South Africa Retail Banking Diagnostic: Treating Customers Fairly in relation to Transactional Accounts and Fixed Deposits

Public workshop jointly hosted by National Treasury and FSCA

1 October 2018

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

FSCA
Financial Sector
Conduct Authority

Contents

Background

- **2008 - Banking Enquiry of the Competition Commission (Jali Commission)**

  - Made a number of findings and recommendations - poor outcomes experienced by the customers of retail banks.
  - Highlighted a clear gap - regulation of the market conduct of retail banks, as well as challenges in the payments environment

- **June 2010 – Minister of Finance meets Bank CEOs**

  - Banks commit to implementing the CC Banking Enquiring recommendations
  - Media Statement – Comp Com, NT, the dti, in consultation with SARB to take panel's recommendations forward.

Background

- **Feb 2011 – Twin Peaks discussion paper - A safer financial sector to serve SA Better**

  - Policy Objectives - *Financial Stability, ***Consumer Protection & Market Conduct,** * Expanding Access - Financial Inclusion * Market Integrity – Combating Financial Crime

  - 2011 Minister – Budget Speech – in the context of the Banking Enquiry

  " I believe it is time to put in place measures that will ensure that banking charges are fairly set, are transparent and do not create undue hardship"

- **March 2011 – the FSB TCF roadmap Published**

  - Financial Institutions expected to measure activities against the 6 TCF outcomes
  - NB, Voluntary therefore not enforceable

Background

- **August 2012 - National Treasury stated –**
- *The Minister noted progress the banks made in meeting some of the recommendations of the Banking Enquiry.*
- *There was more to be done to ensure that all South Africans had access to **fair & cost effective** banking services.*
- *The services offered to middle & low income South Africans must be guided by **simplicity, comparability, transparency accessibility and competitive costs.***

Background

- **2016 –** WB Releases – Achieving Effective Financial Inclusion in SA, A payment perspective

- **2018 –** WB Releases– Retail Banking Diagnostic: Treating customers fairly in relation to transactional accounts & fixed deposits

The FSCA & bank regulation

- The FSCA established April 2018 - dedicated market conduct regulator, with full jurisdiction over all financial institutions in South Africa.

- Historically, SARB focused on prudential oversight of banks. FSB regulated banks’ intermediation only in respect of FAIS Act, and NCR only in relation to credit extension

- Market conduct of banks will be directly regulated for the first time in SA

- 2017, Treasury commissioned the World Bank to undertake a study to provide independent research on the extent to which banks in South Africa treat their retail customers fairly in relation to transactional & fixed deposit accounts

- The study’s analysis & recommendations + public comments on the study will help shape the FSCA’s approach to regulating the way banks treat their customers, including the development of conduct standards

What is fair treatment?

- FSB in 2011 initiated the **Treating Customers Fairly (TCF) initiative** which aimed to achieve the following fair outcomes:
  - Customers can be confident they are dealing with firms where TCF is central to the corporate culture
  - Products & services marketed and sold in the retail market are designed to meet the needs of identified customer groups and are targeted accordingly
  - Customers are provided with clear information and kept appropriately informed before, during and after point of sale
  - Where advice is given, it is suitable and takes account of customer circumstances
  - Products perform as firms have led customers to expect, and service is of an acceptable standard and as they have been led to expect
  - Customers do not face unreasonable post-sale barriers imposed by firms to change product, switch providers, submit a claim or make a complaint.
- The mandate of the FSCA includes **protecting financial customers** by **promoting the fair treatment of financial customers** by financial institutions

Aims of the diagnostic

- Identify shortcomings, from a fair-treatment perspective, in banks’ provision of **transactional bank accounts** & **fixed deposit accounts**

- Identify whether & how any identified major fair-treatment deficiencies could appropriately be addressed through **market conduct regulation**

Analysis

- Practices identified by this process were analysed in relation to:
  - International good practices, such as those identified in the World Bank's **Good Practices for Financial Consumer Protection** and the G20/OECD's **High-Level Principles on Financial Consumer Protection**
  - Research requested by the National Treasury undertaken specifically for the diagnostic
  - The TCF outcomes targeted by the FSB/FSCA as part of the Treating Customers Fairly Program

- The study is written as an 'exception report' – it identifies potential shortcomings in the conduct of banks, rather than also focusing on good practices that do not require intervention

- Findings in relation to 'major banks' refers to Big 4 - ABSA, FNB, Nedbank, and Standard Bank

Summary of findings

- The treatment of customers varies from one bank to another as well as by product offering.
- The findings and the variations in approach by banks point to the need for clear and consistent conduct regulation in the sector, ensuring that all banks uphold consistent standards of customer treatment
- The findings should not be seen as applying to any specific bank or all banks equally

Product Design: Findings

Low income account offerings:

- Transactional account offerings and pricing aimed at the low-income market largely mirror those offerings targeted at higher-income customers (particularly where interest earned can't offset costs)
- Pricing bundles appear intended to drive customer behavior away from branch and ATM services to electronic channels, even though there is still a great propensity to transact in cash in this market
- Product parameters under Financial Sector Code reporting requirements may not focus sufficiently on transactional accounts; complexity of products may also hinder clear reporting.
- Not clear that product changes that can have a significant impact on low-income consumers are consistently subject to internal testing by banks.

Product Design: Findings

Middle income account offerings:

- Structural complexity in bundles, and in each bank's individual transaction pricing, make it difficult for customers to undertake meaningful comparisons of offering
- Bundle pricing seems intended to encourage usage of digital channels and discourage usage of traditional channels. Adds to pricing complexity
- Several banks implemented TCF Outcomes–style concepts in written product-approval and other decision-making policies. However, the level of sophistication and granularity of such policies varies significantly, including variation in focus on customer research and testing, and assessment rigor to ensure suitability for an identified target market
- Overall pricing between the major banks' core bundles is relatively close, and higher than some competitor offerings. (Diagnostic did not cover reasons for pricing similarity or to assess the level of bundle underutilization)

Product Design: Findings

Fixed deposit accounts:

- Wide range of rates offered, and significant variation in product structuring for fixed deposits.
- The availability of a range of offerings not necessarily of concern. However, complexity in comparing individual aspects of alternatives is likely to make it more difficult for retail customers to choose without assistance.

Findings across transaction and fixed deposit accounts:

- **Potentially unfair product terms**: Review of a sample of current bank terms and conditions, and discussions with banks, suggests varying degrees of effort across the industry to ensure that such terms do not contain unfair or excessively one-sided clauses. Clauses of concern include, for example, significant exclusions of liability and the placing of excessive responsibility on customers for some risks (discussed in more detail in report)

Product design: Recommendations

- Strengthen and simplify reporting parameters under the FS Code regarding transactional accounts to incentivize banks more clearly to ensure that pricing as well as features support accessibility
- Introduce measures promoting the provision of full-featured transactional account offerings that respond to the needs of low-income customers, including in terms of pricing
- Set out minimum feature and pricing aspects for such accounts, that banks can enhance and build on, fostering accessibility while allowing for innovation. Parameters should be based on comprehensive customer-focused research, and examine potential market impact, including previous experience with Mzansi accounts
- Consider including in the COFI/FSR Laws specific product-design obligations to ensure that financial institutions' processes for developing and making changes to transactional account and fixed deposit products include clear, concrete steps intended to drive TCF Outcomes.
- Consider undertaking an updated Banking Enquiry–style pricing-versus-costs analysis and a complementary in-depth study of switching behavior and attitudes among middle-income customers.
- A regime that would prohibit unfair terms in transactional account and fixed deposit standard form contracts should be implemented in the COFI/FSR Laws.

Product offer and sale: Findings

Advertising and sales material

- Significant gap, and interpretative inconsistencies, in applicability of the FAIS to transactional accounts. Uncertainty regarding the application of general consumer protection legislation to transactional account and fixed deposits

Product disclosure

- Legal and regulatory framework for disclosure is fragmented and limited. Wide variation in what, when, and how information about product features and pricing is disclosed to retail customers.
- The Code of Banking Practice approach to align and standardize product terminology has important gaps, has been implemented inconsistently. Language used to articulate Ts&Cs in customer agreements remains dense and laden with legal terms and jargon. Wide variation in how banks describe interest rates on fixed deposits.
- Most customer-facing product documentation is available only in English and Afrikaans, despite 77% of adults speaking another main home language
- Industry-led efforts to provide fee calculators to help customers compare products appear to have been largely ineffective

Product offer and sale: Findings

Advice and sales practices and incentives:

- Quantitative sales data a key component of compensation metrics for frontline sales staff, though several banks have recently introduced “quality” sales measures.
- Frontline sales staff often rely solely on income-based account eligibility criteria to guide consumers toward certain products.
- Although several banks use agents or intermediaries to facilitate customer acquisition and product usage, third-party retail agent models have not been fully leveraged to achieve financial inclusion policy objectives.
- Lack of clear rules governing the relationship between a customer, an agent or intermediary, and a bank with regard to transactional accounts and, to a certain extent, fixed deposits

Product offer and sale: Recommendations

- COFI/FSR Laws should explicitly and comprehensively address advertising and marketing practices including to address existing legal gaps.
- COFI/FSR Laws should establish a disclosure regime that covers key features, terms, pricing, and rights and recourse, and manner and timing of disclosure.
- Require provision of a standardized shortform disclosure document to summarize key product features, pricing, and terms and conditions
- Consider feasibility of including an overall cost indicator in short-form disclosure documents for transactional accounts
- Establish standards for disclosing and explaining interest rates and calculation of interest on fixed deposits in a simplified manner
- COFI/FSR Laws should mandate more comprehensive language requirements for key customer-facing documentation, learning from NCA and Use of Official Languages Act

Product offer and sale: Recommendations

- Should establish or support the establishment of a central website and related tools that make it easy to compare features and prices of transactional accounts and fixed deposits.

- COFI/FSR Laws should appropriately strengthen governance of advice and sales related to transactional accounts and fixed deposits, including regarding:
  - the compensation of frontline sales staff and agents to limit consumer risks
  - protective rules governing relationships between banks, third-party agents/intermediaries, and retail customers (leveraging work so far under the Retail Distribution Review).

- Application of these rules should be proportional, and adaptable, to initiatives intended to promote effective access by low-income consumers to transaction and savings products.

Product operation and administration: Findings

Potentially unfair fees:

- Terms and conditions do not seem to have been effectively subjected under the general unfair-terms regime. Common law concepts of penalties and limited legislation seem to apply, but no common understanding as to when a fee would be prohibited as a penalty. Some banks consider that disclosure can be sufficient to avoid a fee being a penalty.
- While there have been some improvements in fee-charging practices, some fees continue to be charged that could potentially be restricted penalties in the sense contemplated under existing legislation or could nevertheless be viewed as unfair or unreasonable

Changes to terms and conditions and fees and charges:

- In Ts&Cs, banks retain extensive unilateral rights to make changes to fees, charges and other terms. Some banks' Ts&Cs contain clauses indicating that a bank can change fees, charges and other Ts&Cs without prior individual notice being given to the customer.

Product operation and administration: Findings

Temporary overdrafts or “shadow” credit limits:

- Some banks allow selected customers to temporarily overdraw their transactional account without a prior agreed overdraft, while others charge for this service. It seems that customers would need to expressly opt out if they are not in fact interested in receiving this service.
- Differing legal views between banks regarding application of NCA to temporary overdrawing and compliance. Indications are that customers do not necessarily understand that they have been granted such credit nor how it operates.
- Some banks started implementing alternative ways to notify customers in case their transactional accounts may not have sufficient funds to cover future debits (to avoid overdrawing as well as dishonors).

Dormant transactional accounts:

- There do not currently appear to be regulatory or self-regulatory requirements, nor uniform industry practices, for dealing with dormant accounts.

Product operation and administration: Findings

Statements:

- Statement requirements for transactional accounts are not currently regulated by legislation. CBP addresses provision of statements for transactional accounts only to some extent. Banks indicated that they provide customers with a statement either on a regular basis or upon request. Practice in this regard seems to vary, and charging for paper statements seems a common practice. Consumer representatives indicated that access to bank account statements is one of the main challenges faced by account holders.

Information about external dispute resolution:

- Information regarding external dispute resolution mechanisms does not seem to be consistently available across all channels

Product operation and administration: Recommendations

- Recommended regime prohibiting unfair terms should apply to relevant fees. Fairness of such fees would be tested against the restrictions in the regime to determine whether the fee is appropriate
- Application of existing legislative and common law doctrines on penalties should be clarified for financial sector participants.
- Recommended disclosure improvements should also be pursued to address the potential lack of customer awareness regarding the application of relevant fees. Such fees should not be enforceable unless disclosed consistently with requirements.
- Should issue specific regulatory requirements on transparency and fair conduct related to dormant accounts. Specific prohibitions of adverse practices should also be considered (e.g. continuing to charge maintenance fees)
- Should consider how best to regulate overdrafts (cognizant of both NCA and COFI/FSR Laws) to ensure banks do not engage in unfair practices in relation to temporary overdrawing of transactional accounts.
- More specific product-design obligations would better ensure that the inclusion of overdraft features is consistent with TCF Outcomes

Product operation and administration: Recommendations

- NCR should also consider a targeted review of banks’ current practices relating to temporary credit
- COFI/FSR Laws should mandate minimum notice periods and require individual customer notice of changes that will have a direct customer impact,
- Unilateral variation rights included in terms and conditions should also be subject to an unfair-terms regime
- COFI/FSR Laws should specify requirements for providing periodic statements for transactional accounts. Regulatory requirements should address minimum content and format requirements, as well as frequency, timing, and manner of delivery (including easy access to statements and other transactional information through electronic channels)
- Recommended disclosure requirements should require banks to disclose clearly the contact information and basic processes for internal and external complaints handling mechanisms

Product closure and mobility: Findings

Potential barriers to account closure:

- Banks generally confirmed that account closure is at the customer's discretion but that some administrative steps would need to be undertaken. The OBS reports only a few complaints related to account closure, but there seems to be a lack of transparency or publicly available information regarding applicable procedures and varying degrees of facilitation by banks

Account-switching processes:

- Banks tend to follow the CBP's provisions regarding switching processes, but these place some of the administrative onus on customers. Industry information regarding switching processes is unclear, and some banks are more facilitative than others. Some banks have developed debit order switching authorization forms as part of initiatives to assist customers to switch in

Early termination and rollover of fixed deposits:

- Customers may not understand fully the implications of restrictions on fixed deposit withdrawals. Automatic roll-overs of fixed-term deposits may sometimes also occur without customer understanding.

Product closure and mobility: Recommendations

- Recommended disclosure requirements should cover clear information regarding closure and switching rights and processes.
- Before considering regulatory intervention, authorities should work with the banking industry to achieve a common and facilitative industry approach to transferring bank accounts, including debit orders
- Recommended short-form disclosure documents should provide brief, clear explanation of consequences of early termination and of implications at maturity if customer does not withdraw a fixed deposit.
- Potential inappropriateness or unfairness of terms governing early withdrawals should also be addressed through the product-design and unfair-terms measures referred to above.
- A coordinated industry approach should be considered for providing alerts ahead of the maturity date of fixed deposits.

Code of Banking Practice: Findings

- CBP remains a key document governing and influencing bank practices in relation to transactional accounts and fixed deposits.
- Several banks suggested that the CBP should be reviewed and further updated in the light of TCF Outcomes, and the report notes some examples where it may currently have gaps or inconsistencies in this regard.

Code of Banking Practice: Recommendations

- The CBP should be reviewed to ensure that it fully reflects the latest public and regulatory expectations in the context of the TCF Outcomes.
- Efforts should be made to enhance consumer awareness of the CBP.

PAFI Paper: “Achieving Effective Financial Inclusion in South Africa: A Payments Perspective”

- Had been shared previously, but publically released along with diagnostic, to support cross-references
- No comment being sought on that paper; for reference purposes only.
- Examined factors that influence access to and use of transactional accounts and electronic payment instruments. Has since been used by the National Treasury/ SARB to inform policy and regulatory developments regarding payment system regulation.

Next steps

- Comments to be submitted – deadline 16 October. Comments can be submitted to marketconduct@treasury.gov.za
- FSCA to engage with banks
- Conduct standards to be developed

FSCA process

- Two phases proposed:
  - Analysis of the findings and recommendations - do we agree with them and to what extent? Are there additional matters to consider?
  - Implementation of the agreed recommendations (through COFI Bill/conduct standards or further research).
- Step 1: NT/FSCA workgroup to review comments
- Step 2: Take the outcome of our internal analysis to stakeholders to say this is what we think, do you agree?
- Step 3: Set up work groups to implement the recommendations
- Engagement with individual banks will be ongoing, and the first high-level conduct standard for banks is being developed in parallel.