the 1997/1998 increases, the major banks expanded their ATM footprints



## Carriage fees: increases in the 1990s

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- SBSA acted with a business rationale and in its own best interests, which were different to other banks' interests (e.g. Nedbank)
- SBSA's network is not essential infrastructure – we would not be obliged to give a competitor access
- Banks have historically provided access to their ATM infrastructure despite not being legally required to do so
  - SBSA's voluntary provision of interoperability is evidence of a desire to enhance competition in the banking system, not harm it



## Carriage fees: increases in the 1990s

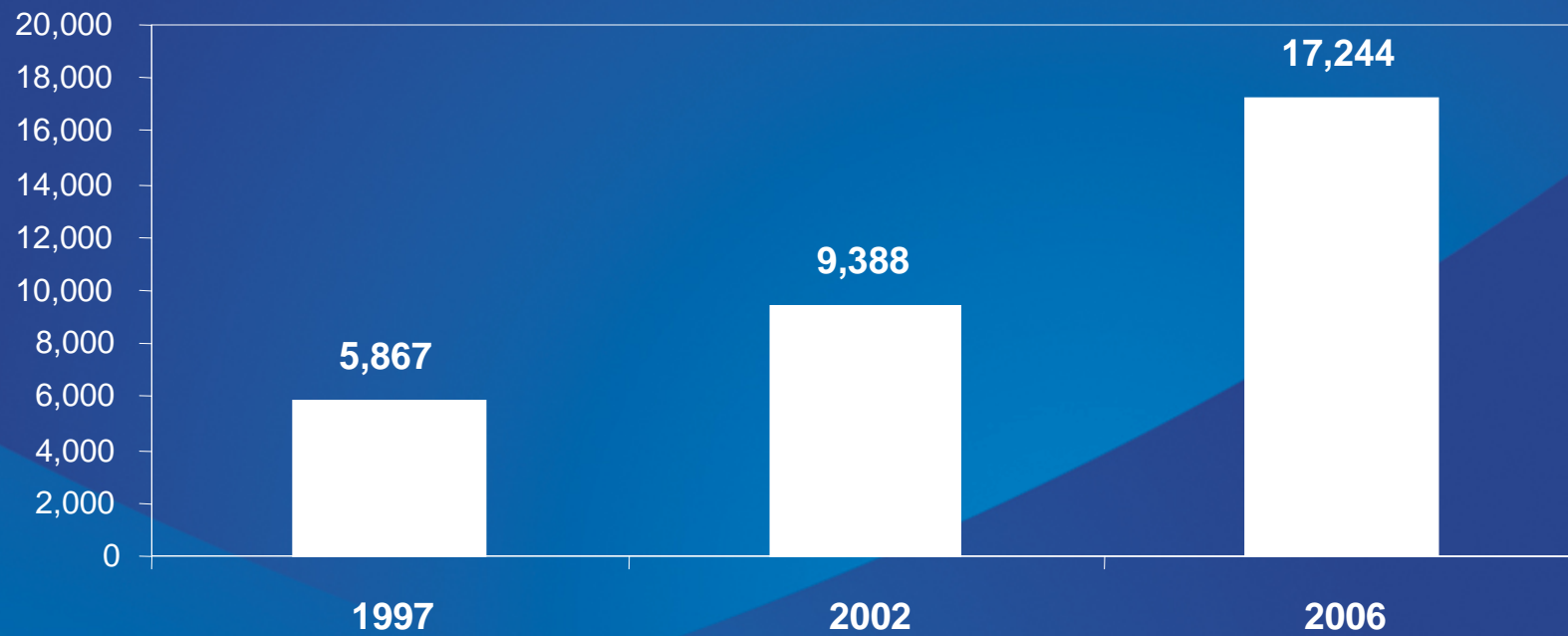
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- No additional information about the 1997 increase letter
- In relation to the 1998 increase letter:
  - bilateral discussions had been unsuccessful
  - SBSA was motivated by concern about free-riding
  - SBSA did not anticipate the response – expected strong opposition and further attempts at bilaterals
  - Bankserv's technology constraints did not play any role
  - SBSA considered refusing to give competitors access to its network



## Increase in the ATM footprint

### Number of ATMs in South Africa





## Introduction of the Saswitch fee

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- SBSA believes that it was a late mover in introducing the Saswitch fee
- When SBSA introduced the Saswitch fee, for most customers there was no real price increase as they could use an SBSA ATM
- There was unlikely to be customer inconvenience because of SBSA's extensive footprint
- There were alternatives such as credit card and telephone banking



## It is not possible for SBSA to change the carriage fee today

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- It has not been possible to change the carriage fees since the signature of the PCH agreement
  - Banks are obliged to interconnect
  - The interconnection fee must be bilaterally agreed and is therefore subject to the bargaining power (and differing incentives) of all other banks
  - SBSA was unable to conclude bilaterals with Absa or FNB
- Arbitration is not a desirable or practical means of setting prices



## Has the PCH Agreement resulted in customer allocation?

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- The carriage fee model was the established approach internationally and in South Africa – The PCH Agreement reflects that model
- The purpose of the PCH Agreement is to facilitate and regulate interoperability – not to influence the development of or competition in the market
- The effect of the PCH agreement and carriage fees has been the development of a number of substantial competing ATM infrastructures in South Africa
- There is currently no separate market for off-us ATM services
- The Enquiry is the only forum in which the banks can debate and potentially adopt a direct charging model. In principle, SBSA supports a direct charging model



## Concluding remarks

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- This process presents an important opportunity to improve the competitiveness and responsiveness of our banking system
- At least as far as SBSA is concerned, we believe that there have been no contraventions of the Competition Act
- Important proposals are emerging from the process, including:
  - Regulated processes for setting interchange fees for debit card, credit card and other payment instruments
  - Direct charging for off-us ATM transactions
  - Access to the NPS for non-banks subject to appropriate regulation
  - Various measures to increase transparency and facilitate comparisons of banking products
- SBSA looks forward to co-operating further with the panel on these and other proposals to strengthen competition in the banking sector and increase value to customers



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# Questions