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**Competition Commission Complainant,
erstwhile Banker, Businessman and
disgruntled banking client**

Competition Commission

Submission:

Enquiry into Competition in Banking in South
Africa

October 2006

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Background

A. Raymond Leonard ("RL")

1. I am a retired Fellow member of both the Institute of Chartered Secretaries and the Institute of Chartered Management Accountants.
2. I worked in the Banking Industry from 1970 to 1989. In the 19 years my responsibilities involved every facet of computerization, administration, treasury and accounting, including both management and financial accounting. I occupied many positions and my final position was as General Manager - Finance and Administration for the subsidiary of one of the four major South African Banks.
3. Since 1989 I have been directly involved in the Information Technology Industry specializing in supplying, developing, installing and maintaining software systems for the Financial Services Industry in USA, Europe, Africa, Australia and Asia.
4. I have also project managed the implementation of strategic inter-bank systems for the South African Clearing Banks.
5. Submissions I make as to the workings of the banks are made as from personal experience and I am led to believe that little of the substance has changed even if the mechanism has changed slightly.
6. I have made complaints against certain banks on the basis of Competition law contravention which are part of a larger litigation process which the banks have initiated against me. I am lead to believe that my complaints formed some of the primary concerns that have resulted in the banking enquiry.
7. I have now retired from active business and am therefore able to devote time to issues that are of public interest where I believe that I can add some value.

B. Terms of Reference ("TOR")

1. I have reviewed the terms of reference ("TOR") and my interpretation of the logical categories and therefore my approach to the paragraph format in my submission, is as follows:
 - a. Level and structure of charges
 - b. Relationship between the costs of providing and charging for services.
 - c. The process by which charges are set
 - d. Level and scope of competition in regard to setting of charges
 - e. The feasibility of improving access by non-banks to the NPS, so they can compete.
 - f. Any other aspects relating to payment systems or the above mentioned charges that could be regarded as anti-competitive.

C. Purpose of this Submission

1. I have, as individual and businessman, over the last few years, become increasingly dissatisfied with the Banking Industry in general but with the "big four clearing banks" ("B4") in particular. It appears as though the B4 believe that they are above the law or at least untouchable because of their association with the South African Reserve Bank ("SARB") and the immense depth of their pockets for funding of legal actions, which they are able to drag on long enough to run the coffers of the small and middle size businesses and private individuals dry!
2. It was not until the advent of the Competition legislation that this playing field has been leveled to some degree!
3. It is only with the Competition authorities as the gate keeper that it is possible for the man in the street to be able to gain access to the platform and information that is necessary for a submission of this magnitude to be worthwhile to the Enquiry.
4. For this reason I am approaching this submission on the basis that it is the first of two prongs and therefore purely sets out the basic complaint and highlights the information that I believe should be requested from the B4 for presentation to the Panel so that the Panel can question the B4 in more detail in regard to specific complaints and issues.

5. Should the Enquiry deem it appropriate, I am willing to make myself available to comment on the Banks responses and/or submissions and to assist in framing relevant questions to be put to the Banks at the open enquiry in respect of issues of public interest.

Either way I would like to participate in the Enquiry!

D. General Comments

1. The Banking Industry has undergone exceptional transformation over the last twenty years. The following historical facts have partly shaped the development of the banking industry as we know it today.
 - a. The number of "Clearing Banks" has reduced from more than twenty to five.
 - b. Clearing has moved from a wholly manual and localized, almost suburban, system to a massive national partially computerized MICR system.
 - c. Classification of "banks" has changed so that we no longer have categories of, for example, "building society" or "general bank" thus moving to "all things to all people".
 - d. International and cross-border banking has become common place.
 - e. The presence, in RSA, of International Banks without clearing status has increased
 - f. Micro-Banking has become common place.
 - g. Clearing risk has increased exponentially with the reduction in the number of clearers and the centralization of systems.
 - h. Computerisation has taken over from previously manual systems and the sophistication of the systems has improved markedly, however many of the processes currently used are little more than automated manual systems which entrench competitive advantage and maintain income margins for the B4.
 - i. Banks are now, in reality, large IT companies with banking licenses and in many cases compete openly with IT companies. They also, with or without the aid of the SARB, block competition from the IT companies of the implementation of non-proprietary software, in what they see as their turf!
 - j. Banking in South Africa, historically, operated openly as a cartel based on the "Register of Cooperation between Banks" ("ROCO"). Although the register was disbanded in the early eighties the cooperation has continued nevertheless albeit on a less formal basis.

- k. The Banks and the SARB having been alerted to the probability of an enquiry by the Competition Commission have been systematically changing procedures and processes in preparation for the enquiry. Some of the changes that I am aware of are as follows:
- i. Banks earning of interest on clients electronic payments has been curtailed to some degree.
 - ii. Second tier banking facilities have been introduced under the name of Mzansi.
 - iii. Excessive bank charges have been partially reduced or increases curtailed. Nedbank's advertised R80 million reductions in fees over the next year is no less than a "confession" in my mind!
 - iv. Limitation of information on websites or the removal of information has become evident. For example the COSAB website has been withdrawn from the web!
 - v. The official restriction by SARB on "sorting at source" (SaS) has been "temporarily" removed but blocked in practice through intimidation.

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Submission

(a). The level and structure of bank charges

1. My complaint is more directed at the proliferation of "no value-add charging entities or engines" that have found their way into the system. I would therefore like to focus on the structure of the various entities that make up the overall industry with the emphasis on establishing:
 - i. If there is a genuine need for the entity in the future or if it is just a monopolistic protection mechanism.
 - ii. If it is essential for, the security of the payments system, that those entities should not be owned or controlled by the B4 but regulated or state controlled. If not the B4 should be required to divest in accordance with a strictly controlled timetable.
2. Charges are levied based on this structure, and as a result there is an exponential escalation in the number of charges through unnecessarily duplicating services or alternatively using the structure to prevent clients from minimizing their costs and potential competitors from entering the arena. In this I refer specifically to the following:
 - a. BankServ
 - b. SASWITCH and other payment switches
 - c. ACB
 - d. NPS
 - e. Internet electronic payments
 - f. EFTpos
 - g. Magtape exchange.
 - h. BMA
 - i. Unexcor
 - j. Central Depository
 - k. Bankscan

- I. Numerous others that I am sure the Panel will be able to identify during the course of the Enquiry
3. Some of these structures were originated before the turn of the millennium and are therefore not relevant to a fully electronic banking system. The structures however remain in place as a sound source of revenue and in most cases a deterrent to competitors.
4. In some cases the services started their lives as competition either between individual banks or by competitors to the banks but the B4 soon joined forces to limit competition amongst them and to block external competitors. Saswitch is a prime example of this.
5. If through this Enquiry the proliferation of entities that levy "charges" can be curtailed then that will go a long way to reducing the overall cost of banking.
6. More important than the "disclosed charges" are the undisclosed or hidden costs incurred by clients or conversely the "undisclosed" profits earned by the B4, some of which are in my opinion illicit! Examples of this are as follows:
 - a. Interest earned by the Banks on their clients' local electronic (Internet) payments in transit from one bank to another must be closely investigated as there is no systemic justification for this anomaly that nets the Banks billions of Rands at the expense of their clients.
 - b. Although the B4 will go to great lengths to justify their actions, there are two arguments to consider as background:
 - i. The Automated Clearing Bureau ("ACB") was commissioned in the 70's, in the days of ROCO, as a partially computerized system but with a HUGE manual administration overhead for the moving of cheques around the country. In commissioning the system the B4 (or B10 as it probably was then) were able to move a proverbial mountain of manual cheques around the country and still make sure that the debit and credit went through on the same day. If it did not then the Banks would lose the day's interest which they were clearly NOT prepared to countenance. Yet the same banks having spent literally billions of Rands on sophisticated computer systems claim that, for purely technical reasons, they cannot provide an electronic banking system that passes the credit and debit on the same day, thus they earn for themselves billions of Rands in interest on their clients' money!
 - ii. Most certainly two of the B4, if not all four, do NOT use their homegrown local systems in their Off-shore operations as these systems are inadequate for the provision of competitive client orientated banking systems in the international banking market. The reason for this is primarily the fact that SWIFT and the international banking clientele require both "transaction date" and "value date fields" to enable the bank to process payments and to ensure that the interest is earned by the correct party and NOT by the bank!
7. Interest earned by local banks on foreign currency receipts and payments, on behalf of clients, are another area that requires careful scrutiny. The undisclosed profits earned by the B4, thus lost revenue to their clients is vast! The current processes are designed in a way that the local bank earns interest on their clients money for between three and five days on international transactions whilst the beneficial owner of the interest is kept at arms length through a series of archaic semi-automated and bureaucratic systems that would be "laughed at" by a sophisticated international banking community.
 - a. Standard World Wide Interchange for Financial Transactions ("SWIFT") is the system used by banks worldwide to process foreign transactions and is specifically designed to allow international payments to be processed so that the banks clients earn interest

on "their own funds in transit" and NOT the banks. A "value date" field is provided for this purpose. Despite this the B4 manage to massage SWIFT messages into a semi manual process that suits their pockets.

- b. This manipulation of interest arises because of the local systems lack of the required date fields being "value date" and "transaction date" as well as the fact that there is no seamless interface between the local systems and SWIFT. This has in my opinion been done deliberately as all other systems where the B4 could make profits have been integrated.
- c. The lack of sophistication of the local banking populous is another factor that allows the B4 to get away with this. How would Joe Public know that if he pays his credit card electronically that the debit and credit should, according to accepted international norms, be processed with the same "value" date and thus he should benefit from the interest and not the B4. When you consider the exorbitant interest rates applicable to credit cards and the fact that it sometimes takes five or six days for an electronic credit to reflect on a credit card statement, this little "quirk" in the system costs Joe Public in the region of R3.00 per R1000 payment per month. A significant bank charge when viewed against the advertised charge for processing of a manual cheque!!!

(b). Relationship between the costs of providing and charging for service.

1. There is no relationship whatsoever! Pricing of charges is not based on a cost + profit but rather on a "what can we get away with" approach. In most cases price escalations are not related to anything except the profit margin of the banks. A review by the Panel, of the B4 budgeting processes would highlight this!
2. As an example, take a look at the Automated Teller Machines ("ATM") system locally.
 - a. All ATMs are connected to their host via SASWITCH although some ATMs are "owned" by ABSA and others by FNB or any one of the B4 for that matter.
 - b. Given this there can be no justification for the B4 to charge more for a cash withdrawal for a non-client than for a client. The transactions are identical from a technological point of view; the only difference is who owns the ATM.
 - c. Some years back it was mooted that the ATMs should be owned by SASWITCH instead of the Banks. This was thrown out as a "bad idea" because then the excessive additional non-client revenue could not be charged!
3. I am however, personally, not as concerned about this aspect as I am about the proliferation of "charging engines" as I believe that the "sins of the B4" will become quite clear under the next section (c) which analyses the processes used to arrive at the costs and the respective mark-up on each product.
4. Perhaps under that section they will be able to justify how they arrive at the conclusion that the cost of processing debit orders for a small client is higher than a larger client.

5. If the playing field is leveled then this area will become openly competitive and the charges will settle accordingly.

(c).The process by which charges are set.

1. There is not doubt in my mind that the "old cartel" is still today colluding in the setting of charges and prices for services and products and this continues to raise its head as the major issue in the mind of Joe Public.
2. The only way to properly investigate the manner in which charges are set is for the B4 to be "requested" to produce for the Panel and the Complainants details of the processes that they use to set charges.
3. It is universally accepted that Activity Based Costing ("ABC") is the "standard" for arriving at the true cost of a process and I would appreciate the opportunity to analyse the B4 costing systems to formulate an opinion on the validity of their approaches.
 - a. If they do use an ABC system across the board they will not be able to justify the excess non-client ATM charges based on my example in section (b).
 - b. Uncovering the processes by which the B4 set their charges will give the Enquiry some insight into the Banks own views of the relationships between the cost and the charge for each product.

(d). The level and scope of competition.

1. I appreciate that there is a balance between competition and integrity of the Banking industry but I believe that there has been wholesale abuse by the B4 of their "fiduciary" positions and as such this Enquiry is long overdue.
2. The role of the SARB is to protect the integrity of the banking process and the industry and not necessarily to monitor aspects relating to competition
3. Over the last twenty years the Banking industry has become very concentrated and although there are many reasons for this, some of which are valid, I will not explore them here as it does not form part of the TOR.
4. It has been pointed out to me that the preamble of the Competition Act reads: That apartheid and other discriminatory laws and practices of the past resulted in excessive concentrations of ownership and control within the national economy, inadequate restraints against anti-competitive trade practices, and unjust restrictions on full and free participation in the economy by all South Africans. I find this most appropriate as the point that I make here is that the industry is concentrated and that this concentration has facilitated and made possible the cartel activities of the banks.

5. The question is then "what has this concentration into the B4 done to competition and how does this affect the resultant cost of services" and the ability of the B4 to continue their domination of the Industry to the detriment of the Small and Medium Enterprise ("SME") at a time when the economy is becoming more and more orientated towards and dependent on SMEs for growth in the Economy
6. In my view, in simple terms, the concentration has allowed the B4 to unfairly CONTROL a large playing field which includes areas that would NOT necessarily be the domain of the Banking Industry as they do not for part of the critical areas around "settlement risk"
7. This extended footprint allows the Banks to dictate the level of charges as well as the structures through which these charges are earned and not surprisingly the earnings flow back to the Banks from the utility companies.
8. A review of the entities, and not just the NPS, listed under section (a) will show the extent to which the B4 control the Industry through second tier structures!
9. Whilst the Enquiry is taking place there is a ground swell of changes that the B4 are making in an attempt to "whitewash" the Panel in to believing that all is well. For this reason any examples that I provide will be challenged on the basis that the B4 are in the process of changing or have changed the process.
10. Be that as it may, examples are essential to the Panel, and so I will use one that I know that the B4 have changed or are in the process of changing and in fact the change may just be seen as acknowledgement of a prior indiscretion!
 - a. The Magtape Exchange Service ("MTS") is a service provided by BankServ's wholly owned subsidiary ACB. This service is primarily directed at high-volume Debit Order ("DO") users. It is antiquated and is in the process of being phased out because the electronic equipment being used is redundant and has to be replaced. The cost of replacement is prohibitive!
 - b. The MTS was initially anticompetitive, and specifically set up for this purpose by the B4, in that the BankServ rules provided that all "mag-tapes" had to be submitted via ACB and that no Bank could or would accept an MTS tape direct. The B4 have adhered religiously to this rule. The MTS however became vulnerable due to its age and the increasingly poor value-add and non-competitive and poor service and gave rise to a very lucrative "cottage IT industry" called Sorting at Source ("SaS").
 - c. Simply, SaS is a service offered by the IT industry, to pre-sort clients DO's into the B4 clearing codes and then submit them direct to the individual clearers (B4) thus saving their clients from having to pay the ACB fee and the Interchange Fee ("IF") where applicable. This impacted the B4 revenues significantly and they approached the SARB to curtail the practice. Although SARB declared the practice to be "unacceptable" they could NOT ban it outright and so they "intimidated" potential users of SaS by saying that it would affect their "credit rating"? Whatever that meant, it effectively killed SaS.
 - d. At this stage the Competition Commission Banking Enquiry was mooted and so the SARB has lifted the "moratorium" on SaS and the IT companies are again allowed to participate in SaS even if it is only temporarily. The IT industry have been advised by the Manager of NPS that the moratorium will be reintroduced in the future!

- e. This time the Banks are better prepared and so they are openly competing with SaS by reducing their charges and notably dropping the IF to prevent the SaS operators from entering the market.

11. Right off the bat it would seem to be contraventions of Section 8(a),(b) and (c)

12. Section 8 Abuse of dominance

It is prohibited for a dominant firm to-

- (a) *charge an excessive price to the detriment of consumers;*
- (b) *refuse to give a competitor access to an essential facility when it is economically feasible to do so;*
- (c) *engage in an exclusionary act, other than an act listed in paragraph (d), if the anti-competitive effect of that act outweighs its technological, efficiency or other pro-competitive, gain; or*
- (d) ...

13. This is a large scale anti-competitive practice that once again shows the B4 flagrant disregard for the Competition Legislation in the protection of what they see as their turf!!?

(e). The feasibility of improving the access by non-banks to the NPS, so they can compete.

1. The NPS is a National Asset and as such it should be available to anyone who wishes to participate. The essential facility doctrine is well covered in Competition Law and should be applied. The qualification for membership should not be based on whether you have a Banking Licence but on whether you:
 - a. Add value to the process and reduce transaction costs
 - b. Do not increase the risk in the settlement process
 - c. Qualify to have a settlement account with the SARB on reasonable terms.
2. I, however, don't think that the NPS is the central concern, provided that SaS and other peripheral solutions that add immense value are allowed and provided that the NPS does not start to take over functions from other B4 Utility Companies when the Commission pressure is felt in the banking utility industry!

(f). Any other aspects relating to payment systems or the above mentioned charges that could be regarded as anti-competitive.

1. The issue that is most difficult to deal with is that of the cartel!
2. Up and until about a year ago The Register of Cooperation ("ROCO") reigned supreme although it was no longer openly "above the line," it was fully functional below the line! Since then the whole cartel operation has gone further underground. The only way to uncover this, is through the enquiry directing specific questions to the B4 as part of their investigation.
3. The removal of the concurrent jurisdiction or authority of the SARB over anti-competitive conduct in the banking industry, thereby giving the Competition authorities exclusive jurisdiction which will oust bias, nepotism and vested interest within the banking industry.
4. The tying of other services and products to standard services, i.e. the compulsory insurance tied to mortgage loans. The packaging of products and concomitant package charges that defy logic. Section 8(d)(iii)

(i) Banking Cartel

1. Pre-1985 there was no pretence about the South African banks NOT being a cartel! They were, they accepted it and so did everyone else. The Banks regulated the agreements between themselves by what they called "The Register of Co-operation" which was commonly referred to as ROCO.
2. This persisted until the eighties when pressure was brought to bear on the banks to become independently competitive and to cancel ROCO. Although this was "formally" achieved with great fanfare, the banks have never really been released from the mentality of ROCO.
3. Up until a year ago banks still operated much the same as they always have, they just steered away from formal arrangements and made "informal" agreements which would fall foul of the definition in the Act of : "agreement", which when used in relation to a prohibited practice, includes a contract, arrangement or understanding, whether or not legally enforceable."
4. This will continue until the Competition authorities puts a stop to it!
5. Apart from the SARB there are two major structures in South Africa that support the informal cartel and they are:
 - a. The Banking Association of South Africa (Its third or fourth name in 8 years?)
 - b. BankServ

(ii) The Banking Association of South Africa

1. The Banking Association in its new guise is no different, from what I can see, to COSAB and its forerunners that effectively replaced ROCO.
2. Either way it was an amalgamation of most of the old style Associations like the Association of General Banks, The Clearing Bankers Association and more, a move that did little to show 'conviction' about NOT being a cartel.
3. The role of the Association in their own words, on their website, is to "establish and maintain a platform on which banking groups can do responsible, competitive and profitable banking....." The important aspects are not what they purport to be doing but the platform that has been established on which all this will be done. Surely if they all agree on a process then how can it be competitive? Certainly appears to be cartel activity.
4. Association Board members are all the CEO's of the major Banks
5. Association members are, or were, 36 Banking institutions, both South African and international.
6. The executive has then set up Committees and Task Groups that cover inter alia the following:
 - Agriculture
 - Asset based finance
 - Banks act risk and compliance
 - CFO's committee
 - Communications committee
 - Debtors finance committee
 - Independent Banks forum
 - Trading risk committee
 - Debit orders task group
 - Liquidators task group
 - Report on parties task group
 - Common approach accord
 - Micro-Finance
 - Netting (Which I think may be their view of SaS)

Plus many more!!

7. To compound matters they then have the Code Of Banking Practice, which represents itself as being a "watch dog" for the Bank clients when in fact it is no more than an agreement between Banks on how to conduct certain aspects of banking business. The setting of standards mean that one party will not try harder to outdo their competitor because it has been agreed and the customer loses out on non-price competition.
8. The committees and task groups are no less than "forums" for the "below the line continuation" of ROCO.
9. In my personal capacity I have recently had an exchange of documents with Nedbank where my Legal representatives served papers in defense of a Nedbank action, on the Nedbank Attorney. Within a day copies of my affidavits had been distributed to Standard Bank who in turn provided copies to their Attorneys Werksmans and asked for comment. Nedbank's Attorney, Alan Lowndes, in addition volunteered to my legal representative, that my matter had been referred to a meeting of the Banks executives as my allegations "could change the way that the Banks do business". This in itself is a collusive practice!

(iii) BankServ

1. BankServ like the Association is an amalgamation of various banking entities. In this case it is companies that previously served the Banking industry such as ACB and Saswitch”
2. Over the years numerous service companies had sprung up, ACB, Saswitch, Bankscan, Joint Banks Credit Bureau, Central Depository and Unexcor as well as others.
3. Each service company had a different structure and shareholding and Bankserv was formed, by the B4, initially to crowd out the smaller Banks, as well as the foreign Banks. To some degree they were forced to loosen their grip and include smaller and even foreign banks, but not completely as can be seen from the structure of Bankserv where the Board and Shareholders are reflected as:
 - ABSA
 - Bank Athens
 - Citigroup
 - Capitec
 - FNB
 - Investec
 - Mercantile
 - Lisbon
 - Nedcor
 - Saambou
 - Standard
 - Teba
4. We would need to review the shareholders and other agreements to gain insight into the TRUE position! What is interesting is that as a concerned person I am not able to assess information such as who are the shareholders of an entity that controls such an integral part of the banking mechanism. Does not say much for the transparency of the institution and their corporate governance.

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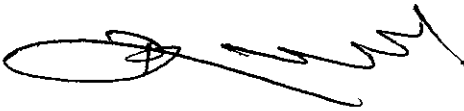
Banking Documentation required to be submitted to the Enquiry Panel.

1. Details of all investments by the B4 in any banking industry service company
2. Copies of all shareholders and any other agreements related to these companies.
3. Details of all memberships in banking related associations, committees, and forums of any nature.
4. Copies of constitutions, terms of reference and minutes.
5. Copies of minutes of all meetings whether internal to the particular bank or the utility, committee, association or forum for the last five years. Taking particular note of the entities that I have listed under the heading Banking Council.
6. Names and contact details of all their staff or directors who serve or who have served in any position for any "bank utility" company in the last five years.
7. Names and contact details of any executive or staff member who serves or who has served on any committee related to any bank utility company, association, committee or forum in the last five years.
8. Details of their costing systems and their approach to product costing.
9. Details of all internet or electronic banking committees or task groups where the B4 discuss the interface of their local systems with specific reference to their inability to seamlessly transfer funds with either same date or an agreed value date.
10. Subpoena the local SWIFT representative to discuss openly how the local approach to international payments differs from International standards as anticipated by SWIFT
11. Subpoena one or two international IT specialists to comment on the validity of the B4 approach to the interface of electronic payments!

I accept that some of this information might be out dated in that it was drawn two years ago at the time of my initial submission to the Competition Commission, but then I also contend that many of the changes now evident have been made as a result of my submission to the Competition Commission, i.e. the Cosab website has been removed from the public eye so it is difficult for me to update the information.

In making this submission I do not waive or reject any part of my initial and subsequently amended complaints to the Competition Commission.

This submission is made me Raymond Leonard in my personal capacity and signed at Sunninghill on 26 October 2006.

A handwritten signature in black ink, appearing to read 'Raymond Leonard', with a large, stylized initial 'R'.

Raymond Leonard