



## SUBMISSION TO COMPETITION COMMISSION

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1. Abbreviations and acronyms

<b>AEDO</b>	<b>Authenticated Early Morning Debit Order</b>
<b>BIG 4 BANKS</b>	<b>Absa, Nedbank, Standard Bank of South Africa and First National Bank</b>
<b>Blue Book</b>	<b><i>Framework and Strategy Document</i> for the SA Payment system, published by the Reserve Bank in 1995</b>
<b>Card Associations</b>	<b>VISA and MasterCard</b>
<b>CPSP</b>	<b>Customer payment service provider</b>
<b>EDO</b>	<b>Early Morning Debit Order System</b>
<b>Feasibility Report</b>	<b>The Report prepared for the Competition Commission by Feasibility dealing with the National Payment System and Competition in the Banking Sector</b>
<b>Intecon</b>	<b>Information Technology Consultants who trades as ALLPS and who is a CPSP</b>
<b>JSE</b>	<b>Johannesburg Stock Exchange</b>
<b>NAEDO</b>	<b>Non-authenticated Early Morning Debit Order</b>
<b>NPS</b>	<b>National Payment System</b>
<b>NPS Act</b>	<b>National Payment System Act No. 78 of 1998 including subsequent amendments through Act No. 22 of 2004</b>
<b>PASA</b>	<b>Payments Association of South Africa</b>
<b>PCH</b>	<b>Payment Clearing house</b>
<b>PSSF</b>	<b>Payment System Stakeholder Forum for Collections in EDO</b>
<b>SARB</b>	<b>South African Reserve Bank</b>
<b>SARB Vision 2010</b>	<b>Published by SARB Payment Division in consultation with the described stake holders summarising the achievements to date and the focus for the next four years</b>

**2. Background of submitting entity and any CPSP**

Information Technology Consultants (Pty) Ltd ("Intecon") registration number 1997/001712/07 is regarded as a CPSP as described in the Blue Book and renders payment services primarily to payers in the low to moderate income categories.

Intecon has been active in their service offering since December 1995 and the previous Boland Bank was used in the early days as acquiring bank. Since 2001 Intecon uses Mercantile Bank Limited as acquiring bank.

This submission will deal with first hand knowledge as experienced by Intecon over the last 10 years when dealing with the NPS, PASA, SARB, the BIG 4 Banks, the relative position of smaller banks in the PASA environment, the effect of the current milieu on low income earners, the governance structures of PASA and the effect on new entrants and low income earners, the effect of pricing in the current bilateral structures and lastly why it is possible for the BIG 4 Banks to exploit users on bank charges.

The last section deals primarily with the effect of all of the above on Intecon as CPSP describing factual occurrences and the ability of the structures described to act anti-competitively not only to entities such as Intecon but generally to all entities competing with the BIG 4 Banks when rendering payment services.

Intecon received permission on Friday 20 October 2006 from Mercantile Bank Limited to do this submission. Prior to last Friday, Intecon was informed that such submission will be subject to approval from the acquiring bank and PASA.

Being a CPSP, this submission will start with comments made in the Feasibility Report pages 168 – 170 dealing with participation of Non Banks (CPSP's).

CPSP's are either a conduit of an acquiring bank or a conduit between the end-beneficiary and an issuing bank [sponsoring bank] and where the end-beneficiary in own name has concluded an agreement(s) with issuing bank(s). The latter is generally referred to as an outsource agreement structure between the end-beneficiary and CPSP.

It is well known and accepted that CPSP's render cheaper, better value added services and better efficiency to end-beneficiaries as a conduit between the end-beneficiary and banks than in a direct structure between the end-beneficiary and banks.

The above has to be understood to understand the long lasting "issues" between CPSP's and banks. Until very recently, PASA

failed and refused to officially recognise through published criteria etc the standing of CPSP's in the NPS. This amongst other reasons was done on purpose and left a "vacuum" in the NPS, controlled by the BIG 4 Banks.

Since the publication of the Feasibility Report, PASA published criteria to be met by system operators (CPSP's). The publication indicated that finalisation is subject to approval from SARB, through directives due to be issued by SARB. The PASA publication evoked various criticisms amongst CPSP's as CPSP's and banks compete directly with each other when rendering payment services. Conditions contained in the PASA publication renders once again the situation where PASA acts as player and referee to the detriment of CPSP's.

SARB took the initiative and started a consultative process and road show inviting all known CPSP's to participate and invited all to comment on the draft SARB Directive circulated. SARB further suggested the formation of an Association, primarily looking after the interests of CPSP's.

An Association of System Operators has subsequently been formed, consisting of the CPSP's.

The comments made that CPSP's or system operators operate in an "absence of rules" environment is not the Intecon experience. Although clearing and settling is the exclusive domain of banks, all payment instructions enter the core of the NPS through an acquiring bank.

In this scenario the agreement between the acquiring bank and the CPSP renders the rules environment as all conditions, entry criteria of the applicable payment stream as defined in the PCH Agreements, etc is passed on by the acquiring bank to the CPSP to be met. The acquiring bank ultimately accepts all risk for any payment instruction that enters the NPS and not the CPSP.

Even in circumstances where transactions are submitted directly to BankServ as with the EFT Payment streams, the CPSP does this under the code allocated by the issuer to the end-beneficiary in terms of the sponsoring agreement between the end-user beneficiary and the banks.

We will deal with sort at source later in this submission.

### **3 THE BIG 4 BANKS ARE POWERFUL**

**We are not repeating the obvious. However, to get the full picture it must always be remembered that "banking" as business is very lucrative.**

**Due to time constraints we will not elaborate on the position of the BIG 4 Banks on the JSE, the relative position and market capitalisation of banking versus other sectors in our economy and the general performance of share prices of the BIG 4 Banks when compared with other countries, both first world and in developing markets.**

**It is sufficient to state that the BIG 4 Banks have outperformed their counter parts across the world. It further has to be remembered that 69% of the income earned by banks relate to fees charged for services and not interest income and that this ratio once again when compared with other economies world wide, is exceptionally high.**

**The momentum on the JSE has to be maintained by the BIG 4 Banks and constant value to share holders of the BIG 4 Banks has to continue. The BIG 4 Banks have to protect their turf, share price and income streams.**

**The BIG 4 Banks have access to all relevant disciplines, especially lawyers and law firms and have access to the best corporate advice available. Planning starts years before implementation and strategies are carefully constructed with fall back plans.**

**The BIG 4 Banks in this regard are all in the same situation. Although competitors with one another in a variety of matters, they are not competitors with regard to strategies in their common interest to protect their turf. The PASA structures implemented and the control of the BIG 4 Banks in these structures are later dealt with in this submission.**

**Due to time constraints we do not elaborate on growth in the economic active society, the high level income earners, the corporate entities, upcoming middle class, income spreads, etc.**

**We will however state that growth for the BIG 4 Banks with regards to fees charged for banking services rendered, income earned on housing products granted and general credit provided, will come from the lower to moderate income earners, the majority of our population. We do not elaborate on the BIG 4 Banks' entry with products etc in this lower to moderate income market.**

The other "income earning sectors" to collect bank charges and fees from, are saturated.

The question remains whether it is justifiable for the growth and momentum required by the BIG 4 Banks to come from the majority of our population through the structures applied that banks in own discretion decide what to charge and where banks are not prepared, on request, to disclose how they calculate their fees.

With bank charges under scrutiny, the BIG 4 Banks move the income lost to other users in the NPS as will be addressed later on in the bi-lateral section. If these users pass the cost on once again to the payers, the BIG 4 Banks will appear to be in good standing but nothing was actually achieved.

4. Blue Book Implementation: Did it fail?

The NPS is described in the Blue Book to be a national asset.

With regards to the implementation for the broader South African economy, our role in the international economy, the corporate entities and the high income earners through the implementation of the various sophisticated systems without repeating any one specifically and products offered, the answer is unconditionally NO: It did not fail but exceeded expectations to render one of the best clearing, settling and banking systems in the world.

The implementation however failed with regards to the lower end of income earners; and

Access to the NPS to promote competition which in itself will create alternatives to the benefit of the majority of our population; and

The preferential treatment of banks once they move away from their fiduciary position as deposit taker of money and become a credit grantor.

We do not elaborate on the SARB Vision 2010 and accept that readers have read and understood the content.

Preferential treatment and priority deductions on bank own systems

To date banks in general believed that once a depository relationship is created through the opening of a bank account, the account holder client now belongs to the bank, enabling the bank as credit grantor or as service provider, preferential treatment on payment above any other provider of services to the same client.

The process generally started when banks demanded that the rendering of products of a credit nature would only happen once the salary deposit account of the client vested with the bank from whom the client wants to obtain the credit as a risk redemption measure.

What happened behind the scenes and on the banking systems?

The information technology employed by the banks on banking systems rendered the position that once salaries are deposited into these accounts, the banks as creditors will always first receive payment.

Banks have placed themselves as preferred creditors ranking on payments above the total external community, disturbing the natural sequence of credit agreements concluded and admitted that affordability levels of the payer played no role in the credit decision making process. As long as salaries are deposited into these accounts, the banking systems will take care of the rest.

Although in existence on all bank systems, the most prominent example of exploitation happened in the African Bank and Standard Bank relationship. This relationship started with a "Joint Venture funding relationship" between these two banks granting credit to customers with opened Standard Bank E Plan Accounts.

This system was enhanced to a point where all available funds in the account to the limit of the repayment due, was collected, meaning that part payment was better than no payment at all.

The above was common practise and no secret. How did SARB, PASA and the banks react? After pressure from a variety of entities not entertaining similar privileges, a circular was distributed indicative that no new priority users may be entertained but the existing privileged use continued.

The broader banking environment and NPS were not prepared to change the practises and behaviour and only the implementation of the conditions contained in the National Credit Act dealing with priority deductions on bank own systems, resulted in a Directive issued by SARB.

The significance: A totally different regulator was required through legislation not earmarked to address NPS related aspects, to normalise the position.

Why was the NPS forced to comply? Other applicable legislation stating that banks may not contravene any legislation.

The result: EDO described fully below, rendering after 10 years an equal collection system for all providers of services to the lower end income earners, changing the position that banks have entertained to date.

5. Self-regulatory nature of the BIG 4 Banks

We are not elaborating on the self-regulatory nature of PASA or the technical structures implemented on payment streams, technically how PCH Agreements work etc. Under the auspices that PASA is self-regulated, the BIG 4 Banks actually regulate themselves.

It however has to be remembered that once the implementation of the Blue Book started, the BIG 4 Banks were in existence. All the various applicable rules on payment streams, entry criteria, processes to be applied, risk redemption criteria etc were made by the BIG 4 Banks and this position continues to date.

Although the principle of a majority vote of all participants in any payment stream prevails, all other participants always need to deal with the block vote of the BIG 4 Banks. Even though the position does exist that in certain payment streams the participants exceed eight rendering a balanced position, banks render services to one another in other streams or the like, once again creating different loyalty once votes are requested.

The position on bi-lateral agreements, where banks have to agree and negotiate fees payable per payment stream with one another, contributes to the position where no smaller participant will hardly ever step on the toes of the BIG 4 Banks due to their infrastructure in existence, especially where the matter under consideration has no impact on a specific participant.

If it is an issue between any of the BIG 4 with another participant, they will take the safe route on the vote. What is best or fair for the industry hardly ever prevails:- Bi-Lateral pricing and applicable procedures on testing and dependencies on co-operation of the BIG 4 Banks for participants to enter a new payment stream renders a commercial impact decision which always prevails.

Except for the Directive issued by SARB regarding the required amendments and compliancy relating to the provisions of the National Credit Act, the introduction of which negatively influenced the BIG 4 Banks and the banking sector as a whole, no decision has been taken to date to the detriment of the BIG 4 Banks!

The self-regulatory nature of PASA where the BIG 4 Banks make the rules, act as players, referees and gate keepers protecting their turf and income streams, is undesirable.

SARB Payment System Department plays only an active role once matters can be described to be in national interest. Even so, a consultative approach is followed by SARB dependant on "buy-in" and agreement of the BIG 4 Banks and a prescriptive approach is not in existence.

This position continued even after the implementation of the NPS Amendment Act that introduced the power to SARB to issue Directives, which once published, force banks to comply.

The submitting party recognises the interdependency between SARB and banks in general, including the BIG 4 Banks, to continue with clearing and settling in the local and international environment and the economy of this country as a whole, but questions whether the income expansion of the BIG 4 Banks must continue at the cost of the majority of the population and specialised competitive service providers competing with the BIG 4 Banks in the service delivery chain.

6. Control in the hands of the BIG 4 Banks: ABUSES

We addressed the negative impact and anti-competitive behaviour of the priority deduction mechanisms on bank own systems only resolved through the NCR and National Credit Act. The impact was severely experienced by competitive credit providers granting credit to the same target market of lower to moderate income earners, the recent entry and playing fields of almost all banks.

In this section we will deal with practical examples of how the control that vests with the BIG 4 Banks are abused. At the outset we stated that the BIG 4 Banks are powerful. Their plans are subtle and carefully orchestrated and on face value all actions can be motivated. Unless an entity understands the reasoning why certain decisions are taken, the rules dictated by the BIG 4 Banks will generally seem to be sound and in the interest of risk and reputation generally in the NPS.

The role of Card Associations: VISA & MasterCard

Very little is ever mentioned of the relationship between the BIG 4 Banks and the Card Associations.

At the outset the submitting party acknowledges that for a certain percentage of the South African population, a VISA or MasterCard logo on an issued card makes sense.

This is relevant for that sector of the population that travels abroad and who transact via telephone booking local air tickets, car rentals, accommodation and the like.

The submitting party however states that a VISA and MasterCard logo on an issued card is as irrelevant to the majority of our population as the exchange rate on the US Dollar or the British Pound and the price of a beer in a London pub.

The majority of our population will never travel abroad where the use of a VISA or MasterCard will be required to transact either as a debit card transaction or as a credit card transaction.

Why do local issued cards, including debit cards, carry these logos?

The BIG 4 Banks concluded agreements with the Card Associations that all existing non-branded ATM cards will be replaced with VISA / MasterCard Debit Cards carrying these logos.

When dealing with branded cards, one has to distinguish between credit cards and debit cards. Credit Cards are identified through the BIN contained in the card number and are signature based by comparing the signature on the purchase slip with the signature at the back of the card. Card Association rules further apply on when the Card Association will accept the risk on fraudulent transactions, when the merchant is liable and in what instances either the acquiring bank or issuer bank are liable once transactions are disputed either due to fraud or otherwise. The so-called charge back rules applies.

Reference to "card fraud" relates to fraudulent transactions when credit cards are used. To curb against credit card fraud, the EMV standards were introduced which in essence indicate that over and above the branded logo of the Card Association, a chip is inserted in the card. The chip contains an algorithm which essentially indicates that when a credit card transaction is performed, prior to switching the transaction, the credit card holder will insert his PIN on the supplied device and the PIN entered will be validated against the algorithm installed.

If positively verified, the credit card purchase will proceed by switching the transaction and all involved will accept that the bona fide card holder performed the transaction through the additional PIN verification.

In the EMV environment, new credit chip cards come to play and EMV compliant point of sale devices used by merchants, ATM's

employed and the central switches of BankServ must be upgraded.

The liability of the Card Associations shift and banks are bearing the liability for fraud that occurs on non-EMV payment systems. South Africa met the 1 January 2005 EMV compliancy date. Exactly how this occurred is uncertain as EMV is not deployed to date in our country. In March 2005 it was reported that 12 million chip card based credit cards will be issued over the next five years.

It has to be remembered that the issue of credit cards to the majority of our population is a rare phenomenon and seldom happens. Non-branded ATM Cards were previously issued by banks and since the agreement with the Card Associations debit cards are issued known as VISA Electron or Maestro, always requiring a PIN to be entered on any transaction.

Technically, a non-branded ATM card can be used for ATM withdrawals and any point of sale purchase with exactly the same risk, if any, as a branded VISA Electron or Maestro. A non-branded ATM Card is a debit card.

What are the point and the relevance?

Only the BIG 4 Banks are issuers and acquirers of both VISA and MasterCard. The rules made by the BIG 4 Banks in the various payments streams where card transactions are applicable, creates a natural entry barrier for all other participants, not relating to risk at all by setting acquiring and issuing relationships from both VISA and MasterCard as minimum criteria.

The implications are that any second tier bank can no longer issue normal non-branded debit cards, they first have to apply and be accepted by at least one of the card associations at a huge entry cost, annual fees and certification cost. This creates a natural entry barrier, bearing in mind that the target market of the second tier bank will almost always operate in the environment where cash withdrawals must happen on ATM's and purchases at merchants in an available funds environment.

The significance however goes much further: Even a well established clearing bank such as Mercantile Bank, cannot join the Debit Card PCH to acquire debit card transactions as one of the requirements set by the BIG 4 Banks is that such participants must be issuers and acquirers of both VISA and MasterCard. Mercantile currently only issues VISA cards.

After proper investigations on the procedures and duplicated costs involved, which creates a natural entry barrier even for

established banks, duplicate membership was not obtained from MasterCard by Mercantile Bank and access to the Debit Card PCH is denied to Mercantile Bank with the reason set that they do not meet the set entry requirements.

From the above it should be clear that in the self-regulatory manner that PASA operates and the control of PASA vesting with the BIG 4 Banks, they set entry criteria and unless met, entry is denied. No entity including SARB however considers entry criteria set and the relevance of these criteria. Only after a participant is part of a payment stream, SARB in defined instances act as instance of appeal with regards to decisions of PASA Council or the PCH Workgroups.

Unless the above position changes access to the NPS will never change. These rules are business gate keeper related and not risk related. The relationship between the BIG 4 Banks and the Card Associations have more implications, not further addressed due to time constraints.

#### The Rule: BankServ has to be used and their role

Ownership of BankServ is not discussed neither their service rendering.

Significantly, all PCH Agreements contain a condition that the PCH System Operator for the specific payment stream must be appointed and agreed to by the participants of the PCH.

BankServ only has banks as clients. A variety of entities are in a position to render similar, better and more cost effective services than BankServ. However the BIG 4 Banks will not accept any other PCH System Operator than BankServ in the retail system environment.

#### Criticism on the BankServ role fulfilled

The Blue Book describes the position where third parties electronically interface to the NPS in standardised ways and formats.

All payment streams contains technical specifications to be met by all participants as the standard, and these technical specifications are agreed to and signed off by all participants prior to commencement of any development work.

Changes to specifications do occur and a proper implemented change control process ensures that technical changes effected are updated in all specification documentation and the latest technical documentation release must always be available.

The objective set is clear: Interfacing to BankServ is in a set technical format from an acquiring perspective and the interface between BankServ to the issuing participants should happen in a further set format.

Any new participant subsequently joining the PCH should receive the latest set of specifications and once development is complete, start to test with BankServ. If the interface to BankServ is working, the acquirer must be in a position to switch through BankServ to all existing participating issuing participants.

The theory of the above indicates that testing is dependant on the efficiency of the new entrant to sort his interface out with BankServ. This however is not the case and testing works totally differently and in practice no time line can be set for when the new entrant will enter payment streams and when testing will be complete and certified.

Remember that alternative entities to BankServ are not allowed in the retail related payment streams as PCH System Operators.

BankServ change control processes on technical documentation do not always work, rendering the position that software developers waste time and money on incorrect software code. There are actually other specifications applicable, not properly documented.

BankServ Test platforms are not readily available, they must be scheduled, booked and co-ordinated. Discrepancies exist between BankServ test platforms and BankServ operational implemented production systems.

Testing has to be done end-to-end with all issuing banks as requirement to go-live as part of system readiness certification done by BankServ. This also has to be booked, scheduled and co-ordinated with other participants. No time lines are agreed and new entrants are dependant on the goodwill of the other participants to co-operate on testing.

Testing with issuing participants is an essential requirement due to the fact that BankServ do not implement from a central switch perspective to issuers on a standardised basis but on an exception basis, meaning that the implementation for ABSA will differ from any of the other participants. Even though specifications are signed off and agreed to, the BIG 4 Banks dictate on implementation and their implementation differs from bank to bank, taking their legacy systems into account, not effecting the changes required on their back office systems. BankServ and other participants actually design software code in accordance to

the actual specifications and four further sets to accommodate the BIG 4 Banks, which influence cost, time lines etc.

BankServ being owned by the BIG 4 Banks comply and bend backwards. During the latest EDO implementation, CPSP's and other participants reached the point where agreed specifications and implementation were no longer debated and where the approach adopted in the end related to: Tell us what you want and we will change the software code once again. The EDO system and designs virtually changed four times during the process, severely affecting all but the BIG 4 Banks.

#### The EDO Sort at source rule implemented

Sort at source in the EFT payment stream was introduced by CPSP's rendering services to end-user beneficiaries as it was clear that no payment of the interchange fees charged, renders a much more cost viable solution to end-user beneficiaries and payers. Higher transaction processing costs either come out of existing margins of end user beneficiaries or are passed on to the payer through price / premium increases.

The sort at source approach affected the fee income streams of banks. We do not repeat the Feasibility report on pages 169-170 and the footnotes relating to sort at source and will not speculate on why the moratorium was introduced in the first instance by SARB or why lifted. When the EFT PCH was introduced, sorting at source was not existence and the EFT PCH does not contain conditions prohibiting sorting at source.

It is however important to record that although the SARB position regarding sorting at source is clear, the BIG 4 Banks once again in the new EDO PCH Agreements, as a compliancy matter to participate in these payment streams, contractually introduced conditions relating to a single acquiring relationship and banning sorting at source, earmarked to recoup lost income from interchange fees, payable by the users of the payment streams.

This rule will only benefit the BIG 4 Banks: The EDO system collection cost will be expensive and these additional interchange fees now payable will be passed on to the end consumer.

The BIG 4 Banks will claim that contrary to the EFT streams where they charge the consumer an unpaid fee varying from R 65 to R 135 for an unpaid item, they do not charge an unpaid fee for EDO and it is actually cheaper for the consumers. The point is actually that the banks should never have charged these fees in the first instance. This loss of income on unpaid items is recouped by the banks with the enforced interchange payable by

the users of the system and through the prices set in the bi-lateral fee agreement structure.

At the outset we stated that banks have to maintain their performance on the JSE.

**The Rule: Bi-lateral fee negotiations as condition for EDO**

Fees chargeable by banks to their customers are the exclusive right and privilege of the bank rendering the service, claiming that this was obtained through agreement with the customer. Not even SARB interfere in this process.

We believe that the above position is wrong with regards to the lower end of the market. Sophisticated users actually pay less even though they use more services due to their ability to negotiate bank fees and charges, and understands the "bundle concepts" in fee calculations much better.

Although a bi-lateral fee negotiation process is prescribed between issuers and acquirers for each payment stream, the finalisation often takes longer than a year to conclude and finalise. In the EDO payment streams, it took 14 months.

This once again influences any new entrant and the operational implementation of new payment streams. Issuers further do not negotiate, they prescribe on what the content of fees should amount to and what fee billable components are.

Although an arbitration process is acknowledged in the PCH Agreements once issuers and acquirers reach no agreement and further conditions that once payment instructions are exchanged with no agreement concluded that at a zero interchange will apply, no arbitration has occurred to date in the NPS.

The reason lies in further conditions of the PCH Agreements that, once the outcome of the arbitration is known, the applicable fees determined are applied retrospectively from date of exchange of the payment instructions.

In this uncertain state, the acquiring participant does not have any idea of what he must charge his client in the mean time. If he sets a fee too high, he is uncompetitive and will be in no position to sell his services. If he sets a fee that is too low to his client and the outcome of the arbitration is against the acquirer, he will be in no position to recoup the interchange fees from his clients and he will absorb the loss. This risk and potential loss is generally not accepted by banks and may have other regulatory implications for the acquiring participant.

**The outcome: Issuers sit back and wait until the acquirers accept their terms as this impacts on the ability of the acquirer to render the service.**

**The submitting party states that the BIG 4 Banks generally misuse their position towards smaller participants and CPSP's associated with the smaller participants, especially where the CPSP's of the bigger and smaller participants in itself compete with one another.**

**There is no argument against the statement that the interchange payable is the biggest factor that influences the final fee passed on to the end beneficiary. This final fee charged must pay the CPSP, the acquiring participant and the issuer for the interchange.**

**The submitting party states that the only reason why banks [the BIG 4 Banks] have not sought exemption to apply multilateral negotiations, is due to:**

- The time value of money during lengthy negotiations to the detriment of new participants which favours the BIG 4 Banks;**
- The ability to dictate on interchange fees payable to them influence all users of services rendered in competition to the BIG 4 Banks. This influences the cost of micro financiers offering credit in competition to banks to the same target market, it influences entities making use of services supplied by CPSP's who are in competition with the preferred CPSP of the issuer and it influences smaller banking participants to compete with the BIG 4 Banks in services rendered.**

**To process any payment instruction carries an inherent cost. The inherent cost varies from bank to bank.**

**However, all information technology departments of banks apply an internal cost of system use to the internal user departments of the same bank. Although these internal department costings are not published or available, it renders a good starting point to determine what fees or charges should amount to.**

**Further, no entity can render a service at his actual cost as published by the IT Departments to internal user departments of the same bank. End users have to pay a realistic marked up fee, otherwise the entity will fail.**

**In the bi-lateral discussion environment, the fees charged by the issuing bank to his corporate customers renders a good starting point of what a realistic interchange fee should amounts to. The reason being that in this corporate relationship the issuer has**

already taken cognisance of his actual IT processing cost and has applied a reasonable mark up in his fees. If the same issuer however dictates to acquirers fees exceeding his corporate rates, the exploitation starts to become more and more evident.

We include in this submission the corporate rates in NAEDO charged by ABSA. We are lead to believe that the interchange rates applied in the bi-lateral agreement between ABSA and Mercantile Bank exceeds the ABSA corporate rates.

The submitting party maintains that multilateral negotiations both on bank account level and for interchange fees payable can only render a better solution than the current position. There are no reasons why Government cannot participate in multilateral discussions on bank account level on behalf of the majority of the population. These users have no negotiation power with their banks. This is currently not possible as the BIG 4 Banks purposefully decided not to apply for exemption.

#### The Rule: Restrictive BIN List applied on AEDO

The EDO system is long awaited and aimed to:

- Randomise all payment instructions whether issued under the AEDO or NAEDO payment streams granting all beneficiaries an equal opportunity to receive payment moving away from the priorities and preferred payment mechanisms implemented by banks
- The AEDO payment stream is developed to address the requirements of the micro lending sector addressing card and PIN retention. During the authentication process card and PIN is used to obtain the authenticated mandate for repayments
- The NAEDO payment stream is designed for insurance companies and for payments due to banks

During the formalisation of the AEDO Business Rules, signed and agreed to by all stakeholders, including the BIG 4 Banks, the agreement reached indicated that a credit card account type may not be used as account type to be debited for AEDO repayments.

The reasoning is sound: Credit is granted already and credit granted may not be used to repay further credit.

Technically, the account type connected to the issued card is an input parameter in the message outlay and credit card account type is not an allowable input parameter accommodated in the technical specifications: Only current, savings and transmission.

AEDO, designed for micro financiers as indicated above, the card and PIN will be used during the authentication process. The first 4 to 6 characters of the printed number on a card is the BIN number.

The BIG 4 Banks further indicated that a BIN List will be loaded on the BankServ central switch and CPSP's are only allowed to switch an AEDO card if the BIN is loaded in the central BIN list. When first communicated it seemed strange as the business rule to restrict access to credit account types can be addressed without a restricted BIN list.

The impact has only materialised in the last two months: Micro financiers are restricted in the use of AEDO as not all cards in circulation in the micro lending industry will be loaded. We attach a letter issued by PASA stating the position. Access to these accounts are however available to the banks for their own deductions, contrary to the stated position in the PASA letter.

The preference of banks for own deductions is implemented once again for their sole benefit.

**The Rule: Users must belong to an Association who is a member of the PSSF Forum**

The BIG 4 Banks implemented the above rule in the EDO PCH Agreements.

In the micro lending industry, Micro Finance South Africa [MFSA] is a voluntary association for micro financiers and a founding member of the PSSF. The CEO of the PSSF is also the CEO of the MFSA.

All micro financiers have to belong to the MFSA, or an alternative association who is accepted as a member of the PSSF, to access the EDO payment streams.

The PSSF has been requested to furnish the entry criteria and entry fees payable should a new association for micro financiers want to apply for membership of the PSSF. To date, this has not been furnished by the PSSF. The implications are that only the MFSA is currently a member of the PSSF and all micro financiers must become members of this voluntary association at an addition cost of R 300 per branch per month.

The submitting party questioned this rule implemented and stated that a further access barrier is created at an additional cost: Micro financiers have to be registered with the NCR, the statutory appointed regulator. If merits for the PSSF exist, why not make the NCR a member of the PSSF and all registered members of the NCR have automatic access to EDO at no additional cost.

The NCR has statutory powers to control and enforce the actions that the BIG 4 Banks want to safeguard against abuses in the NPS where the voluntary MFSA have no such powers.

The feedback indicated that the BIG 4 Banks do not want the NCR in the PSSF. The submitting party states that this is due to the fact that it is the same regulator [NCR] who forced the banks to stop their preferred priority deductions and the implementation of EDO. In addition, the further away the NCR can be kept from the inner circles of the NPS the better:- Although deductions must be randomised to grant all beneficiaries an equal opportunity there are no external measures implemented to audit or ensure that the banks actually comply with these conditions.

Even if the submitting party is wrong on the reasons for not allowing the NCR as member to the PSSF, the additional monthly cost payable by micro financiers, read with the capped interest rates introduced, will lead to an exit of current service providers. Such exit and less competition can only favour the BIG 4 Banks.

The Rule: The rules made by the BIG 4 Banks apply to other participants but not to them, depending on the circumstances

Whenever two banks start to clear, a formal payment stream exists and a PCH Agreement must be concluded. Once in this state, any other participant is entitled to enter this payment stream, subject to meeting the stated criteria of the PCH.

ABSA and Standard Bank of South Africa concluded an agreement allowing NUPAY as CPSP to submit deductions to both ABSA and SBSA accounts. Clearing and settling happens between ABSA and SBSA.

Mercantile Bank and Bank of Athens applied to become members of this PCH, allowing their respective CPSP's the same access and functionalities as NUPAY.

Although the ABSA & SBSA relationship has been in existence for more than three years, no formal PCH Agreement exists, entry criteria is unknown and to date neither Intecon or Mycomax, the CPSP of Bank of Athens, have been able to join this PCH.

The power of two of the BIG 4 Banks, once they stand together and collude, is totally acceptable in the self-regulatory PASA structures.

Lock in of merchants in EDO

No time left to address in here.

7. The Intecon position as CPSP using smaller acquiring banks versus the BIG 4 Banks

Intecon is a CPSP owned by two individuals. NUPAY is a competitive CPSP and the two CPSP's compete directly and head on in the same target market of end users.

ABSA used to own 50% of the share holding in NUPAY. The ABSA share holding decreased to 37% after the latest BEE transaction concluded by NUPAY as published on the NUPAY website. ABSA has a direct interest in NUPAY and has the ability to use their standing in PASA to the detriment of CPSP's competing with NUPAY and the ABSA investment.

The ABSA director who lodged the complaint is further a director of NUPAY and chairman of the PCH.

At the outset we indicated that the BIG 4 Banks always act together in matters of common interest affecting the business of the BIG 4 Banks. This relationship extends further in instances where one of the BIG 4 Banks are active in a market segment but the other three not. The remaining three will always support their other partner in any voting situation. To date SBSA, Nedbank and FNB have not concluded relationships with CPSP's competing with NUPAY. This position changed with the EDO payment stream as FNB recently introduced a new CPSP.

We also indicated that whenever income streams of the BIG 4 Banks are affected they act in a collusive manner. The history to this is set out in the attachment.

Since 2001 ABSA has misused their power and standing as is reflected in the attachment. Their actions should probably be dealt with by lodging a complaint, prohibited by time constraints for this submission.

We did not have time to update the annexure: PASA Compliant with the most recent harassment from ABSA and why Mercantile Bank had to agree to accept the stated PASA position: Sufficient to state that our access to the Saswitch PCH was unilaterally changed with effect Monday 23 October to 07H00 and use is limited. This implementation has a severe negative affect on our users and our service offering. The gross loss of income experienced by Intecon over the last three days is estimated on R 22 000.00. The rules enforced to limit use and access hours are not applicable to any other participant to the PCH.

8. Closure

Please feel free to contact us to add or highlight any aspects described herein. The submitting party is available to render evidence in any public hearing should this be required.



## **NOTE TO THE MEMBERS OF THE EDO PCH PG,**

### **EDO PCH BIN LIST**

Debt collection in the low value market was effected in a number of different ways before implementation of the Early Debit Order (EDO) payment systems. With the implementation of the EDO systems some of the types of accounts accessible for collection via the SASWITCH payment stream would not be accessible via the EDO payment streams any more due to the technical differences between the payment streams.

Although credit card accounts provide for ATM withdrawals via the SASWITCH payment streams these accounts with their sixteen digit card numbers do not provide for EFT debit order withdrawals at all and would thus not be accessible for collection via either the NAEDO or AEDO payment streams. The same would apply for combination cards (kombi-cards) that are based on credit card technology.

Account types that allow for debit card withdrawals (including kombi-cards) based on debit card technology allows for EFT debit order access and would thus provide not only for AEDO access but NAEDO access as well.

A comprehensive list of BINs used before but that now seems to be inaccessible through either the AEDO or NAEDO payment streams was provided to the members of the PCH Participant Group to assist in identifying the reasons for such inaccessibility. The next step was to find solutions for the fact that customers holding such accounts seem to be in need of micro loan financing and recovery of loans would not possible via the EDO systems for these account types.

The two schedules accompanying this memo display the list of BINs that was identified as inaccessible for the reasons explained above.

Appendix A represents the approved registered BIN List of account types that would be made accessible for AEDO and NAEDO collection to be used for recovery purposes

Appendix B represents the list of card (account) types, with a small number of exceptions, which are based on the credit card technology and are thus not accessible for AEDO or NAEDO collection. The relevant restrictions are noted in the "Comments" column.

Should lenders encounter customers intent on borrowing money with accounts in the categories identified in Appendix B (or other account types not identified in these appendices) that do not provide for collection via the EDO payment streams there is no other option available but to refer such customers to their banks with the request that they be provided with an account of a type that would cater for such collection. There are unfortunately no other solutions available.

**EZIEL ESTERHUYSEN**  
**DIRECTOR ; OPERATIONS**

Date: 24 October 2006

**CC:** CSPs  
PCH PG Card  
Bankserv  
PASA Authorised Contacts

Ref: 9778

### When will the service be available?

This service will be available from 18 September 2006 for Absa-on-Absa Naedo transactions. From the 2<sup>nd</sup> of October 2006 clients will be able to process Naedo transactions across banks.

The take-on process can be initiated with immediate effect in order to expedite the administration and customer training, which needs to be completed prior to a customer making use of the service.

The pilot is underway and the pilot customer is African Bank.

### What is the price of the service?

Interchange pricing is still being negotiated and the following are indicative prices.

	Price excluding VAT	Price including VAT
Registration Fee	R1500 Once-off	
Successful Transaction		
<R100	R4 per transaction	R4,56 per transaction
<R1000	R10 per transaction	R11,40 per transaction
<R5000	R15 per transaction	R17,10 per transaction
Multiple representations	R2 per day	R2,28 per day
Unpays	R2 per transaction	R2,28 per transaction
Stop tracking/recalls	R10,00 per transaction	R11,40 per transaction
Disputes	R100 per transaction	R111,40 per transaction

A customer will only be billed for successful transactions. If a transaction is unsuccessful, the customer will only be billed for the number of days the transaction was represented for payment.

### What will the end-user pay?

The client whose account will be debited will pay a transaction fee of R4,75 per successful transaction. They will not be billed for unsuccessful transactions.

### What is the income sharing model?

After the interchange and BankServ fees are deducted, the profit will be shared 50/50 between Absa and NuPay.

### What is the role of the Business Banker or Corporate Banker?

The Business Bankers/Corporate Bankers are responsible for the credit process to attain the credit approval for a debit Naedo limit (ACB Limit).

### What is the role of the Electronic Banking Consultants?

The Electronic Banking Consultants are responsible for:

- Identify the opportunity to provide this service.
- This could be established through the completion of a working capital management analysis especially those customers who's unpaid ratio's are very high.
- Electronic Banking is responsible for the completion of the BI documentation and the registration for a Naedo user code.

### What is the role of NuPay?

- Provide the necessary training to customers.
- NuPay will receive the files from our customers and process these Naedo files to ANTS (Absa Naedo Transaction System).
- NuPay will also be responsible for the reply files to the customers.
- Customer support.



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The Chief Executive Officer  
The Payment Association of South Africa  
P O Box 61380  
MARSHALLTOWN  
2107

7 June 2006

Dear Hendrik,

**STORAGE OF CARD AND TRACK 2 DATA:**

It is with disappointment that we once again raise this issue with your office.

As you know, we brought possible misuse of card and PIN information by a member bank to your attention in February 2002. During September 2002 SARB and PASA investigated the bank on-site and found that PIN was not stored but track 2 data was. PASA Council went through an extensive process of obtaining legal opinion on the validity of track 2 storage. With the assistance of Nedbank's legal team it was clarified that track 2 storage was illegal.

In March 2003 we once again raised a concern regarding these transactions and provided PASA EXO with supporting information to both storage and batching of transaction. The above resulted in a request from PASA to the member bank to apply system changes that would force the swiping of card and entering of PIN. The reported date for compliance was 31 March 2004, but subsequently amended to 6 May 2004 due to technical constraints on the member bank's part.

ABSA Bank Limited/Beperk, Reg No 1986/004794/06

Member of the  
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Directors/Direkteure: DC Cronjé (Chairman/Voorsitter) DC Brink (Deputy Chairman/Adjunk-voorsitter) \*SF Booysen (Chief Executive/Uitvoerende Hoof) LN Angel DC Arnold DE Baloyi \*D Bruynseels (British/Brits) BP Connellan AS du Plessis \*RR Emslie (Alternate/Alternatief) \*C Erasmus G Griffin MW Hlahla LN Jonker N Kheraj (British/Brits) P du P Kruger LW Maasdorp \*NP Mageza (Alternate/Alternatief) DL Roberts (British/Brits) \*JH Schindehütte TMG Sexwale FA Sonn PEI Swartz \*JP van der Merwe \*LL von Zeuner \*Executive Directors/Uitvoerende Direkteure Secretary/Sekretaris: WR Somerville (011/2006)

Authorised Financial Services Provider/Gemagtigde Finansiële diensteverskaffer

At the 45<sup>th</sup> PASA Council meeting it was reported that the member bank had confirmed compliance as at 6 May 2004. It was however noted at the next Council meeting that compliance to the swiping of cards would only become clear once the current loans had run out. It was only at the 49<sup>th</sup> Council meeting that an official compliance date for phase-out was noted as 1 September 2005, to which the banks agreed to condone the misconduct based on an appeal from the SARB. The understanding was however very clear that no transactions would store track 2 data after the said date as the system would force card swipe.

At the following Council meeting it was noted that should the issue re-occur a Special PASA Council meeting would be called where you would inform the member banks that they would be allowed to decline transactions from the transgressing bank. The member bank confirmed compliance during both compliance exercises [Use of Card and Track 2 data] done in 2005 and early 2006.

The following transaction, acquired by Mercantile Bank, occurred on our system on 25/5/2006:

Date	Time	Code	Terminal ID	Sequence	Account Nr	Amount
60525	083822	012000	INT66205	000819270	4058759304	610.00

We have confirmation from the accountholder that he did not swipe his card and enter his PIN on 25 May 2006. He also confirmed that he was in possession of his card at the time of the transaction. The loan was registered on 17 May 2006. The above undoubtedly proves that the system did not force the micro lender to swipe the card, and that the system was still storing track 2 data.

We request PASA to please initiate appropriate action.

Yours sincerely,



Jaap Cornelius

Manager: Group Payment Systems - Regulatory

PASA COMPLAINT: LODGED BY ABSA: INTECON RESPONSE TO MERCANTILE BANK JUNE 2006

When reading the letter from ABSA, a variety of comments are made in the letter to paint the background and history in motivation for the current PASA Council request to suspend the Mercantile access to Saswitch or not to entertain transactions submitted from Intecon and ALLPS user premises through Mercantile Bank.

Careful consideration should be given by PASA Council and all participating member banks before such a drastic decision is taken. The implications will be far reaching not only for Intecon, ALLPS Users and Mercantile Bank, but for all banks and the total NPS.

It has to be kept in mind that all aspects described in the NPS Framework and Strategy first Edition published in 1995 for implementation before the end of 2004 has been met, except for rendering a payment solution for the majority of the South African population making use of micro lending services. In June 2006 and two years later this industry consisting of micro lenders and their clients is still waiting.

PASA as self regulatory institution, the role and influence of the 4 big banks in such a self regulatory environment, the role of the Reserve Bank, the role and the position of the mayor 4 big banks in terms of the openness and access towards the NPS, level playing fields amongst competitors and competitive service providers, current investigations and scheduled public hearings with regards to the investigations launched by the Competition Commissioner all come into play.

It is further an open question whether the banks other than ABSA, who should not be allowed to vote or participate during the Council Meeting and during the decision making process, want to enter the arena, participate and support ABSA in their requests, and by doing so confirm all speculations about the brotherhood of the 4 mayor banks in a matter that purely evolves around the ABSA shareholding and investment in NUPAY, a service provider offering services in the micro lending industry and the power of ABSA in PASA to deny fair competition amongst competitive service providers who offers services to the micro lending industry.

The question remains whether the banks other than ABSA is aware of the apparent careful orchestrated process over the last couple of years to date and whether they were innocently involved in the process to date through the smoke screens created by ABSA.

Although the ABSA involvement through NUPAY will be highlighted, all banks and the NPS are collectively involved with the current matter at hand.

The matter at hand and the statements made above can however only be considered against the history of payment systems and solutions for the micro lending industry, the role of banks and the broader NPS. For the benefit of existing PASA Council members, some relatively short involved at Council level, the background and context of the matter at hand is summarised below.

From the summary one may make a conclusion that a well orchestrated strategy since 2002 was followed by ABSA and NUPAY. The history however starts well before 2002:

1995

NADs were introduced during 1995 through the previous Boland Bank as a solution for the micro lending industry. No question can be raised that an electronic environment from micro lending premises offered a far better solution than cash withdrawals and the associated risk of dealing with cash for this industry.

The loss of human lives, primary micro lenders and people offering security services to micro lenders, over the last 10 years due to the amount of cash in circulation, is well known. The latest incident on 18 May 2006 when Dawid Tyrne, a policeman offering security services, was killed in New Germany after the early morning withdrawals on the National ATM Network, should further be noted by all Council Members. Two robbers were wounded after a gun fight took place.

The NAD transactions occurring from micro lending premises were in the spot light since inception in 1995. A transaction decline occurred on the National ATM Networks, influencing the revenue streams of the 4 big banks.

It should be remembered that since introduction to date, issuing banks paid R 0,25 to the acquiring bank. In 1995, issuing banks debited the clients on saving account level on average with R 2,20. The model further entails that the micro lenders are charged for the services rendered as services cannot be rendered at R 0,25, being the fee paid by issuing banks. Micro lenders are prepared to pay for the services. During the introduction of NAD services for micro lenders in 1995, the services offered had no access hour limitations.

#### How did the banks react after the introduction of NADs?

The negative impact on the revenue streams of the banks lead to a BankServ meeting and decisions made during September 1996 summarised as follows:

- ❖ From 15 January 1997 an access hour limitation was placed on NAD services originated from micro lending premises;
- ❖ All banks agreed to implement system measures and monitoring software to monitor transactions performed on ATM's installed and freely accessible for members of the public, including micro lenders. The monitoring software must ensure that where withdrawal transactions occur virtually within 60 seconds apart in the early mornings of known salary paydays, the ATMs in use must be shut down;
- ❖ Both decisions above were made to ensure fair competition between the 4 big banks and Boland Bank, a relative small player, but still prepared to offer a solution to the micro lending industry;
- ❖ The access hour limitation was introduced by Boland Bank, being the smaller member bank and forced to do so viz-a-viz their relative position;
- ❖ None of the 4 big banks introduced the second decision that would have ensured fair and level playing fields between the smaller member, Boland Bank and the big 4;
- ❖ Mr Schalk Roux, now retired, and formerly a General Manager Boland Bank represented Boland Bank during the September 1996 BankServ meeting and is

- willing to testify about the decisions taken, discussions surrounding the decisions and the position of a smaller bank viz-a-viz the 4 big banks;
- ❖ To curb against the loss of income on the National ATM Networks, the banks changed the billing structures of NAD transactions on saving account level and charge the saving account holder the same fee as if a withdrawal was made on a Cash Dispensing ATM. All transactions of Intecon and ALLPS users are separately identifiable as NAD transactions and are not submitted to the NPS as mini- or script ATM's;
  - ❖ No reference is made in here of the report *The National Payment System and Competition in the Banking Sector* submitted by FEASibility (Pty) Ltd an economic research company headed by Dr Hawkins with a research annex by Prof. Olu Akinboade of UNISA, contracted by the Competition Commissioner about a variety of matters including the fees charged by banks, except for one comment:

With fees charged on the Saswitch network for Cash Dispensing ATM's under pressure, the 4 big banks must consider the implications for their actions taken on NAD fees, primarily submitted by Intecon and Mercantile Bank, especially where the big 4 still pays R 0,25 to acquiring banks. The big 4 exploits their users by overcharging them fees that they are not entitled to.

#### **1999 – 2001**

NUPAY has entered the micro lending industry and offered a solution for micro lenders, limited to ABSA Cards.

Except for NAD transactions, nothing was offered in the banking arena and banks refused to entertain the requirements of this industry.

The position started to change with the purchase of the African Bank Banking License by the former Theta Investments, the consolidation of the micro lending entities owned by Theta Investments into the current African Bank Limited. The JV between African Bank Limited and SBSA with the introduction of priority deductions on SBSA saving accounts after the debacle of deductions on the Government payroll systems started the sage currently outlawed by the National Credit Act.

During 2000, Intecon patented a design aimed to offer a solution to micro lenders without any changes required to existing infra structure of banks or BankServ, primarily due to the unwillingness of banks to effectuate any development or system changes to entertain the payment instructions of the gross of the South African population making use of services offered by micro lenders.

The principles described in the South African National Payment System, Framework and Strategy, First Edition or Blue Book, was used in the Intecon approach:

**2.3.5      *The NPS is open***

**2.3.6      *There is healthy competition amongst customer payment-service providers.***

**2.3.7      *The NPS is a national business asset***

**2.4.15 Service to all the people of South Africa**

**2.5.2 The provision of NPS services is not the exclusive domain of banks**

**3.2.1 Trading system : Deal agreement and payment instruction**

*[146] Most payments originate in trade in various markets, ranging from retail and corporate trade, through trade in formal and more informal markets. Each of these markets utilizes its own market-specific systems... **These systems are developed by the market participants themselves and fall outside the domain of the NPS.***

*[147] These systems should, however, be able to integrate with the NPS, through standardised NPS interfaces, thereby extending the network for the generation of payment instructions that will ensure that electronic payments in particular enter the payment system as quickly and efficiently as possible. This will enhance the trade-related systems and enable CPSPs to provide value-added services from a payment perspective.*

Intecon scheduled a meeting with BankServ and meetings were conducted with Dave Mitchell of Reserve Bank.

After the interaction with BankServ, Intecon was requested by Johnny Plenaar to submit a detailed business and technical solution document about the proposals made which was done and submitted.

In the document submitted, Intecon claimed copyright and indicated that the design is protected by the Patents Act.

The proposal was scheduled to be heard by the former Credit Risk Evaluation Committee. In preparation, a meeting was conducted and called for by Walter Folcker of ABSA, in his office with Intecon representatives, discussing in detail the proposed solution and quoting and discussing from the document submitted and distributed.

However, days prior to the scheduled meeting, Intecon was contacted and requested to abandon any rights with regards to copyright and the patents described in the proposal. Intecon refused.

After the refusal, Intecon was informed that the matter was struck from the agenda of the Credit Risk Evaluation Committee without distribution to member banks and without them reading the proposal. Part of the explanation offered indicated that some of the banks were involved with litigation where third parties offered business solutions to banks, the banks turned the proposals down towards the third parties as not feasible, only to use and implement the same concepts without the third parties who initially introduced the concepts.

The outcome of the litigation referred to are known to the relevant banks.

During this period interaction happened with the MFRC and the Department of Trade and Industry. It was clarified that if a micro lender obtains **both** the card and PIN of a borrower, it will be a contravention of the Exemption Notice.

It has to be remembered that this target market of payers are only issued with ATM or Debit Cards by banks. No credit cards were issued at this point in time by any of the issuing banks. Both the card and PIN is required to conduct transactions on ATM's, NAD's and the merchant environment. Even if any third party keeps a debit card, with the PIN unknown to him, no transaction can occur. It further follows that if a PIN of an ATM or Debit Card is known but the card is not kept or available, no transaction can occur.

## **2002**

Intecon introduced ALLPS in the micro lending industry. The implemented version differs from the patented version.

ALLPS was introduced as a promissory note system and a promissory note is issued by the payer on date of obtaining a loan. The promissory note constitutes the mandate of the payer and corresponds with all repayment instructions of the payer in terms of the loan granted. The lender obtains the mandate through the swipe of the card and the entering of the PIN by the borrower. The promissory note is printed in duplicate and signed by the payer and the original retained by the lender.

Presentment of promissory notes consisting of monthly repayments and the total value of the promissory note is limited by the mandate obtained. No "over collection" can occur. General rules, stricter than on the intended AEDO service offering, was introduced.

The payer leaves the environment with his ATM card. ALLPS further makes use of a tripartite agreement between Intecon, the payer and the lender in terms whereof the payer mandates a partial payment if the cleared funds available are not sufficient to pay the required monthly payment.

Due to the access hour limitation, Intecon was forced to introduce an asynchronous middleware layer, enabling the users as legal holders of the promissory notes to submit all promissory notes on salary paydays in the limited time span before lenders enter the premises.

The ALLPS service offering introduced complied with all Saswitch operator rules and the PCH Agreement in existence during 2002. Neither PIN's or track two data is stored.

Since introduction, the competitiveness of ALLPS viz-a-viz the NUPAY service offering was clear. In 2002 a substantial number of NUPAY users cancelled their agreements with NUPAY and concluded new user agreements with ALLPS.

The ABSA investment with NUPAY became under pressure.

ABSA addressed a letter to PASA claiming that they have reason to believe that Intecon through its ALLPS service offering is storing PIN information. PASA was requested to conduct an investigation.

At the Mercantile Bank premises in Sandton, a full and live demonstration was given on the ALLPS service offering when all aspects contained in the service offering was demonstrated, including asynchronous transaction submissions. Johnny Pienaar, Mike Lear and Hendrik Pelsler attended the presentation on behalf of PASA and SARB.

Two matters arose from the meeting:

- ❖ Mercantile Bank had to consider whether more risk is eminent in the NPS without a forced card swipe when promissory notes are submitted;
- ❖ Intecon was requested whether they will be prepared to subject the ALLPS application to an external audit by one of the five major audit firms to audit the application with regards to PIN storage. During the meeting, Intecon consented to an external system audit, unaware of what such an audit would cost in the end.

Mercantile's position was clear: The ALLPS application as introduced complied with all statutory requirements. More risk will be introduced in the NPS if the users of the ALLPS system retain cards. End-user borrowers will be inconvenienced.

At a cost of R 110 000,00 for the Intecon account, PriceWaterHouseCoopers conducted a full system audit, between 23 September and 9 October 2002. It was confirmed by the external audit report that the Public and Symmetric encrypted PIN and track 2 block are present in the ALLPS SEG-SMF framework for the duration of the transaction as is true for RAM. The ALLPS system did not entertain the swiping of the card during the payment or settlement of a promissory note, as was demonstrated during the visit on the Mercantile premises.

## **2003**

Regardless of the outcome of the initial complaint made by ABSA, the ABSA lobbying process continued and a variety of negative marketing rumors were spread by NUPAY employees, amongst other communication towards the end-user market of an ABSA confirmed date when the Intecon access to the NPS will be terminated, amongst other due to non-compliance with the Exemption Notice and the processing speed of transactions, described by ABSA as batching, aimed to negatively influence the same target market of users.

Keith Wrede, a director of NUPAY, confirmed during a telephonic discussion with George Stiglingh, a director of Intecon on 29 January 2003, that they communicate information received from the market and referred to a discussion between himself and Walter Folcker of ABSA.

The competitiveness of asynchronous transaction processing as was explained and demonstrated on the Mercantile premises requires no further explanation.

PASA approached Nedcor to obtain a legal opinion requesting Nedcor to comment whether the Regulator (MFRC) intended to ban the retention of track 2 information as it is clear that the retention of bank cards and PIN's is prohibited to be kept by micro lenders. We quote from the document marked as Ref: 5411, being the legal opinion referred to by ABSA in its letter dated 7 June 2006:

*"We are aware that track 2 information is not strictly speaking PIN information. To the best of our knowledge, however, the information which is retained and stored is capable of being used (without the PIN and without the physical presentation (swiping) of the card, to initiate subsequent payment instructions from (to the debit of) the account of the cardholder. In our view the principle is the same, and the intention of the legislator is not only to ban retention of PIN numbers, but also track two information which enables payments to be initiated without the intervention of the cardholder.*

The target market of users is issued with ATM Cards or Debit Cards. The reference to the use of Credit Cards capable to be used as described above is inappropriate in the subject matter under consideration.

It is further worth mentioning that the wording used in the Exemption Notice is quite clear and very specific. The wording used does not include track 2 information but includes personal information of Internet Access Accounts of borrowers, linked to the micro lender account as beneficiary, and where the micro lender conducts a credit push transaction from the borrower account, using the personal information of the borrower as was entertained by the banks on condition that no more than the prescribed number of accounts are linked in this fashion. In certain cases this limit was as high as 150 accounts.

*"It seems to us that the primary purpose of the prohibition against the retention of card information which would enable the holder thereof to initiate payments from the account of a cardholder with or without the PIN and without the physical presentation (swiping) of the card, is consumer protection and protection of the integrity of the payment system".*

The key words from the above extract relates to consumer protection and protection of the integrity of the payment system. With regards to the first comment made, the working of the employed ALLPS promissory note system and the mandate obtained from the card holder must be compared with the unlimited and unfettered access on the National ATM Networks. On the National ATM Networks, with a due payment of R 300 and a daily card limit of R 1000, the user can overdraw which is not possible on ALLPS. The ALLPS system offers far more from a consumer protection perspective.

It is open for debate whether the ALLPS system when compared to the National ATM Networks and the undertakings given by the big 4 banks in 1996, offers less protection or less integrity of the payment system.

The existing usage of Credit Card information where no PIN is required and obtained telephonically by travel agents and car hire services, the storage and printing of card information on merchant receipts etc, all acceptable practices and referred to below

in the opinion, is inappropriate to refer to as ATM and Debit Cards require the presentment of PIN's.

*"Whether or not a compelling case may be made for the relaxation of the rules referred to above in specific circumstances is a **business issue** which will no doubt be weighed up against the risk of abuse, fraud, error and violation of consumer rights. It is not strictly a legal issue.*

*An interesting question is whether it is the bank or the customer who owns the information imprinted on a card, and the PIN. Our view is that the information belongs to the bank, and is part of the bank's infrastructure made available to the customer in terms of a binding agreement for use by the customer as a convenient payment method. The bank is in our view fully entitled to attach conditions and rules to the issue of cards and the use by customers and merchants of the bank's point of sale devices, ATM's and the like.*

The ALLPS service offering does not store the property of an issuing bank with reference to track 2 information or PIN information. It is clear that the issuing bank must act in terms of his agreement with a card holder if the terms of the agreement are contravened. Has ABSA acted in terms of their agreements with card holders where these cards were used during the early morning withdrawals on the National ATM Networks? Why not?

*"As the above quoted-quoted regulations under the Usury Act relate only to micro lenders, **the banks have some latitude in regard to the creation of exceptions to the rule against storage, retention and use of track 2 (and other) card information.** They must however be mindful of the above referred risks and the overriding objective of reducing risk in the payments environment".*

The latitude of banks with regards to credit card transactions when compared to ATM Cards requiring PIN is significant and purely relates to the described business issues quoted above.

A further new line was adopted during this period by PASA, directly influenced by ABSA: A participating bank offering any form of services, especially to micro lenders, must through the service offering ensure compliance of all regulatory requirements of relevant legislation, amongst other the Exemption Notice, even where different regulators are appointed to ensure compliance.

Clarification was given in an email dated 16 May 2003 by Gabriel Davel, CEO of the MFRC, addressed to Intecon, J Symmonds, the then acting MD of Mercantile Bank and M Coaker. We quote from the email received:

- "1. The MFRC has been appointed as regulator in respect of the Usury Act Exemption Notice. Contraventions of the Exemption Notice should be reported to the MFRC and not to any other body. Once the MFRC receives such a complaint it will deal with it in accordance with a number of principles and criteria it has developed.*
- 2. It is inappropriate for contraventions to the Exemption Notice to be reported to any other regulatory authority (and most definitely not to a self-regulatory body*

such as PASA). We will take exception if we believe that any body holds itself out as having a mandate over complaints related to the Exemption Notice, and in particular if such body then further takes it upon itself to perform 'screening' or 'gatekeeping function'. If we learnt that this is being done we will take it further.

3. I would like to point out that the MFRC discussed this issue with the National Payments System division of SARB and that we have a very clear understanding of what each other's mandate is.
7. I believe that it is inappropriate for Exemption Notice requirements to be taken into account as a qualifying condition for access to the National Payment System. However, this issue is within the mandate of the NPS Division of SARB and should be raised with them. Our view on this issue has been made clear to the responsible individuals within SARB.
8. We believe that it is beneficial for the micro-lending industry – and for the clients of micro-lenders in particular- that payment systems solutions should be developed and offered that would allow the processing of loan repayments directly from a client's bank account to the lenders'. We further believe that it is beneficial that there should be more than one such system, in order to allow for competition in this area. We also believe that it is inappropriate that allegations of potential compliance or non-compliance with the Exemption Notice to be used as a pretext by competitors in the provision of payment systems to attempt to manipulate approval of another payment system solution. It may be advisable to obtain legal advice on this matter. As pointed out before, such issues should be raise with the SARB's NPS Division".

#### **2004: Forced card swipe**

The ABSA lobbying process continued and was concluded with the introduction of Clearing Rules for the Payment Clearing House Agreement for the clearing of ATM and Related Electronic Debit Payment Instructions (Saswitch) in 2004, almost 2 years after the apparent strategy started to eliminate competitive service providers to NUPAY.

It was the first time when a forced card swipe was introduced and the storage of track 2 information was specifically addressed for this payment stream. The storage of PIN information was from initiation of the PCH Agreement (Saswitch) out ruled and similar conditions with regards to storage of PIN information are contained in the rules governing Visa and MasterCard transactions.

The expected changes to PCH Agreements regulating Credit Card transactions never followed to date. It is as mentioned above, a business decision.

The Clearing Rules introduced only affected Mercantile Bank Limited and Bank of Athens as banks and naturally their service providers competing with NUPAY in the same target market.

It should further be noted that during this time span, Mercantile Bank Limited officially requested entry requirements to join the NUPAY PCH in existence between ABSA and Standard Bank. Mercantile Bank was informed that the PCH Agreement was not

finalised although the clearing and settlement arrangement between these two banks was already in existence. To date Mercantile Bank Limited was denied the opportunity to join this PCH.

Following the introduction of the Clearing Rules in 2004, system changes were introduced forcing the swipe of a card on the presentment of a promissory note. This was completed on 6 May 2004.

### **Upgrade process followed and methodology**

Prior to the forced card swipe introduction, version 2.0F was the software in use. The forced card swipe introduced version 2.0G.

After the first matter was reported in 2005 and it was clear that administratively this user was skipped during the upgrade conducted during 2004, a further software release was done verifying centrally the software version in use in all outlets and ensuring that once an upgrade was done, the user cannot revert back to an earlier version through ghost images of the hard drive or older versions of recovery installation CD left in outlets.

Methodology used: To reduce the upgrade software size patches are created containing only the components that have changed. Each patch assumes all previous patches are in place, and just replaces the components identified for the patch version. These often also include upgrade scripts to update the ALLPS configuration and database. For the most part, this is a manual process, and if all upgrade procedures are followed and all patches applied in sequence, the resulting end version would be the latest.

The sequence of the patches were however not applied in the latest reported matter as is evident from the attached job card, completed on site after the user logged a central support call in Pretoria due to a faulty card reader device.

Changing to the AEDO environment was initially planned to entail an executable change alone. However, Intecon agreed to conduct a full installation instead of the customary patch process.

### **Statistics from 6 May 2004**

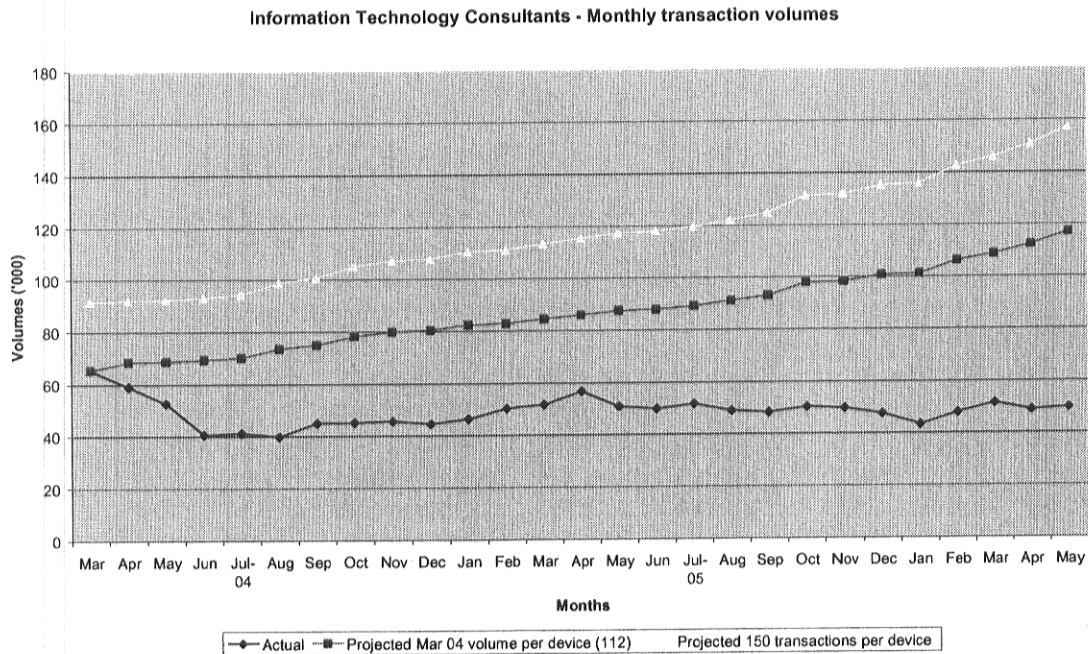
Since 6 May 2004, two devices were reported not to enforce the card swipe, constituting less than 0,2% of all installations who use the ALLPS system.

An active NUPAY sales force consisting of more than 14 full time personnel country wide monitored independently the compliance of all devices with regards to a forced card swipe.

262 ALLPS users cancelled their agreements with Intecon.

438 new ALLPS installations were done of which 169 occurred in the last period based on the undertakings of the NPS of the introduction of AEDOS in September 2005.

The transaction volume on the Saswitch network during the corresponding period from May 2004 to date however did not increase as would have been expected and objectively speaks for itself, easily verifiable by all participating members:



Mercantile Bank conducted random audits at installation sites of ALLPS users as requested by PASA and all matters where transactions were submitted without the presence of the card holders by using the cards were reported to the MFRC for further action by them.

It will be fair to state:

**If** the ALLPS service offering rendered a total legal solution towards this industry not dependant on the swiping of a card during the presentment of a promissory note, the successful transaction volumes on the Saswitch Network originated by ALLPS users would have been in excess of 100 000 transactions on an average monthly basis since September 2004 with at least 155 000 transactions for May 2006.

The National ATM Network however renders a more convenient and more cost effective solution towards micro lenders and their clients: The cost of a transaction consists of the fees payable on account level by the payer and the fees payable by the user of the system. The cost to the payer is the same on a NAD and on the Saswitch ATM Network. Once the fees payable by the user is added, the solution is more costly.

### **Additional steps taken by Mercantile Bank**

KPMG was contracted to conduct physical inspections at random selected ALLPS user outlets, verifying the version in use and the operational working of the software release, ensuring a forced card swipe. The audit started in the broader Johannesburg and Pretoria areas and ALLPS user outlets were selected at random.

From the audit it appears that the present matter is an isolated instance and certainly not the norm.

### **Why is a forced card swipe on Saswitch still a controversial matter at PASA Council level?**

**The answer is simple: NO AEDOS IMPLEMENTATION!**

Is there any significance in the fact that:

- ❖ ABSA on purpose derailed the implementation of AEDOS and to date no acquiring bank is in any position to authenticate and register AEDO agreements against ABSA;
- ❖ ABSA employees tasked with testing to date rendered no co-operation to resolve technical matters;
- ❖ NUPAY representatives indicated as early as February 2006, after the implementation dates moved from September 2005 to February 2006, and again to May, June and July to the end-user market that no AEDOS implementation will happen before September 2006;
- ❖ ABSA to date refused to part with ON-US data to ensure that agreed business principles can be met;
- ❖ ABSA to date, after them signing-off on the technical specifications refused to implement AEDO in accordance to the agreed technical specifications and in the process force all other participants to incur costly software changes?

### **Non-Compliance**

All participants are affected through the late implementation of EDO from a regulatory perspective as is Mercantile Bank with the one device found to be non-compliant with agreed Council decisions.

Administrative problems do occur:- It is only human. A further good example relates to the ABSA undertakings not to install Cash Dispensing ATM's within micro lending premises. However, an ABSA ATM is installed at the corner of Boom & Fhatima Bayat Street, Rustenburg with contact telephone number: 014 592 6180. The installation is done at the back of the premises where no members of the public can access the ATM.

## Going forward

The late implementation of EDO whether on purpose or not, with no fixed agreed date of implementation, makes a mockery of PASA, SARB and the NPS in general. The credibility of individuals is severely affected through communications done during interaction with the target market of end-users.

No principles are agreed of what will happen with issuing banks not meeting the new intended implementation date of September 2006 and neither is Nedcor included for this implementation, regardless of the fact that they have indicated readiness by 20 September 2006.

Participants such as TebaBank still sit on the boundaries and the Post Office Bank is not even in play.

The exclusions of cards issued in the target market not able for usage on AEDO are more than the cards that will be entertained.

The perception of the end-user target market indicates that business, technical rules and implementation dates will continue to change until such time that only one service provider, NUPAY, is left as sole provider of services to this industry.

The formation of the National Credit Regulator and related compliance aspects for this industry and the broader NPS' inability to deliver in terms of undertakings given to date requires remedial actions from the NPS and participants in an effort to restore some credibility.

We quote:

*"As the above quoted-quoted regulations under the Usury Act relate only to micro lenders, **the banks have some latitude in regard to the creation of exceptions to the rule against storage, retention and use of track 2 (and other) card information.** They must however be mindful of the above referred risks and the overriding objective of reducing risk in the payments environment".*

PASA Council is hereby requested to apply the same latitude with regards to credit card transactions to the forced card swipe introduced during May 2004 from date hereof until four months after an EDO implementation, enabling the end-user market the opportunity to comply with their Regulator's requirements until the EDO implementation has been accomplished.

Such a concession will enable micro lenders with the desire to be compliant such opportunity until EDO implementation.

The request would not have arisen should the participants acted in accordance to the just of previous undertakings given to implement EDO.



**Mercantile Bank**  
Member of CGD Group

20 October 2006

Mr A de Swardt  
Managing Director  
Information Technology Consultancy (Pty) Ltd  
P.O. Box 101889  
Moreletta Plaza  
0167

**Fax No.: (012) 998-7914**

Dear Mr de Swardt

### **ACCESS HOUR AND SYSTEM CHANGE**

Following on from our interaction with PASA relating to Card and PIN storage, and multiple cash withdrawals from a single card swipe, we have agreed with PASA to the following limitations which must be implemented by Monday 23 October 2006:

1. Only a single balance enquiry and cash withdrawal attempt may be processed via the ATM switch per card per day.
2. Access to the ATM switch will only be available from 07:00 on weekdays and Saturdays. No access is available on Sundays and public holidays.

Please ensure that these changes are effected and implemented by Monday 23 October 2006, as the system will be monitored by the regulators for compliance.

Yours sincerely

**Matthew Coaker**  
Head: Electronic Services

**Hercu Bloem**  
Head: Corporate Services

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(<http://www.mercantile.co.za>)

Directors: J A S De A Campos\* [Chairman], D J Brown [Chief Executive Officer], G P De Kock, M J M Figueira [Executive]\*, L Hynes,  
A T Ikalafeng, J P M Lopes [Executive]\*, K B Motshabi, S Rapeli, A M Osman\*\* Company Secretary; R van Rensburg  
[\* Portuguese \*\*Mozambican]

Mercantile Bank Limited Reg. No. 1985/006706/06. An Authorised Financial Services Provider

# INTECON

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## FAX COVER SHEET

<b>TO:</b>	<b>MERCANTILE BANK</b>
<b>DATE:</b>	<b>23 October 2006</b>
<b>ATTENTION:</b>	<b>M COAKER &amp; H Bloem</b>
<b>FAX NUMBER:</b>	<b>011- 883 7750 or 784-4081</b>
<b>PAGE(S):</b>	<b>4</b>
<b>FROM:</b>	<b>R DE SWARDT</b>

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**MESSAGE**

# INTECON

P O Box 101889  
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Tel: (012) 998 7979  
Fax: (012) 998 7914  
Date: 23 October 2006  
Our Ref: R de Swardt

**Mercantile Bank**

**Attention: M Coaker & H Bloem**

## **YOUR LETTER DATED 20 OCTOBER 2006**

1. We acknowledge receipt of the above letter, received by fax transmission today.
2. We further refer to the telephonic discussion on Friday between writer and M Coaker.
3. Paragraph 2 of your letter restriction access from 07H00 is implemented as from today.
4. During our discussion on Friday we indicated that paragraph 1 is technically impossible to implement. We discussed a technical solution and to safeguard all concerned, we record our discussion.
5. The only technical solution possible, which we have implemented as from today, will be on a single card swipe and PIN entry once a promissory note is presented:
  - a. To start with a balance enquiry;
  - b. The outcome on this request during the same session will determine either a further withdrawal request or exit of this session;
  - c. If the reply response on the balance enquiry indicates sufficient funds or funds are available but for a lesser amount, we will proceed with a further withdrawal request and exit this session.
  - d. Due to card limits and the behaviour in this market, this will in all instances indicate further presentments for this card and PIN will not happen during the rest of this day.
6. If the promissory note was presented at 07H00 and the outcome on the balance enquiry request at 07H00 was negative indicating that no funds were available at 07H00 and the session was ended, and the same promissory note is presented once again at 08H00 with a new card swipe and PIN entry, technically we cannot stop or control the second balance enquiry request.
7. If in my above example a further balance enquiry was conducted at 08H00, over which we have no control, and if the interpretation of paragraph 1 of your letter is that per card per day we are limited to one balance enquiry, we are as I

INFORMATION TECHNOLOGY CONSULTANTS (PTY) LTD Reg 1997/001713/07

Directors: A de Swardt (Managing), G M Stiglingh, SM Twala  
Intecon Building, 534 Rooitou Avenue, Moreleta Park, Pretoria

am typing this letter, in a state on non-compliance. If this is the interpretation, please notify us immediately as this is the end of the Intecon business and we will have to suspend all access with immediate effect.

8. If the interpretation is however that during any card swipe and PIN entry session, we start with a balance enquiry request immediately followed with a further withdrawal request in instances where funds are available, this is technically possible due to:
  - a. If on the 07H00 presentment of the promissory note the response on the balance enquiry was R 50.00, we will exit as no salary proceeds were paid into the account;
  - b. If on the 08h00 presentment of the promissory note the response on the balance enquiry was R 47.50 [due to the fee charged on bank account level for the first balance enquiry], we will exit as no salary proceeds are still paid into the account;
  - c. If the same promissory note is presented at 13H00 and the response on the balance enquiry was R 1 545.00 or even R 845.00, we will then proceed with a withdrawal request for R 1 000.00 if the promissory note value was for R 1000.00, or R 800.00, as this will be indicative that salary proceeds were paid into the bank account.
  - d. This is technically possible if we follow an interpretation on paragraph 1 that only one balance enquiry and withdrawal request per card per day during one card swipe and PIN entry session on the switch will be allowed and where the outcome of the balance enquiry response will determine whether a withdrawal request was initiated or not.
9. The above describe the position on the promissory note system where central intelligence is applied.
10. ALLPS however supports, as a separate service offering, a user initiated balance enquiry and user initiated cash withdrawal function, and these services are similar to the normal ATM implementation, indicative that card was presented and PIN was entered but no further central intelligence is applied.
11. This working can be best described as follows:
  - a. If a balance enquiry was selected, a balance enquiry is conducted and the session ends;
  - b. If a withdrawal request for a R 1000.00 is conducted, and there is insufficient funds, the response will indicate this and the session once again terminates;
  - c. This working is contrary to the promissory note system where we centrally would have proceeded with a further balance enquiry and a partial dispensing depending on the available amount.
12. These services were designed for use in instances where there is no debt or loan due to be repaid. These services will generally be used after a promissory note was presented and the payer wants to know what the balance in the account amounts to, or where the micro financier offers a cash dispensing service.
13. The following can however occur if these stand alone services are used which we once again have no control over and which we all have to understand:
  - a. At 07H00 a balance enquiry is conducted and the available balance is R 75.00. The session is ended.

- b. At 07H03 he uses the cash withdrawal function and swipes the card and enters the PIN for R 50.00. This transaction will succeed.
  - c. At 08H00 he can do a further balance enquiry by swiping the card and entering the PIN and, for arguments sake, R 22.50 will be available. This session is ended.
  - d. At 13H00 he conducts a further balance enquiry following the same procedure. The balance will now be in excess of R 22.50.
  - e. If, depending on the outcome of the balance enquiry he does a further request for any amount physically entered on the software within the daily card limit and then proceeds to swipe the card and enter the PIN, this request will be switched again and will succeed.
  - f. In this mode, ALLPS works and reacts exactly as any physical ATM.
14. As indicated, we have no control over these functions. However, the debate from PASA started with multiple transaction sessions with a single card swipe and PIN entry which is not the case in the stand alone functions as described above.
15. Please confirm our understanding of our discussion on Friday and our implementation as described above with regards to the promissory note function through your acknowledgment of receipt.

Yours faithfully

  
**INFORMATION TECHNOLOGY CONSULTANTS (PTY) LTD**