Consultation paper

National Payment System Department

South African Reserve Bank

Interchange policy in South Africa

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Contents

1. Definitions and clarifications

1.1 **Account holder:** A legal person to whom a participant pays funds or transfers funds from.

1.2 **Acquiring:** A process whereby a participant acquires or accepts a payment instrument issued by an issuing participant.

1.3 **Beneficiary participant:** A participant that receives an electronic funds transfer (EFT) from the paying participant and makes the funds associated with the EFT available to the account holder.

1.4 **Card:** A payment instrument issued by a participant to a person to effect a payment, withdraw cash or transfer funds.

1.5 **Cardholder:** A person or entity that enters into an agreement with an issuing participant in order to obtain a card.

1.6 **Cardholder fee:** A fee that an issuing participant charges a cardholder for issuing the card. This is typically charged on a monthly basis and may be accompanied by interest charges and/or transaction fees.

1.7 **Card scheme:** A card scheme entails a card payment network to which an eligible institution may become a licensed member.[1] A card scheme facilitates the functioning of the card payment system through rules and standards for clearing payment instructions between issuing and acquiring participants.

1.8 **Chargeback:** A transaction performed by an issuing participant to refund the cardholder in the event that a cardholder and merchant are unable to agree on a reversal or refund transaction.

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[1] See the *National Payment System Framework and Strategy – Vision 2025,* available at https://www.resbank.co.za/content/dam/sarb/what-we-do/payments-and-settlements/Vision%202025.pdf.

1.9 **Four-party card scheme:** An open card scheme that enables multiple issuing and acquiring participants to connect to the same card network. A four-party card scheme has no direct relationship with the merchant or cardholder. The issuing participant has a contractual relationship with the cardholder while the acquiring participant contracts with the merchant. Examples include Mastercard and Visa.

1.10 **'Honour all cards' rule:** A rule that requires merchants which accept cards of a certain card scheme to accept all the cards issued under that scheme (i.e. a credit card, debit card and prepaid card). The 'honour all cards' rule has two elements to it. First, it requires a merchant which accepts cards of a certain card scheme to accept all the cards under that scheme, irrespective of the issuing participant. Second, it requires merchants which accept cards under a particular card scheme to accept all the cards, irrespective of the products (e.g. a credit card, debit card and prepaid card etc.); this is also known as 'honour all products'.

1.11 **Interchange:** The process whereby participants, through their devices, systems and procedures, facilitate the acceptance, collection, exchange, clearance and settlement of payment instruments used by their customers within the national payment system (NPS). Interchange exists in payments where the payer and the payee effecting these payments utilise different participants. If both the payee and the payer utilise the same participant, the need for interchange does not arise.

1.12 **Interchange fee:** A fee payable by a clearing system participant to compensate the other clearing system participant for the cost of providing and maintaining the infrastructure to service their non-customers. An interchange fee can be set as a percentage of a transaction. It can also be referred to as an 'interchange rate'.

1.13 **Issuing:** A process whereby an issuing participant issues a payment instrument to its customers to effect payment, withdraw cash or transfer funds.

1.14 **Merchant service fee (MSF):** A fee that a merchant pays to the card-acquiring participant for providing and maintaining the infrastructure to process payment instructions.

1.15 **Multilateral interchange fee (MIF):** An interchange fee set by the four-party card schemes or collectively by participants.

1.16 **Participant:** A clearing system participant, as defined in the National Payment System Act 78 of 1998, as amended (NPS Act).

1.17 **Paying participant:** A participant that initiates an EFT and associated funds upon receiving the request for an EFT on behalf of the account holder.

1.18 **Payment clearing house system operator (PCH SO):** A payment clearing house system operator, as defined in section 1 of the NPS Act.

1.19 **Point-of-sale (POS) device:** An electronic device used to process card payment instructions.

1.20 **Scheme fee:** A scheme membership fee that the card-issuing participant and acquiring participant pay to a card scheme to reap the benefits that a card scheme provides through the facilitation of clearing payment instructions.

1.21 **Surcharge:** A fee that merchants would charge a consumer for using a certain payment instrument to purchase goods or services, which fee is not charged when paying by cash.

1.22 **Three-party card scheme:** This is also known as a 'closed card scheme'. The card scheme acts as both the issuing participant and the acquiring participant, and contracts with both the cardholder and the merchant. Examples include American Express and Diners Club. When a consumer transacts with a card that is issued within a traditional three-party scheme (e.g. American Express or Diners Club), the transaction does not attract an explicit interchange fee as the card scheme issues the card directly to cardholders and enters into acquiring relationship with merchants.

1.23 **Two-sided market:** A market with interdependencies, where intermediation services bring together the two parties of a transaction (i.e. payer and beneficiary). Interdependencies mean that the demand from one group of customers depends on the demand from the other group, and possibly vice versa.

2. Introduction

2.1 In terms of section 10(1)(c) of the South African Reserve Bank Act 90 of 1989, as amended (SARB Act), the South African Reserve Bank (SARB) is required to perform such functions, implement such rules and procedures, and, in general, take such steps as may be necessary to establish, conduct, monitor, regulate and supervise payment, clearing or settlement systems. Furthermore, the National Payment System Act 78 of 1998, as amended (NPS Act) provides for the management, administration, operation, regulation and supervision of payment, clearing and settlement systems in the Republic of South Africa, and for connected matters.

2.2 The national payment system (NPS) encompasses the entire payment process, from payer to beneficiary, and includes settlement between banks. The process includes all the tools, systems, mechanisms, institutions, agreements, procedures, rules and/or laws applied or utilised to effect payment. The NPS enables the circulation of money; that is, it enables transacting parties to exchange value. The NPS further contributes to the economy and financial stability in South Africa.

2.3 As indicated in Rochet and Tirole, the payments market is a two-sided market, with intermediation services facilitating transfer of value between two parties to a transaction (i.e. payer and beneficiary).[2] As a result, the payment life cycle is interdependent on the behaviour on both sides of the market (i.e. the paying and the beneficiary side of the market).

2.4 Interchange is applied on payment instructions attributed to some payment methods and instruments, as a coordination mechanism to align the incentives of the two sides of the market. For example, in the cards market (credit cards, debit cards and prepaid cards), the incentives can be explained as the indirect benefits afforded to merchants for accepting card payments, as they result in improved convenience and guaranteed payments, and provide higher security in stores. Card acceptance attracts customers as it brings convenience (i.e. access to liquidity and faster payment at point of sale (POS)) and may result in increased sales for merchants. On the card-issuing side, the widespread use of cards provides benefits in the form of increased adoption, revenue and competition for market share.

2.5 These incentives are often associated with costs, hence the need for interchange. The card-issuing participants incur costs for issuing cards to customers (including card scheme fees) and processing card transactions, while acquiring participants incur card scheme fees, the cost of providing and maintaining payment infrastructure, and interchange fees. Merchants pay merchant service fees (MSFs), and consumers pay cardholder fees.

2.6 Interchange allows a participant that enjoys the incentives to compensate the other participant for the cost of providing and maintaining the infrastructure to service their non-customers. Interchange also incentivises a participant for providing payment instruments that enable its customers to transact with another participant. In this regard, interchange is an important part of the NPS as it helps provide a balancing mechanism for the two sides of the market, ultimately supporting interoperability. Interoperability is an important driver of network effects in the payment system by facilitating

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[2] J Rochet and J Tirole, 'Two-Sided Markets: A Progress Report', *The Rand Journal of Economics* 37(3), 2006, pp. 645-667.

growth in electronic payment infrastructure, which supports economic activity. In particular, interchange facilitates transactions that may not have occurred otherwise (e.g. facilitating the withdrawals of cash at an automated teller machine (ATM) using a card that is not issued by the participant that owns the ATM).

2.7 Interchange fees in the two-sided market can be skewed if determined by the market, as it considers incentives between two parties. For example, Garces and Lutes argue that in the cards market, merchants may have low price sensitivity/elasticity to the interchange fee (which is included in the MSF), with the expectation of reaping benefits from accepting card transactions.[3] In an uncompetitive acquiring environment, this may result in merchants accepting MSFs (which include interchange fees) that are higher than optimal. On the issuing side, card-issuing participants may offer customers zero-rated card transactions and additional rewards through rewards programmes in order to increase card adoption as customers may have high price sensitivity/elasticity.

2.8 Over the years, the determination of interchange fees across jurisdictions has been scrutinised by regulatory and competition authorities, largely due to potentially uncompetitive behaviour of participants and card schemes. According to the Competition Commission, the uncompetitive nature of the multilateral interchange fee (MIF) determination[4] and the inefficient nature of bilateral determination have been found to contribute to the inefficient levels of interchange fees.[5] In South Africa, for example, the Competition Commission found in 2008 that an interchange fee should not be left to be set privately by those actually or potentially benefitting from it.[6]

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[3] E Garces and B Lutes, *Regulatory Intervention in Card Payment Systems: An analysis of regulatory goals and impact*, The Brattle Group, Inc, 2019.
[4] Competition Commission, *Interchange determination: An assessment of the regulation of interchange in South African in light of international developments*, 2014. http://www.compcom.co.za/wp-content/uploads/2014/09/Interchange-determination.pdf
[5] European Central Bank, *Interchange in card payments*, Occasional paper series No. 131, 2011. https://www.ecb.europa.eu/pub/pdf/scpops/ecbocp131.pdf?d588133bdfb8099445e16c9473233833
[6] Competition Commission, 'Payment cards and interchange'*, Banking Enquiry Report*, 2008. https://www.compcom.co.za/wp-content/uploads/2017/11/6-Payment-cards-and-interchange_non-confidential1.pdf

2.9 Regulatory approaches and interventions on interchange determination indicate heterogeneity across jurisdictions. Some jurisdictions have adopted the approach of central banks setting caps on interchange fees on card transactions while others have left interchange fee determination to the market. In several jurisdictions, card transactions and ATM transactions attract interchange fees, while transactions made using other payment instruments and payment methods, such as electronic funds transfers (EFTs), do not attract interchange fees.

3. Problem statement

3.1 **Currently, no formal regulatory and policy framework exists for the determination of interchange in South Africa.** Although the SARB has been determining interchange rates for certain payment streams since 2011 (see Section 8 below), this process is undertaken without a formal framework in place. Such a formal framework should provide the legal basis and the policy objectives while outlining the responsibilities of the SARB when facilitating interchange determination.

3.2 **The Banking Enquiry Report[7] identified the following areas (among others) with potential for abuse in how interchange fees were set in South Africa, although most of the problems in card payments have been addressed since the SARB started facilitating interchange determination.**

3.2.1 Card-issuing participants have an obvious interest in maximising interchange fees because interchange provides a stream of revenue to them. However, card-issuing participants would not set interchange fees too high so as not to curb merchants' willingness to accept payment by card, which could negatively impact on their revenue.

[7] In 2008, the Competition Commission finalised the Banking Enquiry Report on, among other things, aspects related to the payment system in South Africa and bank fees/charges. https://www.compcom.co.za/2018/11/27/banking-inquiry/

3.2.2 Interchange fees set a floor for the MSF, which merchants have little power to influence.

3.2.3 There is a lack of transparency and fairness in bilateral interchange determination. The lack of transparency in determining interchange fees means that the methods of setting interchange are opaque and vulnerable to abuse, thus negatively impacting merchants and consumers. Bilateral interchange fee determination is more vulnerable to abuse of market power when compared to a centrally and independently determined interchange fee for all issuing and acquiring participants in a particular payment stream.

3.2.4 Competition between card schemes for issuing participants has the paradoxical tendency to drive interchange fees upwards rather than downwards. In practice, competition in the card environment focuses on the issuing side of the market rather than on the acquiring side, whereby card schemes attract issuing participants by offering them higher interchange fees. This problem could become acute in South Africa as the major card-issuing participants are also the major card-acquiring participants, implying a potential conflict of interest in maximising interchange fees.

3.2.5 Interchange fee determination by card schemes or participants can be vulnerable to market manipulation and inefficiency. By setting high interchange fees and raising card issuance payment levels, card-issuing participants can capture merchants to accept cards in fear of losing their competitive advantage, especially as card adoption grows, thus resulting in inefficiencies. This may result in merchants feeling obliged to accept (indirectly) excessively high interchange fees as they may be relatively insensitive to MSF given that they expect to indirectly absorb the benefits of increased card usage in their stores.

3.2.6 Interchange fees ultimately find their way into consumer prices and, if set high, they have a negative impact on consumer welfare.

3.3 **Bilateral interchange determination can be costly and inefficient.** Bilateral interchange determination involves a participant having to negotiate separate agreements with every other participant, which could mean tens of thousands of agreements.

3.4 **When the private sector determines interchange fees, there is potential to limit competition and stifle innovation.** If card schemes and participants set interchange fees too high or too low (depending on which side of the two-sided market is viewed), it could significantly limit the market entry of new participants that either may not afford the high interchange fees or may not be adequately incentivised. This may be amplified when incumbent participants and merchants partner between themselves to maintain their existing revenue streams.

4. Purpose and scope

4.1 The purpose of this paper is to formulate a policy and regulatory framework for interchange in the South African payments market.

4.2 The scope of this paper covers all payment streams where the principle of interchange could apply. This includes payment streams that fall under the following categories:

- cards;
- electronic payments (both credit push and debit pull transactions, including faster payments); and
- cash outlets or infrastructures (e.g. ATMs and cash-back at POS devices).

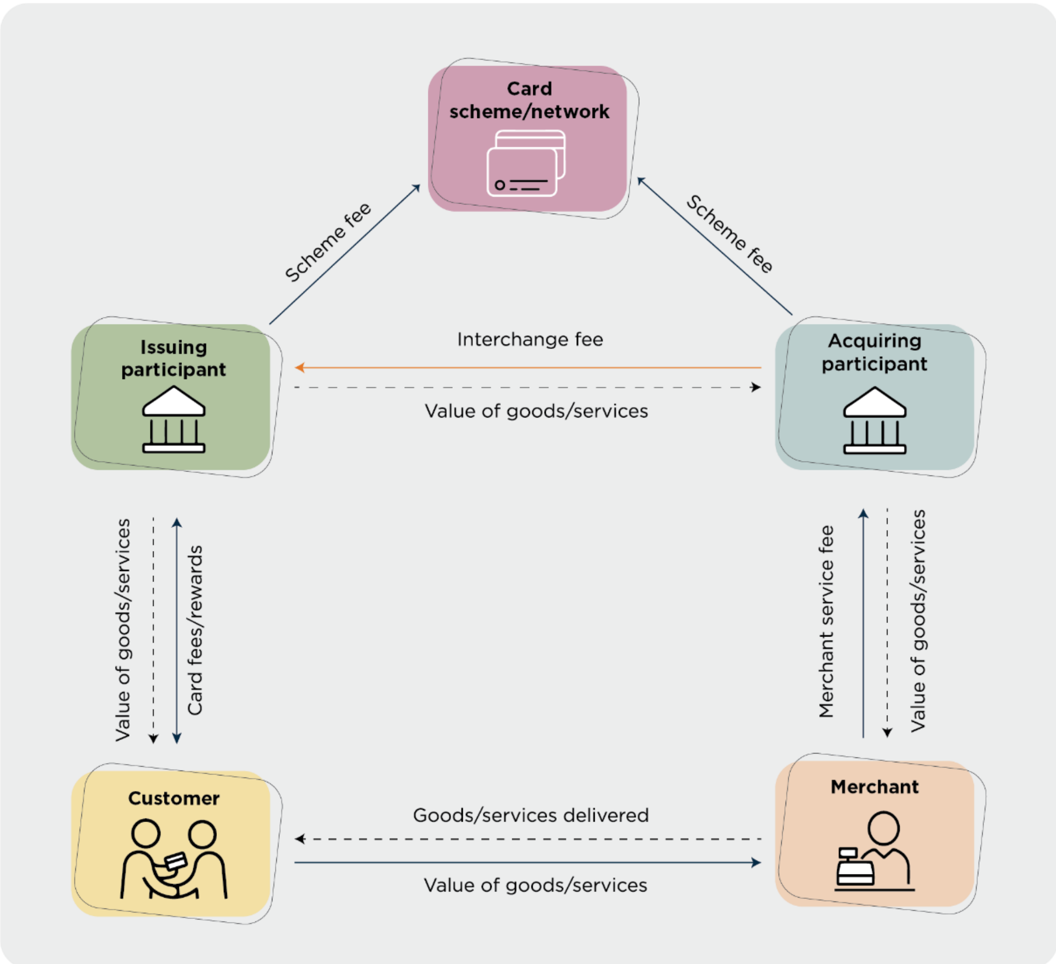
5. Interchange in practice

5.1 Interchange fees can be determined in three ways. Firstly, participants (usually banks) may determine interchange fees bilaterally. However, this method can be onerous, inefficient and unsustainable. Secondly, in card payments, the card schemes (e.g. Mastercard or Visa) or a community of participants may determine interchange fees, also known as MIF. Thirdly, interchange fees may be determined by a regulator through a set regulatory process.

5.2 Interchange can be illustrated using the following examples:

5.2.1 In card transactions, an interchange fee refers to the fee paid by the participant acquiring the transaction to the participant that issued the card each time a cardholder uses a card to make a purchase. Figure 1 below illustrates the flow of interchange fees and other fees when a customer purchases goods or services using a card in a four-party card scheme (e.g. Mastercard and Visa).

Figure 1: Interchange on card transactions at point-of-sale



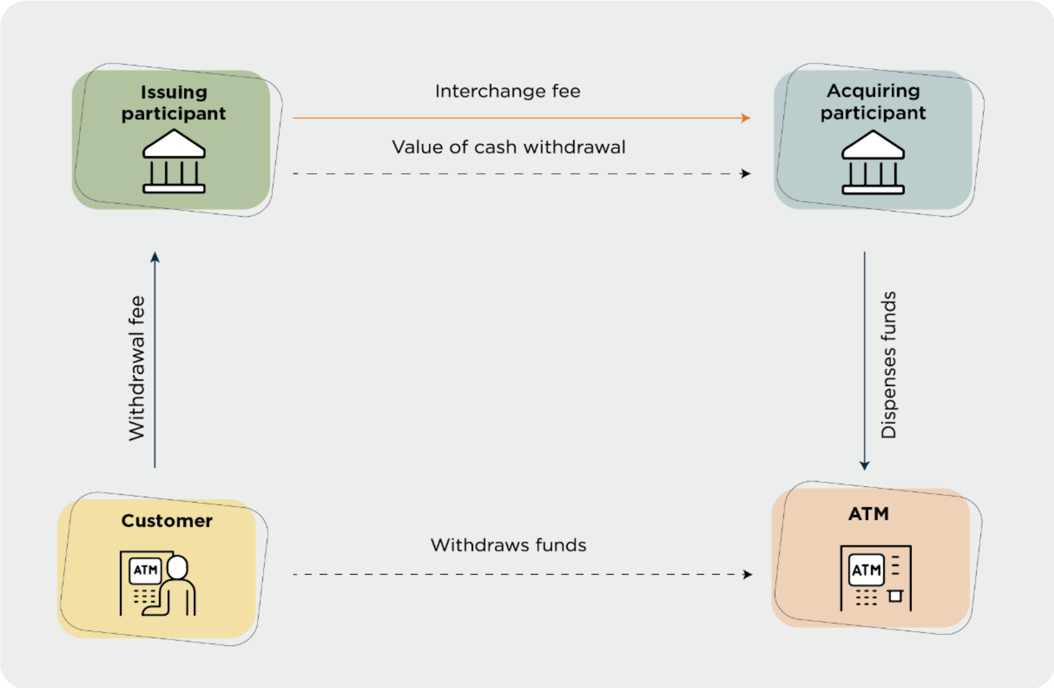
5.2.2 The rate structure of card interchange is typically based on several factors, including the type of card (credit or debit), the security features of the card e.g. EMV 3D Secure[8]), and the type of transaction (e.g. card present or card not present). Card schemes have liability shift rules for card payments, whereby the acquiring participant becomes liable for fraudulent EMV 3D Secure card transactions if it is proved that the security breach occurred from the acquiring participant's infrastructures.

5.2.3 The reason for varying interchange fees is that the benefits and risks of using these cards vary significantly across the types of card or transaction. The riskier the transaction or card type, the higher the interchange fee. Credit cards generally attract higher interchange fees than debit cards because interchange on credit cards includes the cost of providing a payment guarantee (even if the cardholder defaults on the credit card or the transaction happened to be fraudulent). Furthermore, in credit card payments, the issuing participant assumes the cost of any time difference between payment to the acquiring participant and the debiting of funds from the cardholder's current account. In contrast, debit cards operate from the available balance on the current account.

5.2.4 In ATM transactions, when an issuing participant has issued a card to a customer that uses the ATM of another participant (acquiring participant), an interchange fee is payable by the issuing participant to the acquiring participant (the participant providing the ATM infrastructure) (see Figure 2).

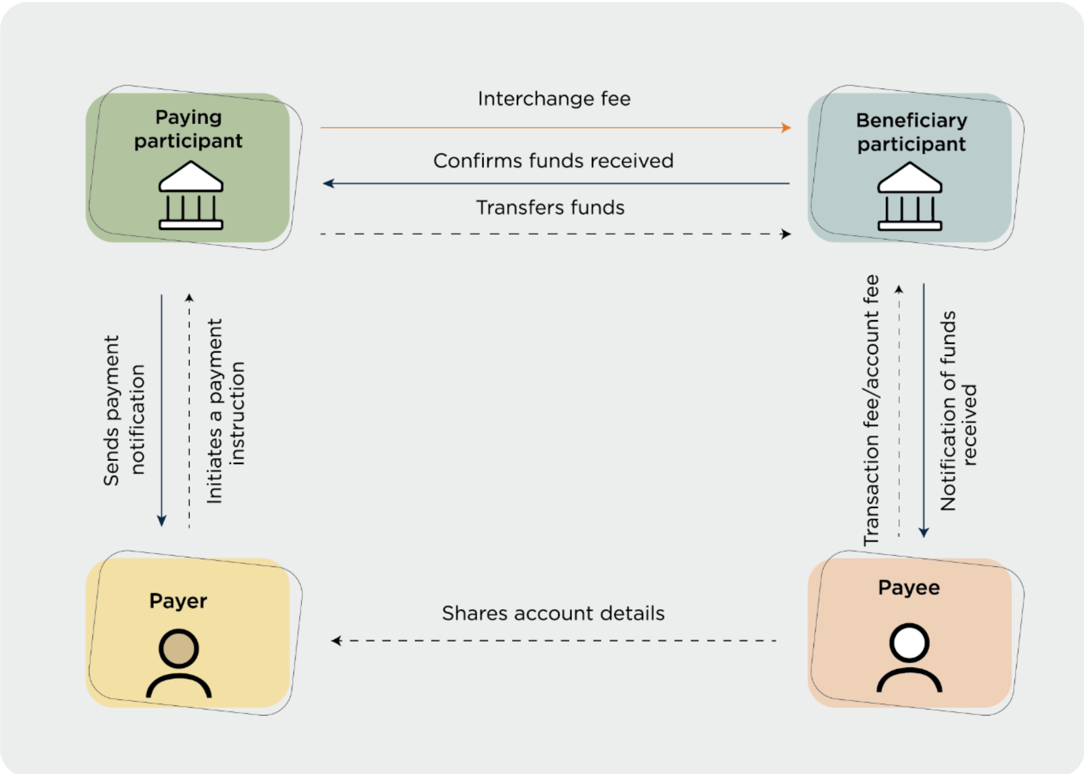
[8] EMV 3D Secure is a standard managed by EMVCo, a global technical body comprising American Express, Discover, JCB, Mastercard, UnionPay and Visa. EMV 3D Secure ensures that a credit or debit card is embedded with a microchip, a personal identity number (PIN) and associated technology designed to enable secure payment at compatible POS devices.

Figure 2: Interchange on ATM transactions



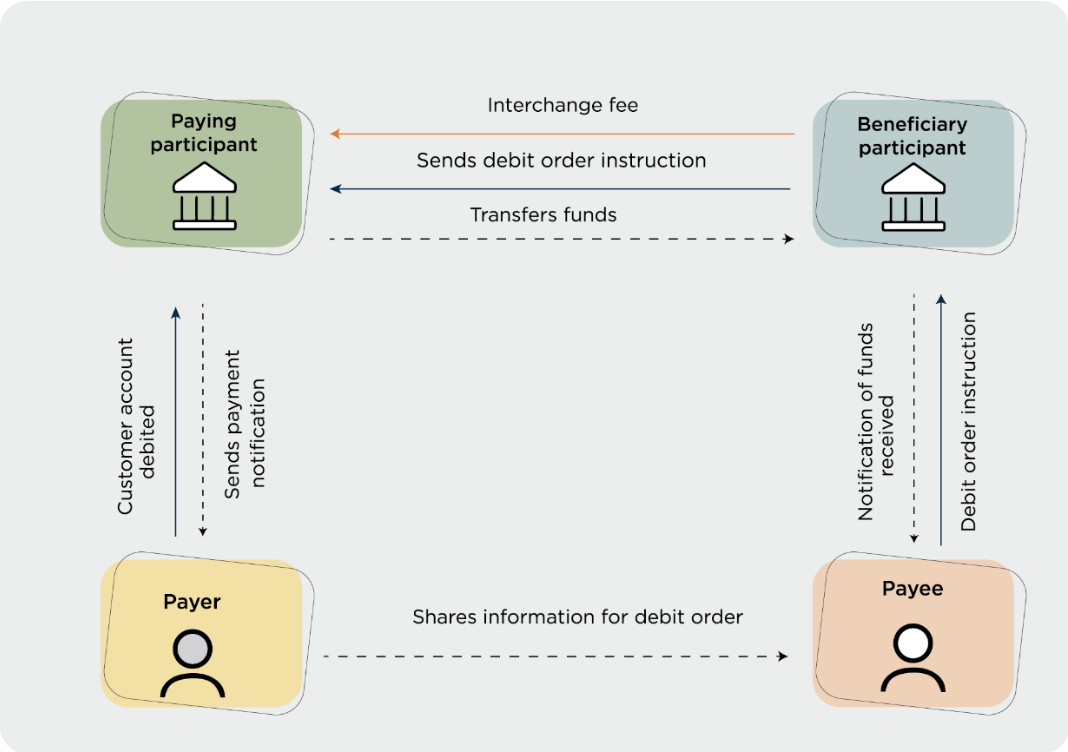
5.2.5 In EFT credit transactions, where a payer transfers funds electronically to a beneficiary, the payer's participant pays an interchange fee to the beneficiary participant to process the transaction (see Figure 3).

Figure 3: Interchange on EFT credit transactions



5.2.6 In EFT debit transactions, the beneficiary participant who initiates an EFT debit instruction pays an interchange fee to the paying participant (see Figure 4 below).

Figure 4: Interchange on EFT debit transactions



6. Policy objectives

6.1 **Create a clear regulatory and oversight framework on interchange determination.** Given the important role that interchange plays in the NPS, it is essential that interchange determination is governed by a clear regulatory and oversight framework. This will also help create certainty on how interchange would apply to new payment services, irrespective of whether they are provided by incumbents or new participants.

6.2 **Promote cost-efficiency in the NPS.** Interchange should be fairly determined to promote efficient use of payment instruments and efficient allocation of resources. Interchange determination facilitated by the SARB should minimise the potential for interchange to be abused to the detriment of end users (According to the Competition Commission this could potentially arise through high fees and prices[9]), which could result in inefficient use of payment instruments and infrastructures.

6.3 **Promote wide adoption of secure electronic payments in the NPS.** Interchange can play a major role in expanding the adoption and use of electronic payments in the NPS, which reduce friction when transacting, and may increase the velocity of transactions and economic activity. Furthermore, electronic payments offer consumers a secure method of transacting and other value-added benefits (e.g. protection against lost, stolen or unauthorised use), unlike cash.

6.4 **Promote interoperability in the NPS.** Interchange facilitates transactions between multiple heterogeneous providers of services in the market or on off-us transactions, for example withdrawing cash from an ATM that does not belong to the participant that issued the card. The objective setting of interchange helps provide appropriate incentives for participants to integrate their systems, allowing all consumers to transact, irrespective of the participant they are contracted to.

6.5 **Promote competition and innovation in the NPS.** The interchange policy and regulatory framework aims to promote competition and innovation by enabling new providers of services, such as non-bank participants, to access the NPS. Fair and consistent facilitation of interchange determination by the SARB should encourage competition and innovation in the NPS. Increased competition and innovation in the NPS would potentially result in lower fees for merchants and cheaper payment instruments or methods of payment as well as improved customer experience.

6.6 **Support financial inclusion.** Interchange determination that encourages the participation of non-bank participants in the NPS should support financial inclusion as non-banks have the potential to provide financial services to

[9] According to the Competition Commission, as interchange fees are a component of MSF, they form part of the merchant's cost strategy and should enter invisibly into consumer prices. This was confirmed by one of the retailers during the Banking Enquiry.

consumers who do not have traditional bank accounts, and should increase market reach to the underserved population.

6.7 **Increase transparency of interchange determination.** Transparency in the approach to interchange determination assists the payments industry in aligning its strategies to how interchange is determined. In addition, transparency of interchange determination by the SARB should contribute to consumer protection through the elimination of potential abuse where the process is left to the market. This aspect should support the Financial Sector Conduct Authority (FSCA) on its market conduct and consumer protection mandate.

7. Potential benefits and risks of interchange regulation or intervention

7.1 Competition authorities and financial sector regulators around the globe have been intervening in the determination of interchange over the past decades, given some of the problems similar to those outlined in Section 5 above. However, regulatory intervention has implications for consumers, merchants, participants, card schemes and central banks.

7.2 Table 1 below lists the potential benefits and risks of regulatory intervention. Changes in interchange may have a substantial impact on all parties involved, namely the participants, consumers, merchants and the entire NPS. Therefore, consideration should be given to the possible impact of the policy and regulatory intervention on the efficiency of the NPS.

Table 1: Potential benefits and risks analysis of regulatory intervention on interchange fees

Participant	Benefits	Risks
Merchants	• Transparency of interchange fee determination, which would help make informed decisions about which payment method to adopt and accept, based on the disclosure of interchange fee determination. • Increased competition between acquirers could lower MSF and fees on payment instruments, and thus increase sales.	• If the interchange fee is set too high, it increases MSF or an equivalent fee, on which smaller merchants may not have the power to negotiate.

Participant	Benefits	Risks
Consumers	• Through increased competition, consumers could benefit from more alternative payment methods that are cost-efficient and convenient. • Potential for increased financial inclusion through the provision of payment services by non-bank participants. • Protection from a potentially excessive interchange fee, which could potentially be passed through to the prices of goods and services. • Assuming that interchange fees are passed through to the prices of consumer goods and services, a fair determination of interchange fees would minimise potential cross-subsidisation between consumers using cards and those using cash. • The creation of interoperability improves customer experience.	• If the interchange rate is set too low, participants may recover the loss of compensation from counterparties by increasing other related fees such as monthly card and account fees. • If the interchange rate is set too high, participants may pass some of the MSF through to the prices of goods and services.
Payment schemes	• Improved efficiency of the NPS through fair and consistent interchange determination. • Increased adoption and acceptance of various payment instruments.	• Loss of market dominance and revenue. • Compliance costs: monitoring and adherence to this framework.
Participants	• Improved efficiency of the NPS. • Increased adoption and acceptance of various payment instruments. • Increased competition could bring opportunities for new entrants to acquire various payment instruments. • Improved transparency of determining interchange. • Increased competition could bring opportunities for new entrants to provide various payment instruments.	• Issuing participants would not be incentivised to issue cards. • Loss of market dominance and revenue. • Compliance costs: monitoring and adherence to this framework.
SARB	• Improved safety and efficiency of the NPS.	• Possible stakeholder dissatisfaction with the methodology or the level of rates determined.

Participant	Benefits	Risks
	• Improved competition and innovation in the NPS. • Improved interoperability in the NPS. • Policy/regulatory certainty relating to interchange. • Improved oversight of the NPS.	• Potential lobbying from stakeholders to disclose the model used to determine interchange. • Inefficient setting of interchange levels due to the high level of complexity involved.

8. The current interchange landscape in South Africa

8.1 In 2011, the SARB initiated and facilitated the interchange determination project (IDP), with the objective of addressing the shortcomings of the practice of determining interchange rates, as identified by the SARB and the payment industry, and as outlined in the Banking Enquiry Report.

8.2 As part of addressing the shortcomings, the IDP aimed to promote, among other things, transparency, fairness and consistency in determining interchange rates, the sustainability of interchange rates, efficiency and interoperability in the NPS.

8.3 **Payment streams:** Tables 2 and 3 below indicate the payment streams in which interchange currently applies, who determines the interchange rate, and the direction of the interchange fee.

Table 2: Payment streams with interchange rates determined by the SARB

Payment stream	Direction of interchange fee	Rationale and qualifying statement
ATM	The issuing participant pays the acquiring participant.	The interchange fee provides an incentive to ATM providers to roll out and maintain the ATM infrastructure, thereby creating interoperability and efficiency within the payment system.
Cash-back at POS	The issuing participant pays the acquiring participant.	Interchange on cash-back at POS aims to incentivise all parties in the transaction in the interest of supporting financial inclusion.

Payment stream	Direction of interchange fee	Rationale and qualifying statement
Debit card and credit card	The acquiring participant pays the issuing participant.	To compensate the issuing participant for providing and maintaining the infrastructure to facilitate and process the transaction.
Authenticated collections (including the Registered Mandate Service[10])	The beneficiary participant pays the paying participant.	To compensate the paying participant for the exposure to fraud risk by enabling these transactions and for facilitating the payment using their processing infrastructure.

Table 3: Payment streams with interchange rates determined by the market

Payment stream	Direction of interchange fee	Bilaterally or collectively?	Rationale and qualifying statement
AEDO and NAEDO[11]	The beneficiary participant pays the paying participant.	Bilaterally determined	To compensate the paying participant for the exposure to fraud risk by enabling these transactions and for facilitating the payment using their processing infrastructure.
EFTs (debit pull transactions)	The beneficiary participant pays the paying participant.	Bilaterally determined	To compensate the paying participant for the exposure to fraud risk by enabling these transactions and for facilitating the payment using their processing infrastructure.
EFTs (credit push transactions)	The paying participant pays the beneficiary participant.	Bilaterally determined	To compensate the beneficiary participant for providing and maintaining the infrastructure to process the payment instruction.
Real-time clearing (RTC)	The paying participant pays the beneficiary participant.	Bilaterally determined	To compensate the beneficiary participant for providing and maintaining the infrastructure to receive the payment instruction and process it correctly.
Card credit payment instruction (CCPI)	The acquiring participant pays the issuing participant.[12]	Set in consultation with market participants	To compensate the issuing participant for providing and maintaining the infrastructure to process the payment instruction.

[10] The Registered Mandate Service is an interim measure intended to bridge the gap between technical and business success while assisting users and consumers in the AC journey.
[11] From 1 November 2021, AEDO and NAEDO have been discontinued.
[12] Where the payer transacts with a card, a card interchange rate applies, meaning that the acquiring participant pays the card interchange fee to the payer's issuing participant and the CCPI interchange fee to the payee's issuing participant.

8.4 **Methodology:** Currently, the SARB applies a cost-based methodology on all applicable payment streams to determine the interchange rates.[13] Data on transactional values and volumes, the costs of providing payment services and other qualitative information is collected from the participants to be used to determine interchange rates and for other regulatory reporting purposes.

8.5 **'No surcharge' rule:** In South Africa, merchants are not allowed to surcharge consumers when they use a card to purchase goods and services. The 'no surcharge' rule aims to prevent discrimination against any cardholder by adding additional fees for using a card.

8.6 **'Honour all cards' rule:** The 'honour all cards' rule in South Africa is applied in its intended form, meaning that merchants cannot choose not to accept certain cards or categories of cards of a card scheme that they have contracted with. This means that if a merchant contracts with an acquiring participant to accept Mastercard and/or Visa cards, it must accept all Mastercard- and/or Visa-branded cards.

8.7 **Frequency of interchange determination by the SARB:** The interchange rates are reviewed on an annual basis to determine whether they are still relevant and, if not, they are adjusted accordingly.

9. Overview of interventions in selected jurisdictions

9.1 Global approaches to interchange regulation show heterogeneity in regulating interchange and some degree of discretion when determining the optimal level of interchange fees. Table 4 below indicates that imposing caps on interchange is the most common method adopted for regulating interchange globally.

[13] At the time of writing this paper, the SARB determined interchange rates for transactions emanating from ATMs, debit and credit cards as well as cash-back at POS devices.

Table 4: Jurisdictional analysis for selected leading jurisdictions on interchange

Country	Electronic payments (debit pull and credit push transactions)	Credit card and debit card	Cash (ATM and cash-back at POS)	Other principles
Australia	• No interchange on both payment streams. • The objective is to increase usage before any regulation is considered.	• The Reserve Bank of Australia applies a cap per transaction on debit and credit cards.	• Dual interchange and direct charging model for ATMs. Interchange on cash-back at POS regulated using a benchmark fee.	• The 'no surcharge' rule has been abolished. • The 'accept all products' rule has been replaced with the 'accept all cards' rule.
Brazil	• Unknown	• No cap is applied to interchange fees.	• Combination of direct charging and bilateral interchange fee agreements for ATMs.	• Unknown
Canada	• No interchange fee is charged.	• The Department of Finance has negotiated a voluntary agreement with Mastercard and Visa to cap interchange fees on credit cards. • There is no interchange for the local debit card network.	• Unknown	• Unknown
China	• Unknown	• Interchange fees are capped for debit and credit cards. • A cap on merchant fees was introduced in 2002 in an effort to curb the increase of interchange fees.	• Fees are set by the People's Bank of China in Mainland China and consortia owning the shared ATM network.	• Unknown
European Union	• No interchange fee for EFT credit.	• The European Commission has placed caps on interchange fees on	• Unknown	• 'Accept all cards' applies while 'accept all products' is banned.

Country	Electronic payments (debit pull and credit push transactions)	Credit card and debit card	Cash (ATM and cash-back at POS)	Other principles
		credit and debit cards.		• Merchants have the right to surcharge payments with cards which are outside of the scope of the Interchange Fee Regulation. However, member states have the option to ban surcharging on all cards.
India	• An interchange fee is charged on EFT debits. • The merchant discount rate (MDR) is zero for unified payment interface (UPI) person-to-merchant transactions.	• The interchange fees on international card schemes are not regulated. • The MDR is regulated to ensure the benefit is passed on to merchants, thereby increasing merchant adoption of card-accepting infrastructure.	• Proposed mandatory free ATM transactions for semi-urban and rural areas.	• Unknown
United Kingdom	• No interchange fee is charged on EFT debits.	• Interchange fees are capped on consumer debit and credit card transactions.	• A dual interchange and direct charging model for ATMs is applied.	• Unknown
United States of America	• Unknown	• A cap on debit cards. • Credit cards are not regulated but the Federal Reserve Board plays an oversight role. • Applies the cost-based approach for debit card transactions.	• Unknown	• Surcharging is permitted. • Merchants are allowed to choose to accept either credit or debit cards.

10. The policy, principles and regulatory framework recommendations

10.1 The following policy, principles and regulatory framework recommendations should apply in respect of interchange determination. These recommendations took into consideration the recommendations of the Banking Enquiry, as reflected in Box 1 below.

Box 1: Banking Enquiry recommendations on ATM carriage fees, payment cards and interchange [a]

The Banking Enquiry made the following recommendations regarding the identified problems on interchange determination:

1. An independent, objective and transparent regulatory process for determining interchange in the payment card and other relevant payment streams should be effected and enforced as soon as practicable. The process should be participatory, independently assessed on the basis of audited data, and overseen by regulators, with public disclosure of all interchange agreements.

2. The IDP should be based on an interchange forum, open to all stakeholders, that would determine the optimal level of the interchange rate applicable to each stream by developing general criteria and getting information on costing (through a third-party costing study) and demand elasticities. Decisions would be made by consensus or by the chairperson, with reasons provided.

3. The ATM carriage fee should be removed, and ATM networks should move to a direct charging model.

4. Card schemes' current rules against merchants surcharging customers who use payment cards should be maintained.

5. There should be regulation or another appropriate statutory intervention to prohibit the 'honour all products' rule. This would seem most likely to facilitate the acceptance of debit cards, by completely freeing the acceptance of these cards from being tied to the more expensive credit card acceptance by merchants.

6. Certain card scheme rules restricting the participation of duly qualified institutions as acquiring participants in the payment card schemes should be abolished.

7. Card schemes should withdraw their prohibitions on pure cash-back at POS, at least to the extent that such transactions are permitted under domestic law.

8. The interchange rates applicable to early debit order (EDO) transactions should be brought within the transparent and objective regulatory scheme which we propose for payment cards and other payment streams.

9. If interchange is to be applied on EFT debit transactions, it should be included within the regulated process, and so be subject to the participatory procedures involved in arriving at and implementing an appropriate level of interchange. The first step would be to establish whether the interchange in this stream is necessary at all.

[a] Competition Commission, 'Conclusion and Recommendations', *Banking Enquiry Report*, 2008, https://www.compcom.co.za/wp-content/uploads/2018/11/8-Conclusion-and-Recommendations_non-confidential1.pdf

10.1.1 **Responsible authority:** The SARB should be the responsible authority to determine, approve, regulate, supervise and oversee interchange rates in South Africa, as the lead regulator, supervisor and overseer of the NPS.

10.1.2 **Policy and legislative framework:** The policy and legislative framework should enable the SARB to fulfil the determination, regulatory, supervisory and oversight roles in respect of interchange. A position paper will be developed to clarify the respective SARB roles and clearly confirm the position of the SARB in respect of interchange determination. The execution of these roles will include consultation with relevant stakeholders, including regulatory authorities and payment industry stakeholders.

10.1.3 **Innovation and efficiency:** Interchange determination should ensure that it promotes innovation and efficiency in the NPS. Interchange can drive investments by participants in the market infrastructure, which enables faster and more cost-effective payment methods. Furthermore, interchange can be used as an incentive mechanism to drive the adoption and acceptance of new payment methods.

10.1.4 **Financial inclusion:** Interchange determination should support financial inclusion through the facilitation of increased access in the NPS by participants, including non-bank participants. Fair and consistent interchange determination could play a major role by encouraging non-banks to provide payment instruments or payment services to those consumers without traditional bank accounts and those that are underserved by incumbents.

10.1.5 **Transparency:** The SARB should disclose the interchange determination methodology adopted and used, the cost principles, the process and the level of interchange rates to the public once determined through publication on the SARB's website. The publication of interchange rates on the SARB website will enable participants, merchants and the public to make informed choices on the suitability of payment methods or instruments. The SARB should inform stakeholders about the considerations included in the interchange rates and what the interchange rates consist of. The considerations included should be reasonable and appropriate.

The SARB should also require participants to disclose to the public the interchange rates for each category of payment instrument and method so that customers and merchants may make comparisons and informed decisions about the cost-effectiveness of the various payment instruments and methods.

10.1.6 **Payment streams:** The SARB should be empowered to determine interchange rates in all the relevant payment streams in order to address the shortcoming related to bilateral and MIF determination in the quest to promote the safety and efficiency of the NPS. In particular, the SARB shall have the power to determine interchange rates in the following payment streams:

a) **Card (credit card, debit card and CCPI):** Interchange is necessary in card payment streams in order to compensate the issuing participant for providing and maintaining the infrastructure to issue the instrument and process the payment instruction. In this regard, transparency and efficiency have been achieved since the SARB commenced with determining interchange rates in this payment stream.

b) **ATM:** Interchange on ATM supports interoperability by facilitating off-us transactions. In other words: it enables the withdrawing of cash at an ATM using a payment card that is not issued by the participant that owns the ATM infrastructure.

c) **Cash-back at POS:** An appropriate interchange for cash-back at POS plays an important role in driving adoption of this payment method as an alternative to ATMs, particularly in areas where ATM distribution is inadequate. It thus promotes financial inclusion and increased access to financial services.

d) **Electronic transfer payments (credit transfers, including faster payments):** In determining interchange rates in these payment streams, the SARB would bring transparency and reduce the inefficiencies of bilateral interchange rate determination. To allow for flexibility, this payment stream includes other methods of payment, such as faster payments and any other related future payment streams that could be introduced in the market. The SARB reserves the right to zero-rate interchange on this payment stream (including other methods of payment in this category) if it deems it appropriate to promote adoption and in the interest of the parties in the two sides of the market.

e) **Electronic payment systems (debit pull payments):** Similarly to the electronic payment systems (credit transfers), the SARB should determine the level of interchange rates in these payment streams, including authenticated collections (ACs) and any other payment stream of a similar nature. The benefits to this approach also include transparency and improved efficiency. The SARB reserves the right to zero-rate interchange in this payment stream if it deems it appropriate and to the benefit of the parties in the two sides of the market.

f) **Interchange in new payment streams:** The SARB should establish the feasibility and applicability of interchange on new and evolving payment streams, considering the relevance and necessary factors such as adoption and market maturity. In this process, the SARB should consult all relevant regulators and stakeholders when undertaking a process to introduce interchange in a new or existing payment stream.

10.1.7 **'No surcharge' rule:** Surcharging on any payment instrument should not be allowed in order to prevent discrimination of certain types of payment instruments. The issue of concern is that some merchants may impose surcharging to recover part of the MSF (which includes an interchange fee) or generate extra revenue. Surcharging is seen as a form of tax for using a certain type of payment instrument or method, and may therefore deter consumers from using a particular payment instrument or method. Although this rule may be seen as a cost-recovery mechanism for merchants for accepting a payment instrument or method, merchants should benefit from widespread usage of payment instruments or methods without surcharging.

10.1.8 **'Honour all cards' rule:** The 'honour all cards' rule in its narrower form (i.e. excluding the 'honour all products' element) should apply. The exclusion of the 'honour all products' element aims to facilitate the acceptance of cards with lower interchange fees by unbundling the acceptance of these cards from being tied to more expensive cards accepted by merchants. The 'no surcharge' rule is necessary to sustain the 'honour all cards' rule.

Although prohibiting 'honour all products' may create uncertainty and inconvenience for cardholders as they would assume that any card with a scheme logo displayed by a merchant should be accepted, this could be alleviated by promoting consumer awareness. For example, merchants should be required to display the card products they accept at the entrance of the shop and at the till. There is no evident downside to the viability of the card schemes by prohibiting 'honour all products' in several jurisdictions, including Australia, the European Union and the United States of America.

10.1.9 **Enforcement and monitoring of interchange rates:** Interchange rates determined by the SARB are binding to the parties in the transaction. Parties failing to apply the determined interchange fees and/or failing to abide by the regulatory framework/rules should be subjected to appropriate sanctions determined by the SARB.

The SARB should require the payment system management body (PSMB) (where recognised) or payment clearing house system operators (PCH SOs) to implement and enforce the application of interchange rates on all participants. The SARB, with the assistance of the PSMB (where applicable), should have the responsibility to oversee and monitor compliance with the interchange requirements.

The SARB should monitor interchange rate application through the collection of interchange fee data, among other things. Participants should be required to submit returns on absolute interchange revenue and expenditure as well as the volumes and values of transactions associated with interchange.

10.1.10 **Fairness and consistency:** Interchange determination should not be biased towards or against any participant, and should be consistently applied or equally applicable to all stakeholders. Fair and consistent determination and application of interchange fees in the different payment streams is important in bringing public accountability and confidence for the NPS.

Interchange should not apply to three-party schemes, except where a three-party scheme licenses a participant to issue cards or acquire cards, or both, or issues cards with a co-branding partner or through an agent. If a three-party scheme appoints a participant to issue cards or acquire cards, or both, or to co-brand or distribute its cards, there is a bilateral fee (similar to interchange or implicit interchange) flowing between the card scheme and the participant or the co-branding partner or the agent.

In this regard, a three-party card scheme should not unfairly benefit from falling outside of the scope of interchange rate determination as the bilateral fees/implicit interchange fee flowing between the card scheme and the participant or the co-branding partner or the agent has the same effect as the traditional interchange fee in a four-party scheme by balancing the two sides of the market. Without a level playing field, issuance of cards by three-party schemes could be promoted at the expense of cards issued by four-party schemes through the bilateral fee, and merchants could feel obliged to accept them.

The SARB should monitor and assess three-party schemes that operate like four-party schemes in order to understand their rationale and the direction of fees or transfer of revenue between the three-party scheme and its licensing partners. This would assist the SARB in ensuring that three-party schemes that operate like four-party schemes do not fall outside of interchange determination.

Interchange rates should be applied equally for the same payment type and should not discriminate whether the participant is a bank or non-bank participant, including those that use financial technology (fintech).

10.1.11 **Being simple, clear and understandable:** The structure of interchange rates in the card stream should be as simple as possible to drive innovation and sufficiently balance the two-sided market considering the type of transactions (e.g. card present and card not present) and the security features of the payment type.

The interchange rate structure should be based on the security and risk nature of the transaction (e.g. EMV 3D Secure, a card-present transaction or a card-not-present transaction) rather than on product type or card brand. Different interchange rates for different types of card products (e.g. a gold card, a platinum card or a private clients card) would bring complexity to the rate structure.

Considering the ever-increasing payment methods that are technology-driven (e.g. Quick Response, Tap and Go, tokenisation etc.), the number of interchange rates per payment stream should be kept at a minimum in order to ensure that they are simple, clear and understandable to consumers, merchants and other participants.

10.1.12 **Data collection and use:** The collection and use of interchange-related data should align to best practice standards to assist with data accuracy, integrity, consistency and completeness.

10.1.13 **Incorporating broader market factors:** The SARB should use quantitative data and take into account qualitative considerations in the determination of interchange rates from both an interchange and a broader market context.

10.1.14 **Interoperability:** Interchange rate structure and the application thereof should encourage interoperability in the market to prevent fragmentation, and should lead to a more harmonised and competitive payment ecosystem. Interchange should facilitate interoperability in innovative payment systems such as faster payments, e-money and mobile money systems.

10.1.15 **Flexibility and adaptability:** The interchange determination process should be sufficiently agile to respond adequately and timeously to ever-changing market dynamics. In this regard, the SARB should have the power to determine interchange rates for relevant existing or future payment streams or any means of payment, whenever it is satisfied that interchange in that payment stream is in the interest of the NPS, including participants and consumers. Furthermore, the SARB should continuously monitor the markets, the applicability of interchange in other payment streams as well as the principles in order to maintain consistency and relevance of its interchange determination.

10.1.16 **Sustainability:** The interchange determination process should result in interchange rates that are sustainable (i.e. interchange rates should be relevant and appropriate for a reasonable period).

10.1.17 **Methodology used to determine interchange rates:** The SARB should apply a methodology that considers international best practice and is suitable to the South African payments environment. In selecting the appropriate methodology and supporting factors, the SARB should consider all the relevant stakeholders' interests in deciding on the methodology and considering the supporting factors.

The methodology should be reviewed every five years, or as and when necessary, to ensure continued alignment with the evolving payments landscape. The review should also include the impact of regulatory intervention on all the affected parties.

The SARB should, however, reserve the right to adjust the interchange methodology if it believes that it would be in the interest of the safety and efficiency of the NPS.

10.1.18 **Frequency/timing of interchange fee determination:** The SARB should determine and review interchange rates annually, or as and when appropriate, using the approved methodology.

11. Conclusion

11.1 Interchange plays an important role in the NPS as it provides incentives for participants to provide and maintain the infrastructure as well as payment instruments through which consumers and merchants transact. Furthermore, interchange ensures interoperability between payment systems and competition between participants. Increased interoperability and competition can drive innovation, which contributes to improving customer experience.

11.2 The SARB's policy and regulatory framework for the determination of interchange follows some of the international practices as well as suitability to the South African payments environment. The SARB believes that the decision to facilitate interchange determination in all the relevant payment streams is in the best interest of the NPS. The evolving payments environment and the increasing role of non-bank providers of services imposes a responsibility on the SARB to continuously assess the feasibility, sustainability, applicability and methodology of determining interchange in order to maintain the safety and efficiency of the NPS.

12. Comments and contact details

12.1 Stakeholders and other interested parties are invited to forward their comments on this consultation paper by 11 March 2022. Comments should be addressed to npsdirectives@resbank.co.za.

Abbreviations

AC	authenticated collection
AEDO	authenticated early debit order
ATM	automated teller machine
CCPI	card credit payment instruction
EDO	early debit order
EFT	electronic funds transfer
fintech	financial technology
FSCA	Financial Sector Conduct Authority
IDP	interchange determination project
MDR	merchant discount rate
MIF	multilateral interchange fee
MSF	merchant service fee
NAEDO	non-authenticated early debit order
NPS	national payment system
NPS Act	National Payment System Act 78 of 1998, as amended
PCH SO	payment clearing house system operator
PIN	personal identification number
POS	point of sale
PSMB	payment system management body
RTC	real-time clearing
SARB	South African Reserve Bank
SARB Act	South African Reserve Bank Act 90 of 1989, as amended
UPI	Unified Payment Interface