

NPS Hearings with the Competition Commission

28 May 2007



FIRSTRAND
— Banking Group —

South Africa has benefited from a world class NPS

The NPS has served South Africa well

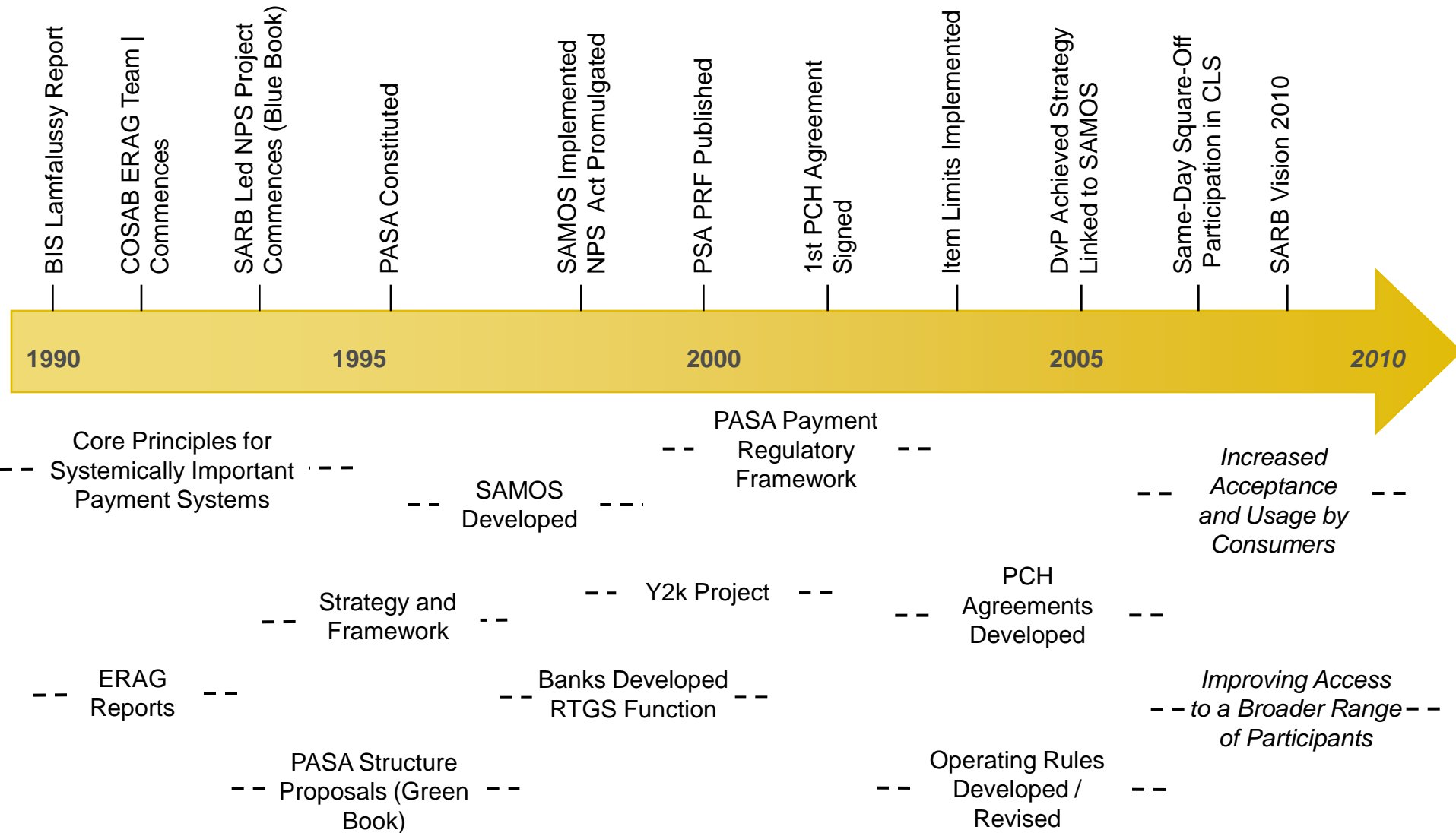
- Bank failures well managed – little effect on economy
- >R 46.8 trillion settled per annum
- >R 41.4 trillion per annum settled real time
- Contributes to sovereign ratings
- Contributes to FDI

The NPS is world class

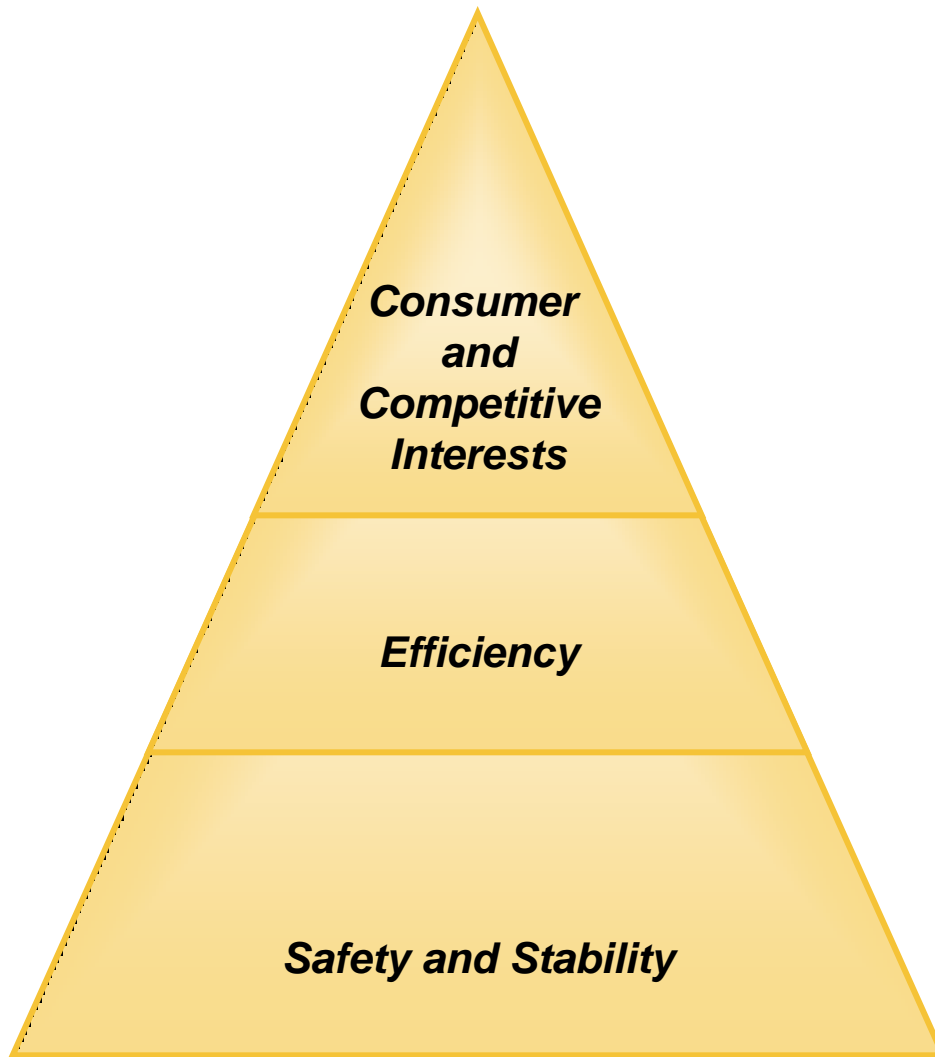
- SA, along with most of the worlds' 20 largest economies, subscribes to BIS
- Complies with all 10 BIS Core Principles as per SARB self review
- Management of liquidity and credit risk (RTGS and Item Limits)



The NPS environment is continually evolving



Safety & Stability are of paramount importance to the NPS. Efficiency and consumer / competitive interests also key



Consumer & Competitive Interests

- Improved access to financial services
- Innovation
- Increased competition (subject to risk management & level playing fields)

Efficiency

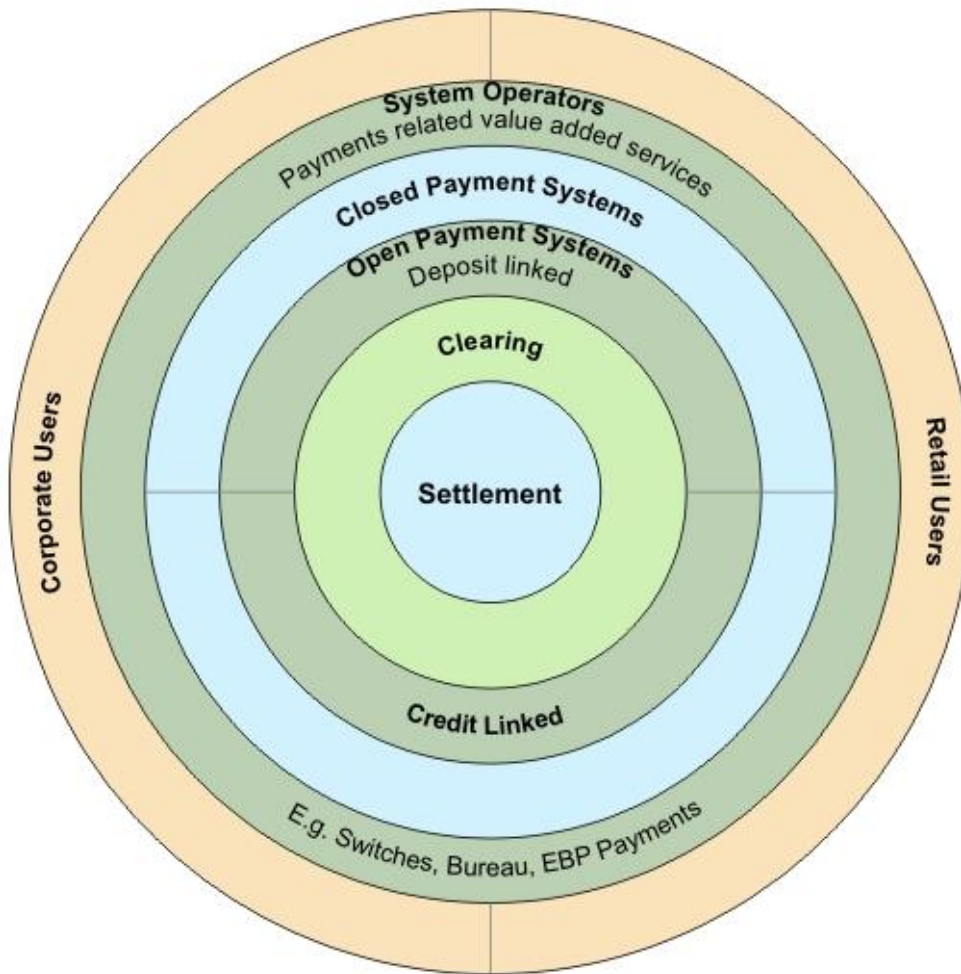
- Optimal utilisation of NPS infrastructure
- Real time transfer of value
- Continuous adoption of best practice

Safety and Stability

- Protection of deposits
- **Clearing** = exchange of payment instructions between banks
- **Settlement** = fulfilment of payment obligations
- Only bank deposits are acceptable stores of value (outside of cash)
- Institution clearing & settling have direct access to all consumers' accounts



There is wide access to payments, Banks* are permitted to clear and settle

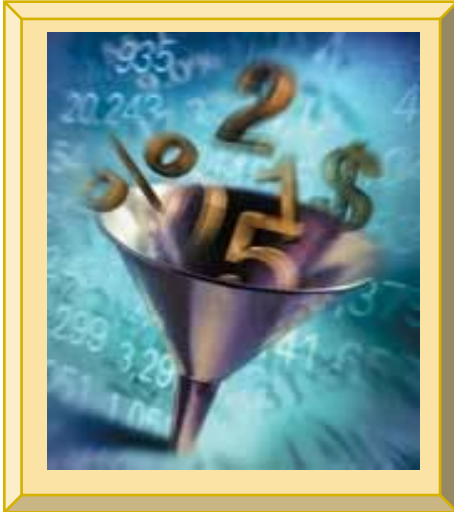


- 36 registered banks in South Africa (+ 15 rep offices)
- 21 registered with PASA (22 including SARB)
- Businesses, consumers and non-banks (e.g. ATM Solutions, Multidata, EasyPay) have access via participating banks
- Non-banks can also participate through alliances, JVs and agent relationships (e.g. Kulula, Sanlam)

* SAPO and Ithala Bank can only clear



Participation in core activities introduces risk into the NPS

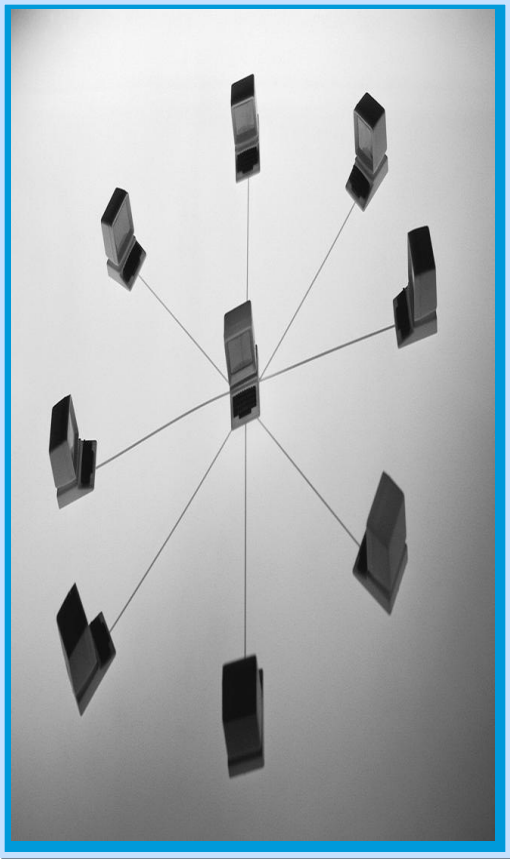


- Participants need to satisfy a number of **essential prerequisites** to maintain safety, stability & efficiency:
 - a) Capital requirements
 - b) Culture of compliance with regulation
 - c) Trust
 - d) Sufficient funding or liquidity
 - e) Mutual self-interest in the effective functioning of the system for both issuing and acquiring
 - f) Technical competence
- Ultimately the SARB decides whether to allow participation in core activities

Non-banks meeting all requirements could possibly participate more fully in the NPS, but criteria and risk need to be carefully defined & managed



Non-Bank Acquiring



FRB supports the ongoing evolution of the NPS to widen access and further competitive intensity

There is no free lunch – with participation comes the need to meet both present and all future obligations of a transaction

All banks and non-banks participating in similar activities must be bound by similar rules & sanctions and satisfy oversight requirements

Whoever introduces the risk must be able to underwrite all aspects of the risk (through the business cycle), note that the risk is based on turnover value

Effective competition requires that the rules do not prejudice against or in favour of non-bank players

Sorting at Source

- FRB's understanding of the regime concerning sort @ source is uncertain
 - Initially a moratorium on sort @ source
 - This was later changed to be legally acceptable, but not favoured
 - Therefore guidelines are required to give greater clarity
- May have unintended consequences:
 - May increase barriers to new entrants and innovation, as more access points are required
 - Volumes decreased on existing infrastructure (operators and acquirers), duplication of infrastructure
 - Smaller merchants may be required to pay more for acquiring
 - Reduced governance and reduced interoperability



Regulation is “delegated” by the SARB as a means of managing the NPS



SARB has responsibility for the NPS and “delegates” responsibility to the PSMB (payment system management body)

The SARB recognise PASA as a PSMB “established with the object of organising, managing and regulating the participation of its members in the payment system” ¹

PCHs manage agreements between members and maintain rules. PASA Council will challenge a PCH proposal if it believes the proposal introduces unacceptable risk to the NPS

There are different degrees of delegation, the benefits of changing the status quo need to be demonstrated



Governance and oversight of the NPS

- FRB supports improving the transparency of PASA
 - Publicly available board minutes of decisions
 - Independent representation on PASA
 - SARB already exploring greater external stakeholder involvement
- SARB mandated to oversee the payments system
- Separate reporting lines within organisations are preferable (acknowledge that skill constraints are an issue)
- Regulatory and compliance representatives must have a fiduciary responsibility to PASA and the PCHs



Innovation

- Existing system has facilitated the launch of innovative industry solutions

Launch of EDO

*Cashback @
POS*

*Mzansi Money
Transfer*

- Innovations have also occurred between a few participants, with the establishment of new PCHs
- Since the weighting of PCHs is by necessity focussed on risk management and setting standards, innovation is secondary
- By definition, launching new innovation in the interoperable space is complex
- In some instances PCH definitions are very specific – could possibly be widened to allow additional transactions



Summary of proposals (recognising this is the domain of the SARB)

Issue

- Non-bank participation in core activities

- Governance and oversight of the NPS

- Innovation

FRB Proposals

- Open to non-bank acquiring
- Risks must be fully covered
- No players should be advantaged over others

- Governance and business reporting lines should be split
- PASA / PCH minutes can be published
- Independent representation
- Support external stakeholder involvement

- PCHs to accommodate innovation
- Broaden definitions and rules within existing PCHs

