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**Presentation by Standard Bank  
to the Competition Commission  
on access and interoperability**

29<sup>th</sup> May 2007



## Standard Bank representatives

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## Overview of presentation

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- Access and regulation
  - new banks / small banks
  - non-banks
- Governance and oversight
- Non-bank participation in the payments value chain
- Sorting at source / multiple acquiring
- Bankserv
- Innovation in the payments system



## New banks / small banks

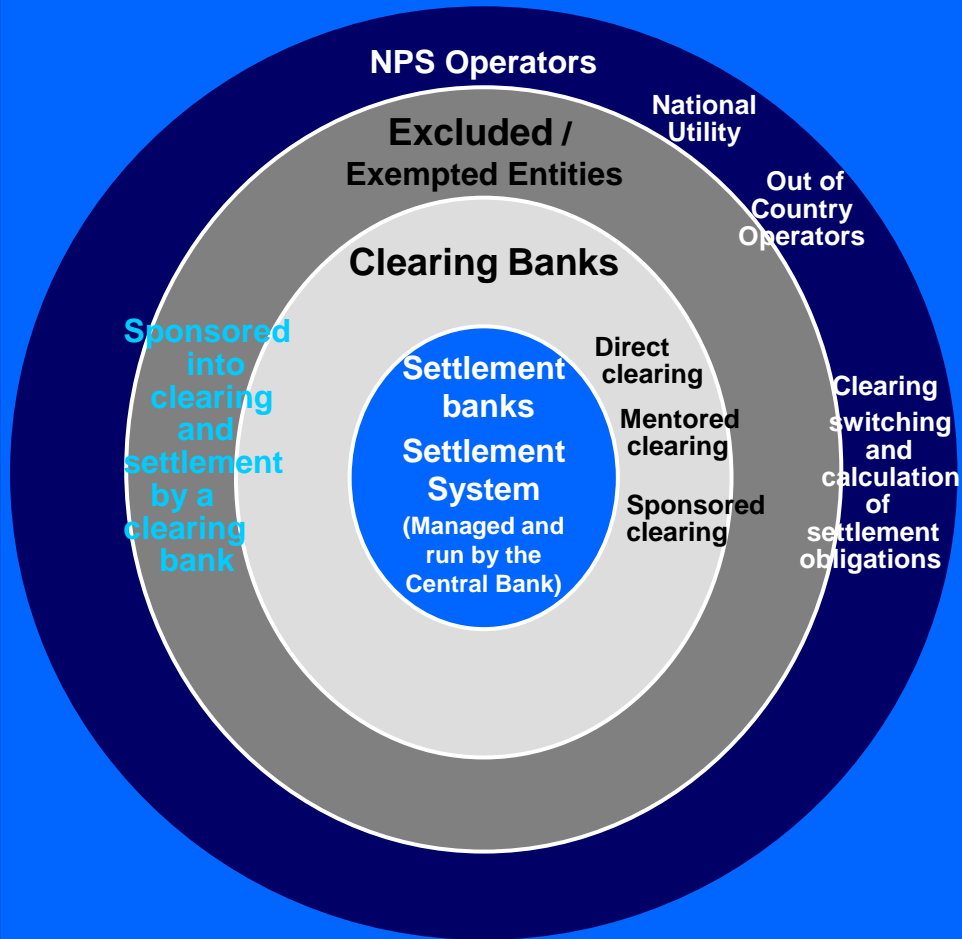
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- Entry for a new bank is easily facilitated, subject to compliance with regulatory and risk management criteria
- Alternatively, a new bank that does not wish to participate fully in its own right can elect to be sponsored - financial (including settlement) sponsorship, technical sponsorship or both
- We support the introduction of dedicated banks and co-operative banks via an appropriate Act, which ensures appropriate governance and oversight



# Non-banks

## National Payments System – Inner core Participants



## National Payments System - Outer core Non-Bank Participants





## Governance and regulatory oversight

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### Inner Core

- Banks have capital adequacy, liquidity (secured by cash reserves deposited with SARB), disaster recovery plans, competence etc prescribed by law and enforced by a regulator
- South Africa follows BIS principles regarding clearing and settlement models – e.g. “survivors pay”
- Compliance with international best practice is necessary for South African banks to participate in the global economy e.g. the global payment system (CLS) admitted the ZAR as one of only 15 currencies settled via CLS

### Outer Core

- The NPS is only as strong as its weakest link – non-banks should introduce no more risk than banks
- Non-banks must therefore be subject to capital adequacy, liquid reserves, governance and regulation appropriate to the risk introduced by them



## Risk introduced by non-banks

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- Lack of regulatory requirements and oversight of the following activities introduces risk e.g.
  - Introduction of payment instructions
  - Deposit taking
  - Multiple acquiring / sorting at source
  - Float holding
  - Disaster Recovery Processes (DRP) / Business Continuity Processes (BCP)
- The following risks need to be regulated and overseen appropriately:
  - Credit
  - Operational
  - Reputational
  - Systemic
  - Liquidity
  - Legal etc



## Consequences of inadequate oversight

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- The NPS enables financial institutions to interact with each other and allows the central bank to regulate and oversee this interaction and the risks associated with it.
- Failure to regulate / oversee non-banks in the NPS appropriately may result in:
  - Increased processing costs
  - Non-optimal clearing between banks
  - Higher costs for smaller banks – higher barriers to entry
  - Customers limited to transacting on own bank infrastructure
  - Reduced interoperability



## Non-bank participation in the payments value chain

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- Non-banks already perform many of the technical functions that form part of the acquiring services either as technical outsource providers (e.g. ATM Solutions), switches (e.g. EasyPay) or consolidators (e.g. bureaus)
- But the key acquiring functions of clearing, settlement and reversal (if necessary) should only be performed by clearing banks that are strictly regulated to limit the risk adequately
- Regulatory oversight under the auspices of SARB is required for non-banks participating in the payments value chain, including system operators, PSPs and BSPs and tighter controls are required through the issuing of directives and rules in this regard



## Sorting at source and multiple acquiring

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- Sorting at source and multiple acquiring are different terms for the same concept used in the EFT and card environments respectively
- Sorting at source
  - Corporate customers of banks or PSPs (on their behalf) are sponsored by more than one bank for the purpose of sorting (clearing) payment instructions and the submitting of payments directly to the banks on which they are drawn, bypassing the NPS operator (i.e. they make all payments on-us) – primary driver was to enable preferential debits
- Multiple acquiring
  - Retailers are acquired (may hold bank accounts with multiple banks) by more than one bank for the purpose of sorting (clearing) and then submitting payments directly to each bank's customer accounts, bypassing the NPS operator – primary driver being the perception that interchange will be avoided



## Consequence of sorting at source and multiple acquiring

- Support restricted multiple acquiring (e.g. by card association) as currently permitted but do not support unrestricted multiple acquiring and sorting at source
- Reduction of volumes processed through the existing operator
  - Erode the current economies of scale and potentially render the existing NPS operator model ineffectual, uneconomic and unsustainable
- Larger volume banks may move to direct clearing
- Smaller volume banks will incur higher processing costs
- Interoperability may be jeopardised
- Proliferation of non-bank service providers will undermine the NPS unless they are adequately regulated (by the introduction of measures to counter operational, credit, liquidity and fraud risk)



- Bankserv should be managed as a national utility on a self-funding, non-profit basis
- Commercial profit maximising motives may:
  - Lead to increased costs to the consumer
  - Jeopardise the provision of a critical service to the economy
  - Drive behaviour that potentially introduces more risk into the system
- Bankserv is a near monopoly in relation to the provision of domestic switching services
- Alternatives for the banks include direct clearing or switching offshore – incurring massive risks and costs
- Banks in South Africa have no viable alternative to Bankserv in the short to medium term, especially in EFT (more than 50% of Bankserv's volumes)



# Innovation in the NPS

- The NPS has seen extensive change and innovation while complying with international risk management standards

1980s / 1990s	2000 - 2007	Future
<ul style="list-style-type: none"><li>•SAMOS</li><li>•NPS Act</li><li>•ATM interoperability</li><li>•Same day value</li><li>•Hub and spoke clearing</li><li>•Code Line Clearing</li><li>•Business Online</li><li>•Internet Banking</li><li>•Credit card budget facility</li></ul>	<ul style="list-style-type: none"><li>•PCH Agreements</li><li>•Same day clearing and settlement</li><li>•Item Limits</li><li>•CLS (1 of 15 countries in the world)</li><li>•Mobile Banking</li><li>•Mzansi NBA</li><li>•Mzansi MMT</li><li>•Sponsorship</li><li>•Mentorship</li><li>•Payroll</li><li>•AEDOS / NAEDOS</li><li>•Enhancing payment transaction protection</li><li>•Payment infrastructure security (e.g. phishing)</li><li>•Chargebacks</li><li>•Cash-back at POS</li></ul>	<ul style="list-style-type: none"><li>•EMV</li><li>•Card authentication protocol (Internet payments)</li><li>•Micro-payments</li><li>•Account verification</li></ul>



## Recommendations

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- All participants that introduce risk into the NPS must be regulated and subject to appropriate oversight
- Legislation governing dedicated banks and co-operative banks should be promulgated (exempted entities should fall under the legislation relating to dedicated banks)
- Appropriate directives and underlying rules on non-bank participation in the NPS should be issued to ensure clarity and reduce risks
- SARB should establish appropriate structures to regulate non-banks
- Bankserv should operate as a national utility



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# Questions



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# Appendices



# Normal clearing via an NPS operator

Corporate A or Merchant A

Corporate B or Merchant B

Corporate C or Merchant C

Corporate D or Merchant D



Bank 1

Sponsors Corporate A & B / Acquires Merchant A & B



Bank 2

Sponsors Corporate C / Acquires Merchant C



Bank 3

Sponsors Corporate D / Acquires Merchant D

NPS Operator



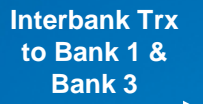
Bank 1 (Issuing)



Bank 2 (Issuing)



Bank 3 (Issuing)





# Sort-at-Source & Multiple Acquiring



Corporate A or Merchant A

Card acquiring / sponsorship relationship:

- Bank 1
- Bank 2
- Bank 3



Corporate B or Merchant B

Card acquiring / sponsorship relationship:

- Bank 1
- Bank 2
- Bank 3



Corporate C or Merchant C

Card acquiring / sponsorship relationship:

- Bank 1
- Bank 2
- Bank 3



Corporate D or Merchant D

Card acquiring / sponsorship relationship:

- Bank 1
- Bank 2
- Bank 3

Payment Service Provider / Bureau



Consolidation of Bank 1's transactions across Corporates / Merchants A, B, C and D



Bank 1 (Issuing)

Consolidation of Bank 2's transactions across Corporates / Merchants A, B, C and D



Bank 2 (Issuing)

Consolidation of Bank 3's transactions across Corporates / Merchants A, B, C and D



Bank 3 (Issuing)



## How multiple acquiring works

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- The retailer swipes cards issued by all of the South African banks through a single device.
- The retailer (or a service provider) sorts the transactions into batches destined for each bank
- It then sends the transactions directly to each relevant bank (bypassing the NPS operator)
- Each bank sees only its own transactions which (combined with the bypassing of the NPS operator) reduces the ability to detect fraud and other irregularities and reduces economies of scale for the industry



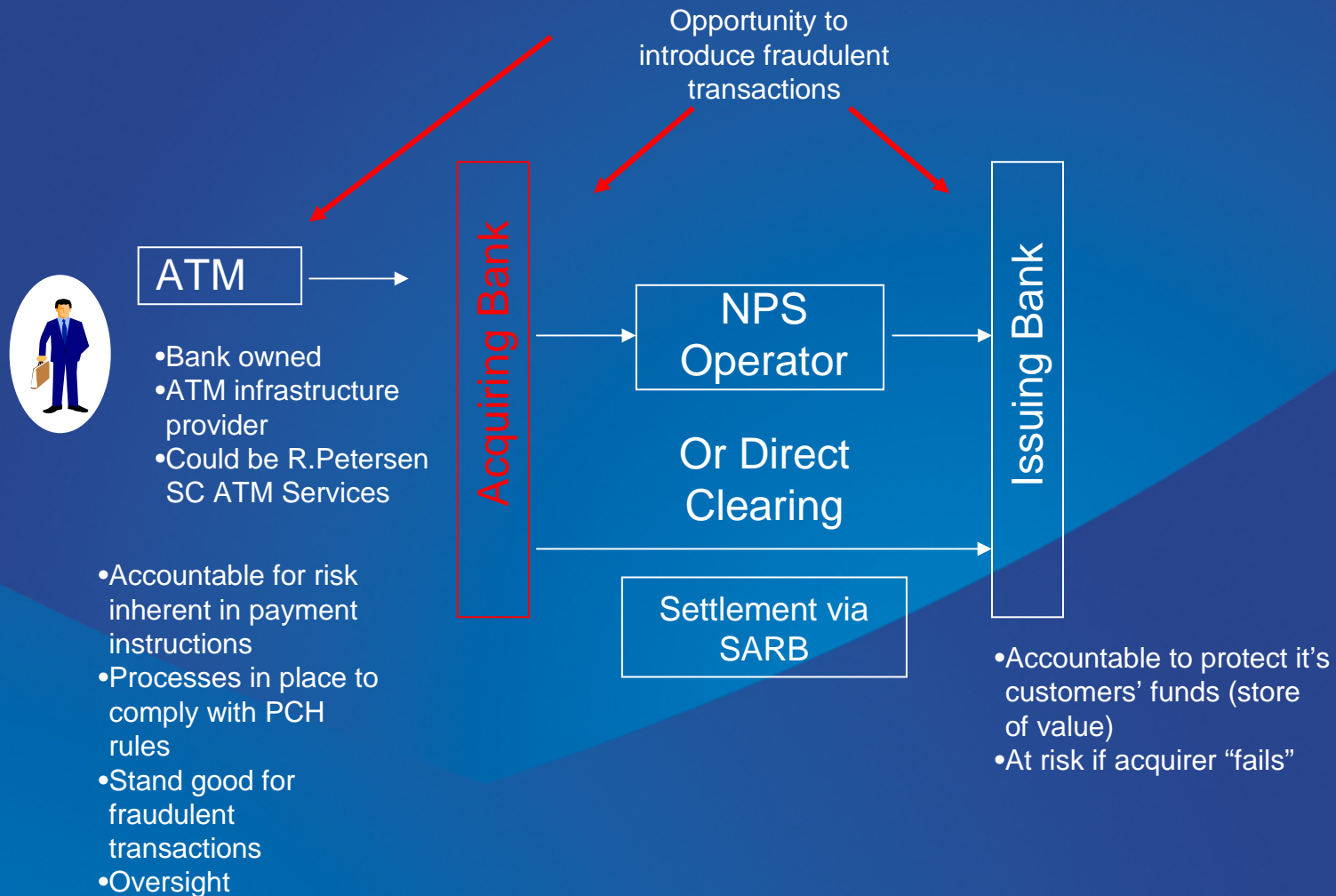
# Functions of Acquirer

## Functions

- Setup and maintain relationship with Issuing Bank to allow customer / merchant / corporate to use and accept payment mechanisms
- Sign-up merchants / corporates to provide payment facilities
- Carries risk of transactions introduced into the payment system
- Processes transactions to collect on behalf of customers / merchants / corporates using various payment services
- Ensure operational efficiency in interfacing with operator and SARB
- Clear payment instructions to the operator
- Clear payment instructions directly to issuer
- Provide information on fate of transaction to beneficiary
- Fulfilment of payment obligations arising from payment instructions cleared
- Maintain customer / merchant / corporate's account and ensure daily account reconciliation
- Install, services, maintains and operates acquiring infrastructure
- Upgrading existing acquiring infrastructure and enabling new technology / enhancements
- Providing transaction security around acquiring infrastructure
- Disaster recovery
- Adherence to governance and regulatory oversight

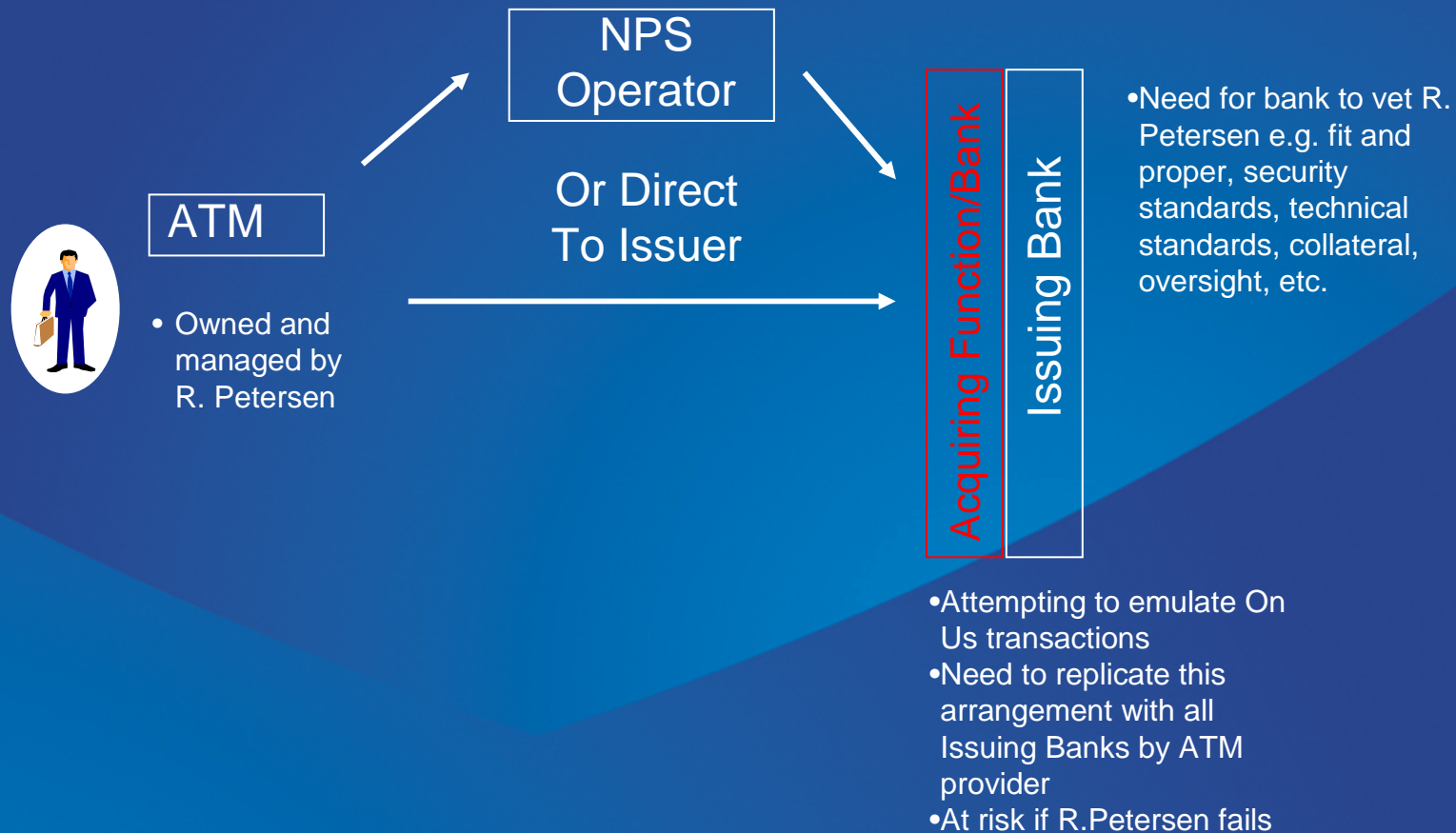


# Normal Transaction via Direct Clearing / Operator





## Transaction via Direct submission to Issuer or via Operator with attempt to bypass normal acquiring bank functions





## Transaction via Direct Clearing / Operator with ATM provider (Non-Bank) assuming some acquiring functions

