

**CONFIDENTIAL****Terms of Reference for the Facilitator of the Interchange Determination Project****1. Introduction and background**

For several months the South African Reserve Bank (the Bank) has been involved in a protracted process of discussion with the National Treasury (NT), the Department of Trade and Industry and the Competition Commission (CC), in an attempt to find a resolution to the issues raised in the Banking Enquiry Report (the Report) concerning interchange. From a safety and efficiency point of view, the Bank has been concerned for some time about what seems to be an impasse in the payment system when it comes to interchange<sup>1</sup> negotiation in many of the different streams. This is largely due to the banks being aware that a major concern contained in the Report related to the fact that banks were setting, or had an influence over, interchange setting mechanisms. The recommendations on interchange (recommendations 8 to 14) are attached in Appendix 1.

As a result of the abovementioned discussions the Bank has made a proposal on the progress going forward, which will entail a Bank-facilitated and overseen revision of interchange rates for all payment streams in South Africa, including interchange in the card environment. This proposal has been supported by the NT and the CC and has been endorsed by the Bank's Governors' Executive Committee. It was originally estimated that the process would take six to twelve months to finalise, however, it appears from initial discussions that this may not be achievable. It will, therefore, also be required of the facilitator and technical experts to provide a more realistic estimate during the initial study.

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<sup>1</sup> The term interchange is used generically in this paper. The first step of this project will be to define interchange and identify which of the payment streams qualify for interchange determination.

## **2. Objectives**

The objective of this project is for the Bank to facilitate a fair and transparent process whereby interchange rates for each of the payment streams, officially recognised and registered with the Payments Association of South Africa (PASA), are reviewed in terms of:

- whether they are feasible and/or justifiable in that stream; and
- are realistic and appropriate for that payment stream based on acceptable parameters.

A further objective of this project will be to build South African experience in the interchange review and determination process. Therefore, the project should result in recommendations for a sustainable mechanism or process to be established whereby interchange rates can be reviewed as required by changing market conditions from time to time for:

- a particular payment stream; or
- all payment streams; or
- the introduction of a new payment stream.

## **3. Project process**

The following sections define in high-level terms the process and, where relevant, the principles that should be applied in this project. The first process to be undertaken to launch this project will be the appointment of appropriate expertise. Although the Bank will be responsible for the project in its entirety, there will be reliance on outside consultants in the course thereof.

### **3.1. Appointment and role of a lead facilitator**

A person capable of facilitating the process must be appointed. This person will play a critical role in facilitating the process of interchange determination among technical experts and stakeholders in the payment system. This will, of course, include bank and non-bank stakeholders. It will be expected of

this person to not only facilitate the initial process of reviewing interchange in all payment streams, but also to recommend a process by which future interchange revisions could be conducted, as referred in 2 above.

### **3.1.1. Major conditions of employment**

- 3.1.1.1. The facilitator should have a proven record of expertise in facilitation.
- 3.1.1.2. A thorough knowledge of the national payment system (NPS).
- 3.1.1.3. May have no bias towards any stakeholder or stakeholder organisations that could in any way be interpreted as compromising the transparency or fairness of the process.
- 3.1.1.4. Must have a good working knowledge of interchange determination and application and the ability to work with, and facilitate, experts in this field.

### **3.2. Appointment and role of subject matter experts**

Subject matter experts can be appointed, with the approval of the Bank, to assist the facilitator in this process. It is envisaged that in the initial study only one subject matter expert would be required, but thereafter more than one.

#### **3.2.1 Major conditions of appointment**

- 3.2.2 Proven expertise in interchange strategy determination and application.
- 3.2.3 If more than one expert is required, these experts should be appointed based on their proven knowledge of interchange determination and understanding across different or multiple payment streams.
- 3.2.4 May have no bias towards any of the stakeholders or stakeholder organisations that could in any way be interpreted as compromising the transparency or fairness of the process.

### **3.3. Deliverables**

#### **3.3.1. Initial study**

The first major deliverable in the project will be an initial study. An initial study is required to finalise the scope of this project in more detail. This would result in the delivery of more final requirements for the detailed process, expertise, budget and prioritisation of the sequence of reviewing the various payment streams.

The initial study will include the requirement for the facilitator and technical expert/s to research and obtain known probable parameters for the determination of interchange in the relevant payment streams. The results of the initial study will be presented to, and considered by, the Steering Group<sup>2</sup> before the project will be given the go-ahead to continue to the next phase.

A possible issue in this regard is that the previous 2003 study by the banks was focused on card interchange.<sup>3</sup> Some of the complexities of the card process are thoroughly documented and could be used as a basis to determine the validity of some of the dimensions in the process for non-card payment streams. However, the parameters used in the interchange determination in the past years in other payment streams should be available (with the assistance of the banks) in order to facilitate this process.

#### **3.3.2. Development of a model**

The second major deliverable in the course of this project will be the development of a “model” for the review of interchange in the various payment streams. It is envisaged that the model will be developed from the research done in the initial study, and the experience and knowledge of the subject matter expert/s on dimensions and parameters that should be

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<sup>2</sup> See section 3.4 for more information regarding the Steering Group

<sup>3</sup> The Banking Enquiry Report acknowledged the validity of interchange.

considered in the review. The model would form the core of the discussions with stakeholders but, in its final form, would be fairly firm and non-negotiable based on previous experience and facts.

### **3.3.3. Identification of stakeholders**

3.3.3.1. This stage would identify the stakeholders or stakeholder representative groups to be consulted in the process. It will be a specific requirement in this project that stakeholders will not be permitted to gather together to discuss interchange or specific aspects relating to the determination of the actual interchange rate. Therefore, in this process consideration will have to be given to the following:

- The different payment streams concerned;
- Persons/organisations that have an influence on, or directly affected by, the interchange process considering the issuing, acquiring and the other user perspectives;
- The fact that it will not be possible to consult with every stakeholder concerned and therefore a broad spread of views will have to be considered;
- Although the facilitator will be required to determine and recommend the appropriate stakeholders or stakeholder organisations, it is assumed that these would include consideration of clearing banks, international card payment schemes, retailers, payment system stakeholder forums (PSSFs) and other bodies represented on the National Payment System Strategy Body (NPSSB).

### **3.3.4. Consideration of stakeholder input**

3.3.4.1. Consultation should be based on the model that has been developed and should not be a process that gathers input with a “blank-page” approach. This approach is particularly recommended due to the time-consuming process and complications that will most certainly be experienced if a basic model on which consultation is based does not exist.

3.3.4.2. Additional input and suggestions/requirements provided by stakeholders should be considered and evaluated against the model. The proposed process is that outlying demands and requirements should be eliminated, but that reasonable input for refining and improving the model should be included in the process.

### **3.3.5. Quantitative analysis**

3.3.5.1. Once the model has reached a final stage and parameters for the use in the quantitative analysis have been concluded, formal agreement and commitment of stakeholders to the implementation process must be finalised.

3.3.5.2. The facilitator will assist in the identification and appointment of a person or organisation that has the capability and expertise to provide the data processing and calculation required to process the data collected from stakeholders in the interchange determination process.

3.3.5.3. The process to facilitate the submission of required data from stakeholders should be launched.

3.3.5.4. This quantitative process should be monitored by the facilitator.

### **3.3.6. Qualitative analysis**

3.3.6.1. A qualitative panel must be established in the course of the project which will be used in final deliberations on the interchange determination in each payment stream. This will include the use of interchange to influence behaviour and to reward risk reduction in the payment system, in terms of policy or strategy determination by the Bank from time to time, for example:

- the encouragement of authentication and risk reduction, such as EMV standards;

- the encouragement of credit-push payment instruments;
- encouragement of cash withdrawals at point-of-sale devices; or
- any other strategy.

### **3.4. Steering Group**

3.4.1. The steering group will meet at pre-determined intervals during the project to measure progress and make determinations relating to the project progress or any decision that may be required to facilitate the project progress. The facilitator will provide progress reports to this committee and such meetings will include input/advice from any technical expertise that may be required to ensure project progress and completion.

3.4.2. The results of the initial study (as referred to in paragraph 3.3.1 above) will be presented to, and considered by, the Steering Group before the project will be given the go-ahead to continue to the next phase. The results of the initial study will form the basis of a detailed plan that will be documented for the future use in the project and be presented to the Governors' Executive Committee.

### **3.5. This Steering Group will be chaired by the Bank and consist of:**

3.5.1. the Deputy Governor responsible for the National Payment System Department (NPSD); or

3.5.2. the Head: NPSD;

3.5.3. other members of the NPSD nominated by the Deputy Governor; and

3.5.4. external experts determined by the Bank.

3.5.5. The Steering Group will, from time to time, provide feedback and make submissions where required to the relevant Deputy Governor and/or Governors' Executive Committee to provide feedback on progress.