

## Chapter 4

### Penalty Fees

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## Introduction

The market power of the major banks is particularly manifest in their charging of penalty fees.

In dealing separately with the subject of penalty fees, we confine our analysis to the fees charged by banks to individual retail customers when the customer's payment order is refused, usually for lack of funds. These fees are commonly referred to as *dishonour fees*. The data relied on relate only to personal transaction accounts (PTAs) and thus exclude corporate and other business customers.

Within the category of dishonour fees, we have further concentrated on fees charged for rejected debit orders. In this area we have seen clear indications of a growing problem of abuse. Cheques, on the other hand, are in decline as a means of payment and the risks for banks which arise when cheques are written against insufficient funds are significantly different from those involved in the routine processing of debit orders.

Penalty fees are difficult to define and banks ascribe different meanings to the term. For example the higher per transaction fee that may be charged to a customer who uses more than the permissible number of transactions in a particular bundle may or may not be specified as a penalty. There is no magic in the label. We have not considered it necessary to analyse such fees separately from our general treatment of costing and pricing in the previous chapter. The same applies to fees charged for rejected ATM transactions – even though, technically, they could be included among dishonour fees.

A number of other categories of penalty fees, charged in the past by South African banks, are now outlawed in terms of the National Credit Act. These have been summarised by FNB at our request:<sup>1</sup>

- *Honouring Fee (Excess Item or Excess Availment Fee)*. These fees are charged when a bank makes the exceptional decision to honour a cheque or debit order presented for payment against an insufficient balance, based on the bank's knowledge of, and relationship with, the customer in question.
- *Late Payment Fees on Credit Cards*. This is a fee charged when the minimum payment due on a credit card is not received [REDACTED]
- *Over Limit Fees on Credit Cards*. This is a fee charged when a customer exceeds his/her credit card limit [REDACTED]

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<sup>1</sup> FRB, August 2007, The impact of the NCA on the charging of penalty fees, p 2. The document explains: "The NCA, among many other things, governs the interest, fees and charges that may be levied in respect of any applicable credit transaction from 1 June 2007. The NCA lists the interest, fees and charges that are permitted, sets out how these should be calculated and imposes maximum interest rates, fees and charges. No other interest, fees or charges relating to any lending or credit transaction are permissible under the NCA."

- *Penalty Interest.* This is additional interest at 3 per cent on the portion of a balance that exceeds the agreed account limit.
- *Early Settlement Penalty Interest.* Certain term loans (such as vehicle finance loans) charge three months penalty interest on early settlement of a loan, unless three months' notice of settlement of the loan is given.

Our concern is essentially with fees for dishonoured or rejected debit orders (dishonour fees), which make up the bulk of the penalty fees still levied by banks, primarily for insufficient funds. In the data presented below, the figures for dishonoured cheques and stop orders are lumped together with the figures for debit orders because these figures have not generally been separated in the information submitted by the banks. [REDACTED]

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Table 1 shows the four major banks' fee revenues from dishonour fees in 2006, together with the volumes (i.e. number) of such transactions. Almost R1 billion accrued to the big four banks in 2006, for almost 24 million dishonoured or rejected transactions, from around R11 billion non-interest revenue for PTAs.

**Table 1 Dishonour fee revenues and volumes (debit orders, stop orders & cheques)**

2006 Data	Total PTA non-interest income (R)	Revenue from dishonour fees (R)	Number of dishonour transactions	Average revenue per transaction (R)	As % of Total PTA non-interest revenue
Absa	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
FNB	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Nedbank	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Standard Bank	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Total	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

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FRB  
Nedbank  
SBSA

Source: Banks' Submissions, March & April 2007, Part A Data Request.

Table 2 and Table 3 show the levels of the penalty fees charged by these banks for each dishonoured transaction on basic transmission accounts (savings accounts) and on current accounts respectively. They provide a recent historical view of changes in the dishonour fees (which have been applied at the same level to all rejected debit orders, stop orders and cheques). Comparative data for Capitec Bank is also included where applicable, namely in respect of basic transmission accounts.

<sup>2</sup> Standard Bank has stated that its penalty fee revenue is less than 3% of its total fee income from personal and business banking. However, by including business banking, a much larger category than PTAs is created, within which rejected debit orders (on the paying side) would obviously have a far smaller part. (See SBSA, August 2007, Second Submission, Part A Data Request, Annexure 2, p 2.)

**Table 2 Penalty fees for dishonoured transactions on basic transmission accounts**

Dishonour fee (cheques, debit orders and stop orders)	2003	2004	2005	2006	2007	2008
FNB Smart Accounts	R 110.00	R 110.00	R 55.00	R 40.00	R 40.00	R 30.00
Absa FlexiSave <sup>3</sup>	R 65.00	R 110.00	R 110.00	R 36.00	R 36.00	R 36.00
Nedbank Transactor	R 110.00	R 75.00	R 75.00	R 50.00	R 50.00	R 28.00
SBSA E Plan	R 30.00	R 30.00	R 31.50	R 31.50	R 31.50	R 31.50
Capitec Global One	R 10.00	R 10.00	R 2.00	R 3.00	R 3.00	R 3.50

Source: Infochoice, 2007 and Banks Pricing Brochures 2008.

The data in Table 2 suggests that – typically from 2004/2005, although Standard Bank was slightly earlier – the banks revised their dishonour fees on transmission accounts downwards. It was around this time that the fees on basic transmission accounts came under scrutiny due to the Financial Sector Charter. The downward trend in fees is less apparent, if at all, in the case of current accounts (see Table 3<sup>4</sup>).

**Table 3 Penalty fees for dishonoured transactions on current accounts**

Dishonour fee (cheques, debit orders and stop orders)	2003	2004	2005	2006	2007	2008
FNB Personal Cheque Accounts	R110.00	R110.00	R110.00	R95.00	R95.00	R95.00
Absa Sliver Current Account	R100.00	R110.00	R110.00	R100.00	R100.00	R 100.00
Nedbank Everyday Current Account	R110.00	R75.00	R75.00	R75.00	R75.00	R75.00
SBSA Classic Current Account	R100.00	R110.00	R115.00	R99.00	R99.00	R 105.00

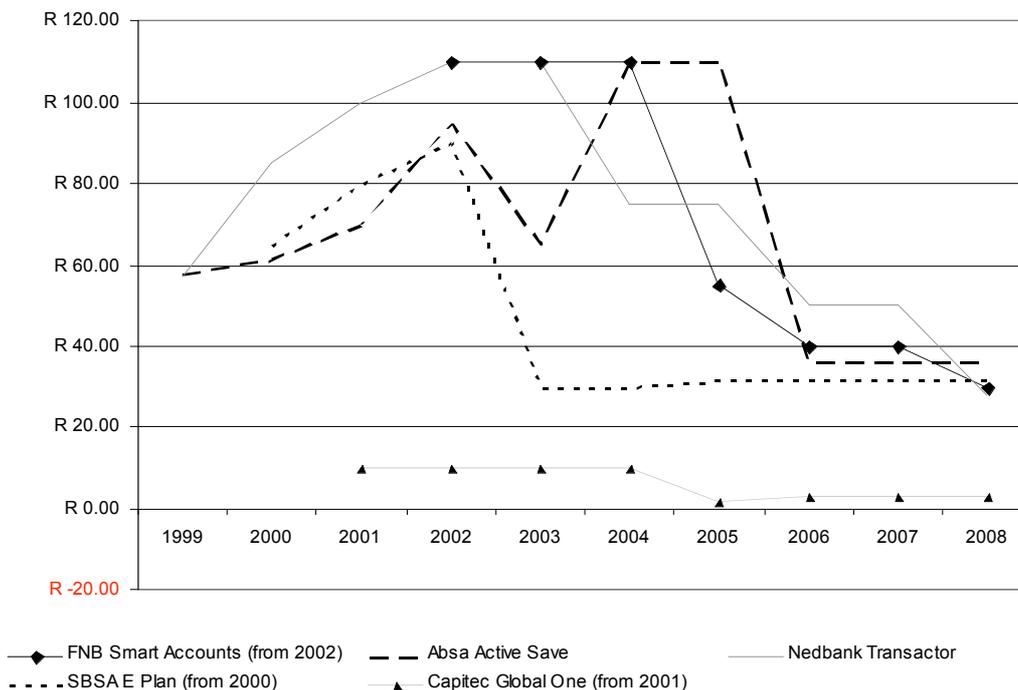
Source: Infochoice, 2007 and Banks Pricing Brochures 2008.

Figure 1 and Figure 2 present in graphic form the historical data contained in Table 2 and Table 3 respectively, together with comparable information going back to 1999 where available.

It should be noted that FNB's dishonour fees indicated in Table 2 and Table 3 – and thus carried over to the graphs in Figure 1 and Figure 2 – are expressed in the bank's pricing brochures as "minimum" fees. The same applies to Absa's 2008 pricing brochure. We shall return to the significance of this in due course (Section 4.4.3).

<sup>3</sup> This account has been renamed the Flexi Account in 2008.

<sup>4</sup> This is perhaps one of the few areas where price changes have been to the benefit of transmission account holders rather than more affluent current account holders.

**Figure 1 Historical view of dishonour fees on transmission accounts**

Source: Infochoice, 2007<sup>5</sup> and Banks Pricing Brochures 2008.

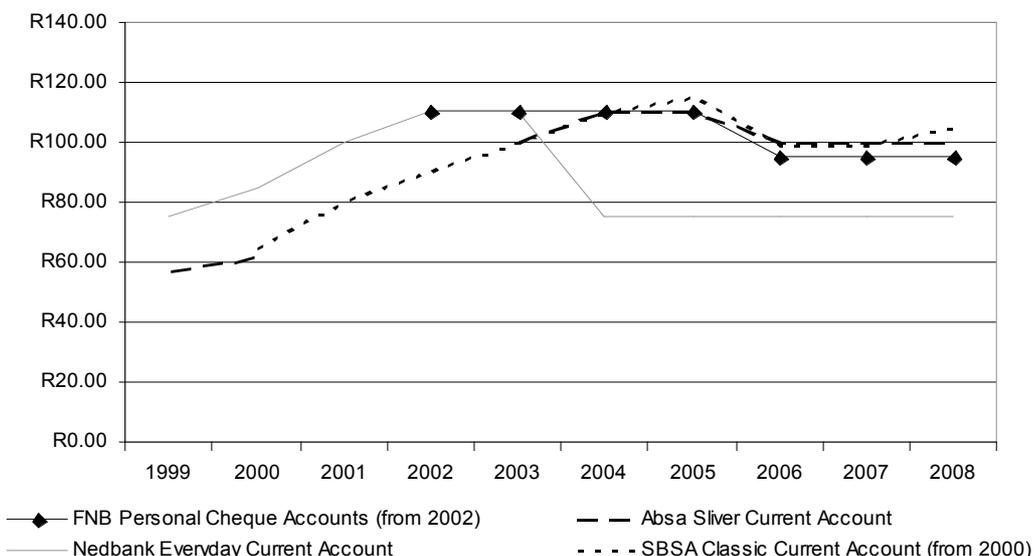
Between 1999 and 2002, it appears that dishonour fees charged by the four major banks on transmission accounts were generally increasing despite the entry of Capitec.<sup>6</sup> After 2002, Standard Bank was the first to reduce its fee, followed by FNB and Nedbank. Even then, however, their fees remained much higher than those of Capitec. Capitec's dishonour fees are set at only R3.50 per item in 2008, compared with R28.00 per item charged by the lowest among the major banks. All this suggests that, while other major banks' penalty fees may provide a restraint on each of the big banks' pricing of such fees (which are simply comparable across banks), there does not appear to be an imperative to price-compete with a relatively minor player like Capitec. Moreover, as we shall go on to show, penalty fees are not competed down to any identifiable relationship to cost.

As Figure 2 shows, dishonour fees on current accounts have not decreased in recent years to the extent observed on transmission accounts.

<sup>5</sup> Data is incomplete for some of the banks, prior to 2002. This is as provided by Infochoice, and does not necessarily suggest that there was no fee charged at the time.

<sup>6</sup> Excluding the Mzansi accounts, these are the account types most similar to the Capitec Global One account.

**Figure 2 Historical view of dishonour fees on current accounts**



Source: Infochoice, 2007<sup>7</sup> and Banks Pricing Brochures 2008.

#### 4.1 Relationship between the cost of and fees for rejected debit orders

It is evident that no relationship exists between costs incurred by the major banks and the dishonour fees which they charge. This basic evaluation by Mr Weeks of the Enquiry’s Technical Team at the outset of the hearings on pricing behaviour and market power, presented in Figure 3, was never refuted.<sup>8</sup> The same transaction type, which should have roughly similar processing costs, attracts a substantially different penalty fee on different types of account. Moreover, there are huge disparities in the penalty fees charged by different banks for the same transaction.

The four major banks were asked to provide unit costs for various transactions in PTAs. Two banks, FNB and Nedbank, provided the requested information – although with qualifications that cost allocations can be misleading where used for different purposes. We accept that the unit costs reported are only approximations. Nevertheless, on savings accounts, FNB reported a transaction cost of [REDACTED] per successful debit order, [REDACTED]

[REDACTED]  
 [REDACTED]  
 [REDACTED]  
 [REDACTED]

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<sup>7</sup> Data is incomplete for some of the banks, prior to 2002. This is as provided by Infochoice, and does not necessarily suggest that there was no fee charged at the time.

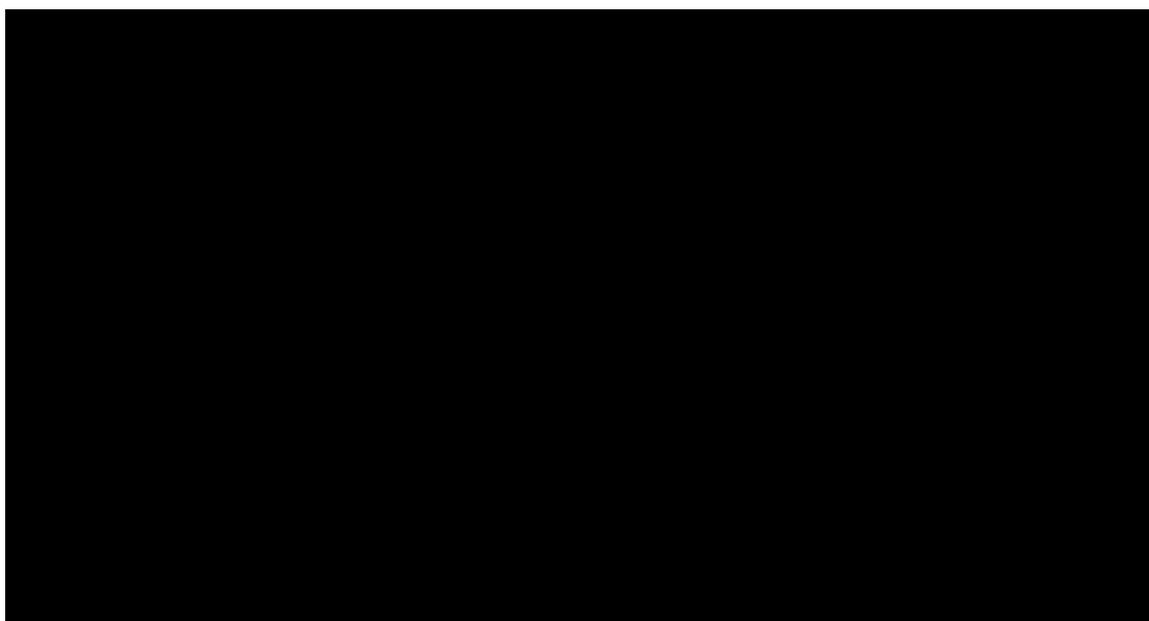
<sup>8</sup> Transcript 18 June 2007, p 30.

FNB stated that, in general, “penalty fees are levied at high enough levels to cover the costs of the transaction” – a considerable understatement – “but more importantly to change customer undesirable behaviour.”<sup>9</sup> Mr. Shuter of Nedbank maintained at the hearings that “the level of penalty fees in Nedbank are reasonable relative to the various costs the bank incurs when clients default relative to the market”, [REDACTED]

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[REDACTED]<sup>10</sup>

**Figure 3 Estimated cost and pricing of debit orders (FNB and Nedbank, 2006)**



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Source: FRB and Nedbank, March 2007, Second Submissions, Part A data request, Infochoice, 2007, and Pricing Brochures<sup>11</sup>

We have no reason to suppose that the situation is significantly different where Absa and Standard Bank are concerned.

## 4.2 Penalty fees as a growing stream of revenue for the major banks

The volumes (number) of transactions attracting penalty fees have increased substantially over the past five years. This is apparent from the detailed figures supplied by FNB, which are set out in Table 4. Disaggregated historical data of this kind was not supplied by the other major banks, so a direct comparison has not been possible. However, there is no

<sup>9</sup> See FRB, March 2007, Second Submission, Part A Data Request, p 8.

<sup>10</sup> See Transcript 9 July 2007, pp 124-128.

<sup>11</sup> In FRB, March 2007, Second Submission, Part A Data Request, p 11, the dishonour fee “currently charged” on Smart Transmission Accounts was given as [REDACTED]. In fact, according to FNB’s pricing brochures, the minimum dishonour fee at that time was R40 per item. It was reduced to R30 with effect from 1 June 2007.

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reason to suppose that the trends have been significantly different in their case. It is clear from the information below that rejected debit orders make up the vast majority of dishonoured transactions. The volume of rejected debit orders increased by more than 90% between 2002 and 2006, As has been mentioned above, the decline of cheques as a payment instrument has been influential in the decline in the number of rejected cheques over this period.

**Table 4 Volumes of selected transactions on which penalty fees were charged (FNB)**

Type of fee	2002	2003	2004	2005	2006
Dishonour fee - debit order	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Dishonour fee - stop order	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Dishonour fee - cheque	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Card replacement fee	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Declined transaction fee - another ATM	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Declined transaction fee – own ATM	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Grand Total	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

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Source: FRB, March 2007, Second Submission, Part A Data Request.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] Even if these are disregarded, the historical trend remains clear. Revenue from dishonouring fees has increased most substantially. [REDACTED]

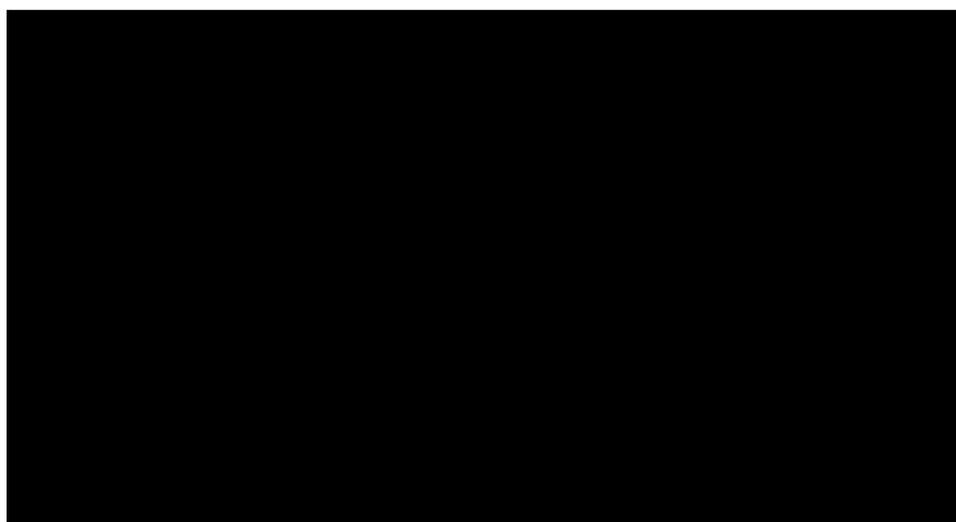
[REDACTED]

[REDACTED]

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**Figure 4 Revenue from penalty fees (FNB)**



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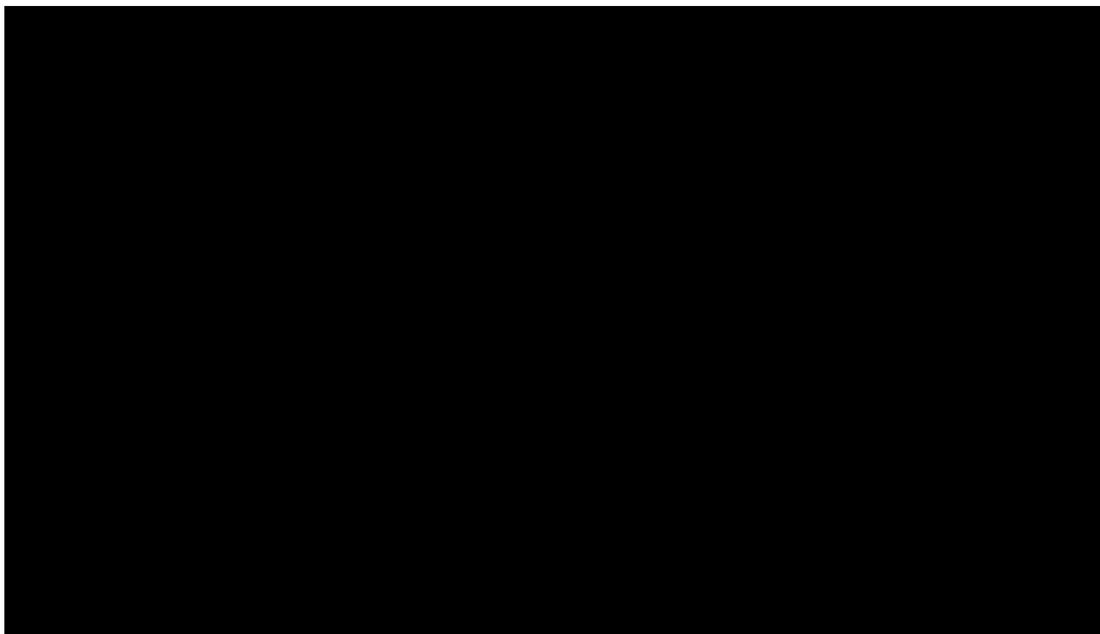
FRB, March 2007, Second Submission, Part A Data Request.

Total revenue is the product of price and quantity. Since the penalty fee (or “price”) charged for a dishonoured transaction has been reduced, it is important to ascertain whether or not the annual growth in the bank’s penalty fee revenue has been due simply to a growth in the number of PTAs. At the same time any annual change in the average number of dishonoured transactions per PTA must be identified.



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**Figure 5 Growth in the number of PTAs and dishonoured transactions (FNB)**

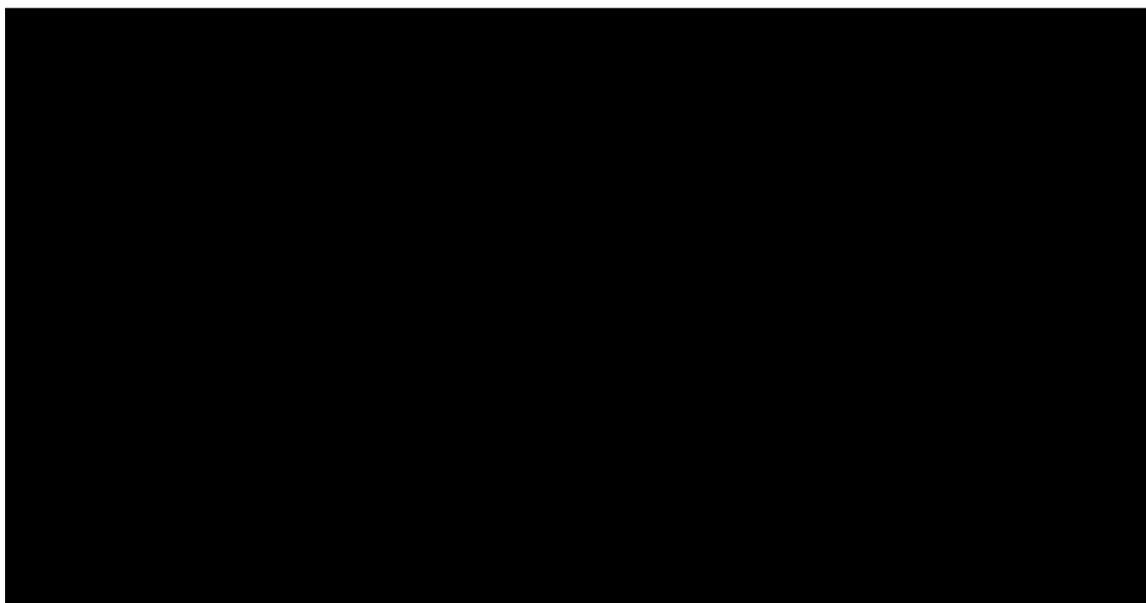


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*Source: FRB, March 2007, Second Submission, Part A Data Request.*



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**Figure 6 Average dishonour fees, and growth in dishonour fee revenue (FNB)**Confidential:  
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*FRB, March 2007, Second Submission, Part A Data Request, Pricing Brochures and Infochoice, 2007.*

Data provided by the major banks in respect of penalty fees have not been sufficient, or have not been sufficiently consistent, to allow precise comparisons to be made. However, analysis of the banks' responses to Parts A and B of the Technical Team's Data Request has revealed that the average rate at which debit orders are rejected, and thus attract a penalty fee, is roughly twice as high for basic savings or transmission accounts as for all PTAs taken together. In other words, in accounts typically held by lower income customers, a relatively high proportion of debit orders presented for payment are dishonoured for insufficient funds.<sup>12</sup> This means that the burden of penalty fees is falling disproportionately on those least able to afford them.<sup>13</sup> Where detailed data has been provided, indications are that as much or even more revenue is earned by banks from rejected debit orders on these accounts than from the processing of successful debit orders.

[Redacted text block]

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FRB, Absa,  
Nedbank

[Redacted text block] (The omission of Standard Bank from this analysis is the result of that bank's failure to provide comparable data at the product level.)

<sup>12</sup> Standard Bank reports that "89 percent of unpaids are due to the customer having insufficient funds in his or her account." (SBSA, August 2007, Second Submission, Part A Data Request, Annexure 3, p 2.)

<sup>13</sup> Cf the evaluation by Mr Weeks, Transcript 18 June 2007, p 29.

### 4.3 Need for consumer protection against exploitative penalty fees

Both the level and the volume of the fees charged for rejected debit orders by the major banks provide grounds for grave disquiet. In general, the vulnerability of the ordinary customer to exploitation and abuse through penalty fees is considerable. Payment by debit order is routinely required nowadays for all manner of regular services, which have become an essential part of everyday life. Reliance on debit orders is widespread throughout the mass market served by banks, and it is notable that debit order facilities have recently been added to the basic Mzansi account offerings.

True, the customer undertakes when opening a transaction account to have funds available in the account to meet any payment instruction which the customer issues. Penalty fees in the strictest sense are said to provide compensation for the bank for breach of contract by the customer, while discouraging such further behaviour. Although the bank, in rejecting the payment instruction, does not pay money out, it does incur costs and is said to be exposed to risk through the undisciplined and undesirable behaviour of its customer. Penalty fees are said to be a necessary means of protecting banks. While this argument may have validity where customers write cheques for which they have not provided sufficient funds, we are not persuaded by it as a justification for the dishonour fees currently being charged by the major banks where electronically-processed periodic payment orders are concerned.

The argument that penalty fees are necessary to deter “kite-flying” or “cross-firing” (the depositing of worthless cheques and drawing against them by the customer before the funds are cleared) has no evident relevance to debit orders. References to the cost of risk management systems needed to detect and forestall such activities would seem to be similarly limited in relevance.<sup>14</sup> Costs incurred by a bank in deciding whether or not to extend a credit facility to its customer who lacks sufficient funds to meet a debit order cannot legitimately be recovered by way of a dishonour fee; and honouring fees are now evidently prohibited by the National Credit Act (see above). The assertion that banks suffer significant harm to their commercial reputations when their customers’ debit orders are rejected as unpaid is supported neither by evidence nor (in our view) by the probabilities.<sup>15</sup> Merchants accepting or declining to accept debit orders from particular customers surely evaluate the likelihood of the customer defaulting, not the customer’s bank.

[REDACTED]

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Absa

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<sup>14</sup> See Transcript 18 June 2007, pp 89-93 (Mr Tshabalala of Standard Bank). Mr Shuter of Nedbank likewise sought to defend existing penalty fees for rejected debit orders with arguments which combined all types of customer default and the bank’s costs in managing them – including even the costs of debt collection: see e.g. Transcript 9 July 2007, p 134. We are not persuaded that penalty fees on rejected debit orders can be justified by these arguments.

<sup>15</sup> Cf Transcript *id.*, pp 140-141; SBSA, August 2007, Second Submission, Part A Data Request, p 2. Also see (FNB) Transcript 9 July 2008, pp 149-150.



in inhibiting undesirable behaviour, and that this is demonstrated by the fact that “the number of customers who incur a penalty fee more than once is much less than the number of customers who incur the first one.”<sup>22</sup> We do not find that reasoning convincing, and least of all where debit orders are concerned. Most customers signing debit orders will have no intention of defaulting, inter alia because they will want to retain the services for which their periodic payments are to be made. It is also unclear how many poorer customers simply abandon their bank accounts when faced with a penalty fee debit. [REDACTED]

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In our view, moreover, the whole argument based on “disciplining the customer” by way of the routine charging of penalty fees rests on an objectionable premise. By this line of argument, banks in effect assert a right to be judges in their own cause. Where dealings between ordinary mortals or companies are concerned, when one contracting party breaches their obligations and causes expense or loss to the other, the latter has to claim compensation and enforce that claim in the courts if payment is not forthcoming. Where a contractual penalty is specially provided for, the same applies. A bank, however, is in the unique position of having the customer’s deposit at its disposal, into which it can dip its own spoon. Although the funds deposited become in law the bank’s money, with the bank having an obligation to repay the balance to the customer on due demand,<sup>24</sup> in effect the bank is able, by debiting a penalty fee, to help itself to “compensation”. The law should be taking a dim view of this form of self-award in much the same way as it frowns on other forms of extra-judicial self-help.

The fact that the banker-customer contract may authorise the bank to make the debit does not alter the essential iniquity from a social perspective where routine transactions such as debit orders are concerned. Here we have *pacta sunt servanda* – the legal principle that contractual obligations once undertaken must be observed – operating in conditions of gross inequality both of bargaining power and means of enforcement. The fact that major banks can also exercise market power in determining the level of the penalty only makes matters worse.

It was suggested in the hearings that the prevailing penalty fees should be regarded as justified because banks’ customers are protected by the Conventional Penalties Act.<sup>25</sup> This

<sup>22</sup> Transcript 9 July 2007, p 171.

<sup>23</sup> FRB March 2007, Second Submission, Part A Data Request.

<sup>24</sup> *Foley v Hill* and others (1843-60) All ER Rep 16 (HL); *Standard Bank of SA Ltd v Oneanate Investments (Pty) Ltd* 1995 (4) SA 510 (C) at 530G-532E; *Liebenberg v ABSA Bank Ltd t/a Volkskas Bank* [1998] 1 All SA 303 (C) at 308b-309j.

<sup>25</sup> Act 15 of 1962 as amended. See Transcript 18 June 2007, p 89, pp 151-152 (Standard Bank); FRB, July 2007, Penalty fees, p 4.

idea is without merit. The Act provides for the enforceability of contractual penalty stipulations “in any competent court”.<sup>26</sup>

If upon the hearing of a claim for a penalty, it appears to the court that such penalty is out of proportion to the prejudice suffered by the creditor by reason of the act or omission in respect of which the penalty was stipulated, the court may reduce the penalty to such extent as it may consider equitable in the circumstances: Provided that in determining the extent of such prejudice the court shall take into consideration not only the creditor’s proprietary interest, but every other rightful interest which may be affected by the act or omission in question.<sup>27</sup>

First, banks are not in the habit of claiming penalty fees by suing their customers in court: they simply debit the fees to the customers’ accounts – in fact, about 24 million times in one year by the big four banks alone (see Table 1 above). Second, for the customer to have to challenge the debit each time by way of court action in order to have the fee reduced is patently ridiculous. Third, even in such a case it would be far from certain that the proceedings initiated by the customer would be characterised as “a claim for a penalty” to which the Act would apply. Fourth, even if the Act were to be held to apply, the customer would bear the onus of proving the disproportion between the penalty and the prejudice suffered by the bank<sup>28</sup> – this, when banks themselves claim not to know precisely what particular transactions cost them, and when the broadest non-proprietary interests of the bank would also have to be quantified. Fifth, it would be an easy matter for a bank to avoid the Act by so wording its banker-customer contract that the fee would be triggered by an act or omission by the customer not technically treated as a contractual breach.<sup>29</sup> In short, it would take a Franz Kafka to imagine a more hopeless legal labyrinth for banking consumers needing a way out of unfair penalties.

Apart from their overall vulnerability to having their deposits unceremoniously eroded by their banks, customers are, in our view, kept significantly in the dark over penalty fees. Very often, customers are not aware of the full extent of the penalty fees they can incur and will only become aware of these fees to their horror after substantial sums have been deducted from their accounts.<sup>30</sup>

Penalty fee categories – including fees for rejected debit orders – are now generally disclosed by the banks. But the information remains incomplete.

In the case of FNB, only the “minimum charge per item” for dishonoured payments is disclosed in its fee brochures. The customer would not appreciate from the brochure that the indicated “minimum” fee of R30 per item on a savings account would increase to R60 per

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<sup>26</sup> Section 1(1).

<sup>27</sup> Section 3.

<sup>28</sup> *Smit v Bester* 1977 (4) SA 937 (A); *Chrysafis and others v Katsapas* 1988 (4) SA 818 (A) at 828I-J.

<sup>29</sup> Cf *Sun Packaging (Pty) Ltd v Vreulink* 1996 (4) SA 176 (A).

<sup>30</sup> Cf Transcript 18 June 2007, p 28 (Mr Weeks).

item after three unpaid items in a rolling twelve-month cycle, and a “minimum” fee of R95 per item on other PTAs would increase to R120 per item.<sup>31</sup> In Absa’s case the meaning of “minimum” fee in its 2008 pricing brochure remains obscure. By taking note of this particular feature of penalty charges where FNB and Absa are concerned, we do not mean to exonerate other banks. In our view it is not at all clear to banks’ customers how penalty fees are applied. This is something which we have tried to uncover during the Enquiry.

Let us take as an example an ordinary debit order drawn on a savings or current account, which provides for a series of periodic payments on the first day of each month for twelve months, from January to December. On the third occasion that it is presented (1<sup>st</sup> March), the debit order is rejected for insufficient funds. The bank charges its customer (the debtor) a dishonour fee of, say, R100. (If other debit orders falling due at the same time have also “bounced”, which is quite likely, then the dishonour fee imposed on the customer would be multiplied since the fee is charged per item.) Suppose the creditor holding the debit order wishes to have it presented again for payment after a few days, expecting that the debtor may by then be in funds. Can the creditor do this, and if rejection occurs again, will the dishonour fee be charged again? And if the payment due in March has failed, can the debit order be presented again for purposes of the April instalment (etc)?

It turns out that the only general protection that the debtor has against repeated levying of penalty fees for the same debit order arises indirectly from the rules that are applied to inter-bank clearing of debit orders. When our hearings began, these PCH rules – although submitted to us – were covered by a claim of confidentiality. Certainly banks’ customers have been altogether in the dark about their provisions. During the hearings, the claim of confidentiality was lifted. In the Rules governing the clearing of debit and credit electronic funds transfer payment instructions (i.e. the PCH clearing rules applicable inter alia to ordinary debit orders)<sup>32</sup> paragraphs 3.1.9.2 to 3.1.9.4 provide as follows:

When an item is returned unpaid the user<sup>33</sup> must attempt to get payment outside the system.

If an item is returned “Not provided for” on two consecutive mandated action dates the user must remove the payment instruction from the system unless the user has received a new subsequent commitment from the payer to meet future payments.

When an item is returned “Account Closed” or “Payment Stopped” the user may not submit the item again.

These provisions evidently mean that the ordinary monthly debit order in our example, once it had been rejected on 1<sup>st</sup> March, could not be presented again for payment during March. The creditor would have to attempt to get payment from the debtor for the March instalment

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<sup>31</sup> FRB, March 2007, Second Submission, Part A Data Request, p 11. Compare Mr. Jordaan, Transcript 9 July 2007, p 159: “We have brochures which detail the fees, every single fee, that we charge our customers, including penalty fees.” Likewise FRB’s Additional Submission, July 2007, Penalty fees, p 3: “All FNB’s penalty fees are fully disclosed and transparent.”

<sup>32</sup> Commonly referred to as the EFT PCH rules.

<sup>33</sup> The “user” means in effect the creditor holding the debit order.

“outside the [interbank payment clearing] system”. However, the debit order could still be presented again for purposes of the April instalment once that instalment fell due – and so on. If the debit order were to be rejected again for insufficient funds in April (or on any two consecutive due dates), then it would have to be removed from the system unless replaced by a renewed commitment from the debtor to meet future payments. A debtor may at any time instruct his/her bank to stop payment of a debit order, or close the account on which it is drawn, whereupon it may not be submitted again. The creditor’s recourse against the debtor would then lie outside the system.

We believe that banks’ customers are not generally aware that they have the power to stop a debit order by a simple instruction to their own bank, and that they do not need the permission of the creditor (the holder of the debit order) in order to get the bank to discontinue payments on their behalf. Customers generally should be more clearly advised of this by their banks (see further below). This is a separate matter from any breach of contract that may result as between debtor and creditor when payment is stopped.

Despite the existence of these rules, Absa acknowledged that “multiple rejected debit order fees can arise when the merchant presents the same debit order multiple times.”<sup>34</sup> Although the EFT PCH rules state that the mandate in respect of a debit order that has been returned for lack of funds on two consecutive occasions is regarded as cancelled, Mr von Zeuner explained:

Banking systems do not currently identify those instances where a debit order is presented more than twice. Manual checks are, however, performed when concerns are raised about this by a specific user.<sup>35</sup>

FNB agreed that the rule is difficult to monitor.<sup>36</sup>

It should be noted, furthermore, that the PCH rules relate to inter-bank clearing. They have no application to debit orders processed within a single bank – i.e., where both the debtor and the creditor (beneficiary) are customers of the same bank.<sup>37</sup> Moreover, the PCH rules restrict the number of times a single debit order can attract a dishonour fee. They do not deal with the problem of multiple debit orders hitting the account of the customer with insufficient funds.

The banks’ own rules and practices regarding the number of times that penalty fees could be charged to a customer in respect of refused or rejected debit orders have remained far from clear.

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<sup>34</sup> Transcript 17 July 2007, p 5 (Mr von Zeuner).

<sup>35</sup> *Id.*, p 7.

<sup>36</sup> FRB, Additional Submission, July 2007, Penalty fees, p 3.

<sup>37</sup> The penalty fee to the customer is the same in both cases.

Mr Ntombela of Nedbank, while referring to the limitations imposed by the PCH clearing rules, nevertheless said: “The fee will be charged as often as the default happens.”<sup>38</sup> He confirmed that every incident of default attracts a penalty, except in the case of Mzansi accounts where the first such incident attracts no fee.<sup>39</sup>

Mr von Zeuner of Absa referred to the fact that the Enquiry Panel had raised the question of default charges where electronic payments are concerned. “When we look at the issue,” he said, “we believe that there is room for improvement in the area of rejected debit orders.”<sup>40</sup> In a written submission, Absa had acknowledged:

There is generally no limit on the number of times that default charges are levied – a fee will be levied each time the default behaviour occurs. Returned or rejected debit orders are an exception to this: from June 2007, Absa will be introducing a pricing cap on mass market savings accounts (e.g. Mzansi and Flexi Save) to limit the maximum number of charges that can be posted to customer accounts.<sup>41</sup>

Absa’s 2008 fee brochure now indicates that, on Mzansi accounts, the first dishonoured transaction per month attracts no penalty fee while dishonoured transactions thereafter attract a minimum fee of R30. In the case of Flexi Accounts, the minimum dishonour fee is R36, with only the first four being charged per month. The reference here to minimum fees is a curious new feature. The position for the customer therefore remains obscure.

In the case of FNB, the first dishonoured transaction on an Mzansi account attracts no penalty fee, while a flat fee of R30 is applied to dishonoured transactions thereafter. In the case of Smart Transmission Accounts and other PTAs, however, the fee for dishonoured transactions is described as a minimum fee. After three unpaid items in a rolling 12 month cycle, the fee indicated in Table 2 and Table 3 above is further escalated substantially.<sup>42</sup> This important detail makes no appearance in the bank’s pricing brochures.

Mr Tshabalala of Standard Bank, while contending that penalty fees are normal and ubiquitous and that it was the duty of the bank to charge them,<sup>43</sup> acknowledged that it was unfair to treat rejected debit orders in a similar way to cheques, especially where the low end of the market is concerned.<sup>44</sup> Thus Standard Bank had now capped its penalty fees for rejected debit orders on certain accounts:<sup>45</sup>

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<sup>38</sup> Transcript 9 July 2007, p 57, p 117. See also Nedbank, May 2007, Second Submission, Part B Data Request, pp 9-11.

<sup>39</sup> *Id.*, pp 57-58. The penalty fee on Nedbank Mzansi accounts is R10 per incident of default thereafter.

<sup>40</sup> Transcript 17 July 2007, p 5.

<sup>41</sup> Absa, March 2007, Second Submission, Part A Data Request, p 29.

<sup>42</sup> FRB, March 2007, Second Submission, Section 6, p 11.

<sup>43</sup> Transcript 18 June 2007, p 62, p 89.

<sup>44</sup> *Id.*, p 88.

<sup>45</sup> *Id.*, p 93. See also SBSA, August 2007, Second Submission, Part A Data Request, Annexure 2, p 3.

- E Plan: capped at two per month per account.
- Savings Account: capped at two per month per account.
- Mzansi: the first two rejected debit orders attract no penalty fee; thereafter capped at two penalty fees (for the next two debit orders run sequentially with no funds in the account). This effectively means that Mzansi account holders can be charged a maximum of two rejected debit order penalty fees per month.

Nevertheless, the penalty fees remain substantially out of proportion to relevant costs and there is no cap to the number of times penalty fees can be imposed for rejected debit orders on current accounts.<sup>46</sup>

In an attempt to address the concern where the same payment order is presented numerous times by a creditor, there have been some industry innovations.

MR. TSHABALALA: ...The industry working with the regulator has come up with two systems AEDO and NAEDO...the essence of it is that the customer is in control....The benefit of this is that the rules are that first the salary has to go in. So no lender can jump the queue and hit the account before the salary has gone in.... The point being that you cannot do it more than once. If you do it more than once, you are only charged once. So you only charge the penalty once as opposed to 5, 10, 15 or 20 times.<sup>47</sup>

AEDO and NAEDO are the types of Early Debit Order (EDO). Their operation is analysed in some detail in the chapter of this report on Payment Cards and Interchange. Here only one aspect need be considered. The PCH rules allow for credit tracking in the EDO payment streams, whereby payment instructions are processed a minimum of twice per day for up to 32 days. This raised the concern that multiple penalty fees could potentially be applied by the defaulting customer's bank to the same debit order item in the same month.

In a submission dated 10 July 2007, PASA has clarified at our request how the credit tracking process works. If a beneficiary user of an EDO stream requests credit tracking in respect of an early debit order, then the paying bank will implement it.<sup>48</sup> The service is paid for by the beneficiary. Credit tracking is applied in two forms – limited and full credit tracking. In the case of limited credit tracking, the paying bank ascertains twice a day over the requested period whether or not funds have been credited to the customer's account, so that the debit order can then be paid. In the case of full credit tracking, the posting of a credit at any time of the day will cause the pending debit order to be fetched for immediate processing. PASA regards credit tracking as repeated re-presentation of the payment

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<sup>46</sup> *Id.*, p 4.

<sup>47</sup> Transcript 18 June 2007, pp 93-94.

<sup>48</sup> Transcript 17 July 2007, p 6 (Absa). Cf also SBSA, August 2007, Second Submission, Part A Data Request, Annexure 3, p 1; FRB, March 2008, Response to request for additional information, p 8.

order.<sup>49</sup> It must follow that the number of times that a customer's bank could potentially levy a penalty fee is a matter currently within its own hands. This is not satisfactory.

When it comes to major banks charging their account-holders for unsuccessful early debit orders, the pattern is currently uneven.

- Nedbank testified that it charges no penalty at all for failed debit orders in the EDO streams, and indeed sees that as one of the objects of AEDO and NAEDO.<sup>50</sup>
- Absa has also not been charging its account-holder for default in these streams.<sup>51</sup>
- In the case of Standard Bank, Mr Shunmugam testified:

Obviously the charge to the customer is at the end of the tracking cycle. So if after three days he tracks and he picks up there is funds there and it is successful, there is no unpaid charge but if at the end of the 32 days or whenever is stipulated there is an unpaid then we will generate an unpaid fee at the end of the tracking cycle, once.<sup>52</sup>

However, this statement appears to have anticipated things to some degree. In a subsequent written submission, Standard Bank clarified its position:

At this stage, SBSA only charges the corporate for unsuccessful AEDO and NAEDO transactions. SBSA's intention is to levy an unpaid fee on the paying customer in the future in the same manner as for an ordinary debit order at the end of the tracking period. This is not being done at present due to technical limitations.<sup>53</sup>

According to a subsequent submission by Standard Bank on 20 March 2008, this seems to have taken effect.

- FNB, in a response to a request for additional information (17 March 2008) has stated that it charges the account holder R2.65 as an unsuccessful transaction fee in the NAEDO stream (the EDO stream in which it is involved).<sup>54</sup>

This evidence shows the vulnerability of the customer to penalty fees being imposed in the EDO streams at the discretion of individual banks. As the case of Standard Bank shows, this can be at the same exploitative level as now prevails for rejected ordinary debit orders. At the same time, as the case of FNB reveals – with its “unsuccessful transaction fee” of only R2.65 – the earlier argument about the vital need for penalty fees to be high in order to deter customers from signing debit orders which they cannot meet is radically undermined.

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<sup>49</sup> “[S]ince the EDO systems are not real time systems, no ping can take place.”

<sup>50</sup> Transcript 9 July 2007, p 121 (Ms Whateley), p 122 (Mr McLachlan).

<sup>51</sup> Transcript 17 July 2007, p 6.

<sup>52</sup> Transcript 18 June 2007, p 157.

<sup>53</sup> SBSA, August 2007, Second Submission, Part A Data Request, Annexure 3, p 1.

<sup>54</sup> FRB, March 2008, Response to request for additional information, p 8.

The Panel raised the question of whether the corporate beneficiary which attempts unsuccessfully to collect on a debit order for which the debtor has no funds should be charged a penalty fee. Mrs Nyasulu of the Panel suggested that “it is fairer to the end consumer if you levy the charge against the beneficiary because after all they were the ones who went through a credit granting process and took the responsibility to lend to that particular individual.”<sup>55</sup> However, Standard Bank argued that, since no breach of contract by the corporate is involved, such a fee would not be applicable.

On the other hand:

If a customer incurs no fee for a returned debit order, he or she would have no incentive to advise the corporate of a change of bank account or salary payment date. The corporate has no means of monitoring these changes, no matter how careful it is at the time of accepting the debit order. If there was no fee for the customer, the number of unpaid debit orders would increase.

Aside from the adverse consequences to the bank of high levels of unpaid debit orders, the corporate would incur increased costs (in the form of increased administration, increased credit exposure and related interest) and would increase its charges to the customer.<sup>56</sup>

FNB submitted earlier:

The fact that a debtor will pay his bank for failing to honour a commitment to a creditor provides the latter with comfort that debit orders and cheques will most likely be honoured.<sup>57</sup>

Unmistakable in these passages is the banks’ assigning to themselves the role of protectors of the collecting customer (the corporate) by penalising their own account-holding customers – the man and woman in the street – for failing to pay.

In contrast, Mr von Zeuner of Absa suggested that banks should actually assist their customers in cancelling debit orders, in order to reduce the incidence of rejected transactions. He proposed –

... exploring the possibility of cancelling debit order agreements at the bank. This will enable banks to provide customers with the ability to cancel direct debits. This is analogous with the BACS scheme rules in the UK, which allow customers to cancel a direct debit at any time by phone or internet, although in some instances written confirmation can be required. The customer still bears the responsibility of making alternative payment arrangements.<sup>58</sup>

This is something we believe should be supported and implemented by all banks and we recommend accordingly.

It would not, however, alter the need for decisive regulatory intervention in order to protect banks’ customers from exploitative dishonour fees in respect of all debit orders.

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<sup>55</sup> Transcript 18 June 2007, p 160.

<sup>56</sup> *Id.*, pp 1-2.

<sup>57</sup> FRB, March 2007, Second Submission, Part A Data Request, p 9.

<sup>58</sup> Transcript 17 July 2007, p 6.

#### 4.4 Recommendation for regulatory cap on debit order dishonour fees

The Task Group Report (Falkena III) recommended that penalty fees should be on a cost-plus basis and open to regulatory oversight.<sup>59</sup> This recommendation appears to have been ignored. In our view the abuse of debit order dishonour fees analysed above needs to be addressed through the recommendation below without delay. We do not think that it is likely to be combated effectively enough, or with the necessary clarity and certainty, by way of section 8(a) of the Competition Act.

The data provided above shows that, in 2006, the cost to banks of processing rejected debit orders was below R5 per item (See Figure 3). Indeed, Capitec charged *the customer* only R3 per dishonoured item and was presumably covering its cost (See Table 2). Today, Capitec charges R3.50. The processing costs of the major banks may well be even lower than those of Capitec. Therefore, based on this data, we have no reason to believe that, currently, banks would be unable fully to recover their costs ordinarily incurred in respect of rejected debit orders (including a fair return on outlays) by means of a fee capped at approximately R5 per dishonoured item.

The appropriate cap should be imposed by regulation. It should apply both to savings and current accounts, and to ordinary as well as early debit orders. The cap should be regularly reviewed in order to take into account changes in costs. Banks, which incur additional expenses or losses in particular cases through their customers' default in respect of debit orders, can terminate those customers' accounts and/or sue for damages. They ought not to have the liberty to help themselves to some self-determined compensation out of their customers' accounts.

The regulatory remedy should also include a provision to ensure that the re-presentation of dishonoured items cannot itself amount to an abuse.

Whether such price regulation should be imposed using existing regulatory powers of the SARB, or by way of section 9(1) of the Sale and Service Matters Act 25 of 1964 (as amended), or by other existing or special legislation is a matter on which we are not best placed to express an opinion.

In our view, if the necessary regulatory intervention is not forthcoming within a reasonable time, the Commissioner, after consultation with National Treasury and SARB, should recommend to the Minister of Trade and Industry that he consider directing the Consumer Affairs Committee established under the Consumer Affairs (Unfair Business Practices) Act

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<sup>59</sup> Exhibit H, p 155.

71 of 1988 (as amended) to conduct a full-scale investigation into dishonour fees in respect of debit orders charged by the four major banks.

Should the latter Act be replaced by the enactment of the Consumer Protection Bill, 2007, now before Parliament, then the necessary investigation could be initiated or continued as may be appropriate under the new Act.