**South African Reserve Bank**

**Interchange Determination Project, Phase 2 ATM results**

## 1 Introduction

The purpose of this communique is for the South African Reserve Bank (the Bank) to share the results of the Bank facilitated interchange determination project, with specific reference to the ATM phase, and more detail on:

- the project background and approach;
- the results of the ATM facilitated rate determination;
- other relevant considerations; and
- the next steps in this process.

## 2. Background

The Interchange Determination Project (IDP) was launched in 2011, following the recommendations from the Banking Enquiry Report[1]. The Banking Enquiry Report had made various recommendations, of which a specific note on interchange was "We recommend that an independent, objective and transparent regulatory process for determining interchange in the payment card and other relevant payment streams be effected and enforced as soon as practicable".

On the back of this recommendation, the Bank embarked on a Bank-facilitated and overseen revision of interchange rates[2] for all relevant payment streams in South Africa. This was supported by the National Treasury and the Competition Commission, and was endorsed by the Bank's Governors' Executive Committee.

[1] The Panel of the Banking Enquiry, established in 2006 by the Competition Commission of South Africa to enquire into particular aspects of competition in retail banking and the national payment system of South Africa. More information is available at http://www.compcom.co.za/.

[2] When a customer of a bank uses the infrastructure of another bank (e.g. an ATM), a fee is payable by the customer's bank to the bank providing the infrastructure. This fee is referred to as interchange.

The specific intent of the IDP is to review interchange rates applied in all relevant payment streams in terms of whether they are feasible and/or justifiable in the particular stream. The intent is also to determine if interchange rates are set at realistic and appropriate levels based on acceptable parameters as well as to make the components of interchange transparent. The report [3] of Phase 1 of the Interchange Determination Project concluded that interchange rates were a necessary part of the incentives to roll out and maintain infrastructure required to provide the various payment services, thereby creating interoperability and efficiency within the payment system. In addition, the study identified the instruments that would need to be addressed as priority areas.

The Bank contracted a service provider to facilitate Phase 2 of the IDP (Phase 2) under the oversight of the National Payment System Department (NPSD). The overall objective of Phase 2 encompasses the evaluation and determination of costs to provide payment services in a particular payment stream, from which an appropriate interchange rate will be determined.

The ATM payment stream was selected as the pilot stream, with the card stream being the next priority area to be addressed. The ATM rate calculation is complete and the results can now be shared.

The ATM phase considered withdrawals, balance enquiries and declined transactions as these transactions account for approximately 80 per cent of transactions undertaken on ATMs.

When looking specifically at the background of the ATM payment stream, it is noted that interchange rates were last revised in 1999 and clarity on the method of determination for these rates is not known i.e. the approach that was used to determine the actual rates or the items that were considered in the calculation of these rates are unknown.

### 2.2. Phase 2 approach

A key item to consider is what the cost of an ATM transaction is and if interchange is reflective of this. The methodology followed for Phase 2 was based on this cost-

[3] http://www.resbank.co.za/RegulationAndSupervision/NationalPaymentSystem(NPS)/IDP/Pages/Default.aspx

based approach and within the ATM interchange environment, from a global perspective, this is the recommended method. The approach for Phase 2 was structured to encompass:

- a survey (with both qualitative and quantitative information requested);
- data collection and analysis;
- stakeholder interviews;
- building of a costing model (including option analysis); and
- implementation planning.

To measure the success of Phase 2, the project team defined guiding principles that have consistently been considered and applied throughout Phase 2 to steer the undertakings of the project team. Core to the principles is the safety and efficiency of the national payment system (NPS), as well as acting in the interest of the NPS as a whole, rather than that of individual stakeholders. These overarching principles are supported by additional principles, which are:

- fairness and consistency;
- simplicity, clarity and ease of understanding;
- transparency and justifiability;
- not hindering innovation and efficiency; and very importantly
- sustainability

The ATM results have been measured against these principles and the team is confident that the outcome meets them.

## 2.3. Consultation with stakeholders

It was of utmost importance for the project team to follow a consultative approach on the project, in the interest of obtaining a clear understanding of the ATM value chain and industry issues. To do so, the project team hosted interactive meetings with affected stakeholders throughout the 11 months of the project to date, as well as obtaining information through surveys. The project team consulted with acquiring and issuing banks, third-party service providers related to ATMs and retailers.

### 2.4. Information gathering (sources)

In addition to stakeholder interviews and surveys completed, the project team gathered additional information by conducting detailed research into the ATM environment and key industry issues, benchmarking South Africa against global information and examples, as well as cross-industry comparisons.

## 3. ATM results

### 3.1. Overall rate structure

The first element to consider is the overall rate structure. The current ATM interchange rate for withdrawals consists of a fixed and a variable rate, thus a combination rate is applicable.

As ATM infrastructure costs consist of both fixed and variable costs, the ATM rate structure needs to be reflective of this balance.

For the purposes of the new rate, the costs considered to be “fixed” are any costs which are needed for any/all ATM transactions (i.e. for withdrawals, balance enquiries and declined transactions), while variable costs are considered to be any costs that are dependent on the transaction value which would thus be costs specific to withdrawals only.

The new ATM rate structure consists of a fixed element and a variable element expressed as a percentage of the amount withdrawn. This is slightly different from the current rate structure where the variable element is expressed as a rand-value per R100 withdrawn.

As the current ATM rate structure is very similar to the new rate structure, it is feasible that implementation thereof should not be a very complex or time-consuming exercise.

### 3.2. Qualitative adjustments

The basis of the new ATM interchange rate is thus the weighted cost per transaction. The costs per transaction were determined using the ATM survey data submissions, with weighting applied according to ATM market share (calculated with reference to ATM numbers and them-on-us transaction volumes where interchange is applicable).

After the determination of the true cost of an ATM transaction, a number of qualitative adjustments were made.

- The first adjustment to be highlighted is the "fixed cost apportionment" adjustment. The primary purpose of an ATM is to withdraw cash and therefore this transaction will carry the appropriate share of costs. To ensure that balance enquiries and declined transactions are not overly expensive in the interest of driving correct consumer behaviour in appropriate markets, a portion of fixed costs was reallocated from balance enquiries and declined transactions, to withdrawals, taking into account the usage of an ATM as a basis for this calculation.

- The second adjustment is an "inflationary allowance", which was made to ensure that costs considered remain relevant over a period longer than just one financial year. Qualifying costs were increased using a three-year weighted inflationary percentage.

- The last notable qualitative adjustment is an "infrastructure incentive". The ATM interchange relates to the usage of infrastructure by one party for which the other party needs to be compensated. In the South African market, there are only a limited number of infrastructure providers for ATMs, which places pressure on these banks to maintain and roll-out ATM infrastructure to support millions of ATM transactions. To recognise these infrastructure providers and compensate them for the provision of our existing ATM network, an additional percentage was added to the costs considered for the ATM rate. This percentage was based on short-term weighted-average cost of capital. This incentive serves as a proactive approach to protecting the existing ATM infrastructure, as well as to incentivise the roll-out of additional ATMs within the South African market.

### 3.3. Rate to be implemented

As mentioned above, the new ATM rate is determined through a cost-based methodology, with the addition of qualitative adjustments on top of the cost per transaction.  The rates that are to be applicable for the next year i.e. 2014, are as follows:

- ATM withdrawals: R3,48 + 0,53 per cent of the amount withdrawn
- Balance enquiries: R1,33 per transaction
- Declined transactions: R0,94 per transaction

These rates will apply from 1 April 2014 to December 2014, after which the South African Reserve Bank will communicate the subsequent rate for 2015 should there be a change.

### 3.4. Timeframe for revisiting new rate

In order to keep these rates current, the aim is to gather information on an annual basis with the objective of assessing whether any changes to applicable rate or qualitative adjustments are required. It is, however, not the Bank's intention to necessarily amend rates annually, but rather only as and when required.

### 3.5. Effective date for implementation

As the new ATM interchange rate structure is very similar to the current ATM interchange rate structure, and based on feedback obtained from stakeholder sessions, the Bank estimates that approximately four months will be sufficient for implementation. Therefore, the ATM interchange rates, as outlined, should be fully implemented by the end of the first quarter of 2014.

The Bank will consult with the Payments Association of South Africa regarding the industry's implementation and compliance with these recommendations.

## 4. Conclusion

In conclusion, the Bank would like to take this opportunity to thank the project team, and those that worked closely with them, for the excellent work they have undertaken during Phase 2 (ATM) of the interchange determination process. The cooperation of the banks and other stakeholders involved during this process is also appreciated.

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