

The National Payment System and Competition in Banking¹

Sigmund Freud is reputed to have said that every love affair involves at least three individuals. As every banker knows, however, every commercial transaction involves at least five parties.

If a consumer pays a retailer for goods by cheque it might look as if only two parties are involved, but if the customer banks at Bank A and the retailer at Bank B, four parties are already involved. The switching of transactions takes place through a payment system operator, like Bankserv, which brings the score to five. Then when we include the interbank settlement that takes place through the books of the Reserve Bank, we have six. Conceptually the position remains the same if the consumer pays with a credit card or over the Internet.

The infrastructure that has emerged over time to handle the verification, clearing and settlement process is known as the National Payment System (NPS). The NPS is considered to be an essential infrastructure – required by households and businesses alike. The NPS is also considered to be efficient, but efficiency is not synonymous with fairness. As in other areas where an essential infrastructure is involved – such as telecommunications – ownership, access for new competitors and pricing are likely to come under scrutiny from consumer protection agencies:

- **Ownership:** In SA, the NPS is both publicly and privately owned. SAMOS, the interbank settlement system and the system through which high value transactions are processed, is essentially owned and controlled by the Reserve Bank. Ownership and control of Bankserv, which carries the vast majority of switching transactions through the system, is dominated by the big four banks. MasterCard and VISA - alternative switching operators - are owned by international card companies.
- **Access:** Banks participating in the clearing and settlement system are self-regulated by the Payment System Association of South Africa (PASA). Through PASA, the payment clearing house arrangements and rules which govern participation of the different payment streams (cheques, EFTs, ATM and so on) are established. Historically, the payment system has been the preserve of banks, although technology now allows non-banks to provide similar services. The Report points out that rules for the participation of non-banks do not exist.
- **Pricing:** The pricing aspect raises concerns about interchange fees – the fees involving merchants and bankers when they share infrastructure - and the prices charged to consumers via bank accounts. While bank charges have received the most news coverage, the report concentrates on interchange and the implications thereof.

The Report seeks to identify costs associated with transactions - but to date has found little link between transaction cost and the fees charged to the consumer. The analysis reveals several anomalies. SASWICH fees for "off-us" ATM transactions may be as high as 4.5% of the value of an average ATM withdrawal. The fees for cheques, however, appear to be low and this indicates the presence of cross-subsidization.

In the compilation of the report, FEASibility relied on public data and on interviews with present and would-be players. Some detail – such as that related to interchange fees and earnings, or to the profitability of specific payment streams - was clearly not forthcoming from the incumbents. It is anticipated that the inquiry, which may include public hearings, will shed further light on the subject.

This Report arose from the 2004 *Competition in South African Banking* report which acknowledged the importance of the NPS but did not analyse it. This Report initiates the process whereby the complexity of the NPS system - and its possible impact on competition in the banking sector – is made transparent to the Competition Commission and the public at large.

If only banking were as simple as love.

The report is available on www.compcom.co.za and www.feasibility.co.za

¹ By Dr. Penelope Hawkins (Managing Director of FEASibility (Pty) Ltd)