CGAP | TECHNOLOGY PROGRAM

Notes on Regulation of Branchless Banking in South Africa February 2008

Since emerging from the apartheid era, South Africa has made it a priority to extend reliable financial services to low income individuals who traditionally have been excluded from financial access. Government policies aimed at greater inclusion and consumer protection, coupled with a well developed financial sector and innovative private actors, have resulted in a number of successful branchless banking models despite regulations that limit electronic money issuance to banks only. South Africa currently has two mobile banking models with transformational potential - WIZZIT and MTN Mobile Money – both of which involve nonbanks and banks working in partnership. For both, the bank account application is fully integrated with the mobile phone, enabling the customer to use the mobile phone itself as a payment instrument. Other nonbanks have obtained permission to offer limited payment services without any bank involvement.

The South African government has taken an active role in creating regulations to facilitate the development of bank-based branchless banking. For example, banking authorities successfully took a proportionate regulatory approach to applying anti-money laundering/combating the financing of terrorism (AML/CFT) standards. By lowering the documentary evidence needed to open an account, while capping transaction limits on such accounts, South Africa became a model in how to address financial security concerns while allowing low income individuals greater access to financial services.

Governmental initiatives facilitating branchless banking continue, most notably in pending legislation which would allow greater access to payment systems and create new categories of banks subject to reduced minimum capital requirements. However, despite major steps forward in the development of branchless banking, pending telecommunications regulation threatens to limit branchless banking's potential.

These notes offer details on what the CGAP branchless banking diagnostic assessment found in South Africa. CGAP has released "**Notes on Regulation of Branchless Banking**" detailing our findings and observations on this important topic in India, Kenya and Pakistan. Similar notes will be released for Brazil, the Philippines and Russia.

CGAP, BRANCHLESS BANKING AND THIS SERIES OF POLICY DIAGNOSTICS

CGAP is a global resource center for microfinance standards, operational tools, training, and advisory services. Its members – bilateral, multilateral, and private donors – are committed to building more inclusive financial systems for the poor. The CGAP Technology Program is a multi-year learning initiative co-funded by the Bill and Melinda Gates Foundation to find and test promising technology solutions to improve access to finance.

CGAP defines branchless banking as the delivery of financial services outside conventional bank branches using information and communications technologies and retail agents. Because of their potential to radically reduce the cost of delivery and increase convenience for customers, branchless banking approaches can expand coverage to new, previously unserved segments of the population. Technology can help a range of market actors to push the boundaries of access to finance, including not only banks but also microfinance institutions, mobile phone operators and technology companies.

Two models of branchless banking – bank-based and nonbank-based – can be distinguished. Both make use of retail agents such as merchants, supermarkets or post offices to deliver financial services outside traditional bank branches. In the **bank-based model**, every customer has a direct contractual relationship with a prudentially licensed and supervised financial institution - whether account-based or involving a one-off transaction - even though the customer may deal exclusively with a retail agent who is equipped to communicate directly with the bank (typically using either a mobile phone or a point-of-sale (POS) terminal).

In the **nonbank-based model**, customers have no direct contractual relationship with a fully prudentially licensed and supervised financial institution. Instead, the customer exchanges cash at a retail agent (or otherwise transfers, or arranges for the transfer of, funds) in return for an electronic record of value. This virtual account is stored on the server of a nonbank, such as a mobile operator or an issuer of stored-value cards.[1] The balance in the account can be used for making payments, storing funds for future use, transferring funds or converting back to cash at agents. If the system relies on a POS network and plastic cards, customers must visit a participating retail agent to conduct a transaction. If the system is mobile phone-based, customers need to visit a retail agent only to add value or to convert stored value back into cash. A more limited version of the nonbank-based model can be found in payment networks, which involve a technology provider or other nonbank institution offering a network of "payment points" (for example, payment terminals, ATMs or retail agents equipped with POS devices) where a customer can make payments due to third parties or a governmental entity can make payments to beneficiaries.

[1] The stored-value card, like other stored-value instruments, is often referred to as "e-money." There are various definitions of e-money, including the following from the European Union's Electronic Money Institutions Directive (2000): “monetary value as represented by a claim on the issuer which is: (i) stored on an electronic device; (ii) issued on receipt of funds of an amount not less in value than the monetary value issued; (iii) accepted as a means of payment by undertakings other than the issuer.”

1. Introduction

From March 14 to 23, 2007, a two-member CGAP team went to South Africa to analyze the policy and regulatory environment for branchless banking.[2] This document summarizes the team's findings.[3] It is based on the team's insights from interviews with a wide range of stakeholders including the National Treasury, South African Reserve Bank (SARB), Financial Intelligence Centre (the South African financial intelligence unit), Competition Commission, Banking Ombudsman, Postbank, Payments Association of South Africa (PASA), Bankserv (the privately run banking clearing house), private banks, mobile operators, technology firms and independent experts. The team has also undertaken an analysis of existing legislation as well as upcoming legislative developments relevant to branchless banking.

South Africa - Highlights

- Creating an inclusive financial sector with adequate consumer protection is a top priority of the Government of South Africa.
- A well developed financial sector and innovative private actors have resulted in a variety of successful branchless banking models – from mobile banking to nonbank payment services – despite regulations which limit electronic money issuance to banks only.
- Banking authorities successfully applied a proportionate regulatory approach to AML/CFT standards. By easing the documentation requirements for opening an account while capping transaction limits on such accounts, South Africa became a model for addressing financial security concerns while allowing low income individuals greater access to financial services.

South Africa is one of seven countries[4] in which CGAP has undertaken diagnostics of the regulatory environment for branchless banking. The country is rich in branchless banking models. For a number of years, nonbank payment networks using both POS terminals and smart cards have been facilitating third party payments as well as the distribution of welfare payments. More recently, a number of bank-based models have evolved, including two mobile phone-based transaction banking products that facilitate person-to-person transfers using mobile phones. Policy makers and regulators have been deeply engaged with the development of these models, largely due to a strong government commitment to promoting financial access to persons previously excluded from the formal financial system. This has led to innovative regulatory solutions. On the

[2] The CGAP team members were Mark Pickens (Microfinance Analyst, CGAP) and Hennie Bester (Genesis Analytics). The South African law firm of Webber Wentzel Bowens provided advice on the interpretation of various laws, regulations and bills. Genesis Analytics provided logistical support. The Notes were authored by Mr. Bester, CGAP Policy Advisory Consultant Kate Lauer and CGAP Consultant Michael Tarazi.

[3] This document summarizes results from a rapid analysis of the policy environment for branchless banking in South Africa conducted in March 2007 with follow-up through December 2007 and is subject to the limitations of such an approach.

[4] The other six countries are Brazil, India, Kenya, Pakistan, the Philippines, and Russia.

other hand, the insistence of the regulator on bank-based models for all transaction services beyond just payments to third parties has prevented the emergence of any stored value models operated by nonbanks.

Within Africa, South Africa is particularly important since its financial sector has expanding relationships with many African countries. Banking models developed in South Africa can and do find their way into other countries on the continent.

2. State of Play: Government Authorities

South Africa has a vibrant and sophisticated financial sector, the strength and stability of which have been foundational to nine years of uninterrupted economic expansion. However, during the apartheid years, much of the population was excluded from banking services and certainly did not enjoy significant consumer protection. Following the post-apartheid transition, the new government accordingly placed increasing emphasis on financial inclusion and consumer protection, while maintaining strong policy insistence on the stability of the financial sector. The need for stability was underlined by South Africa's own "small banks crisis" in 2002 which saw the collapse of one small bank, the pre-emptive take-over of another[5] and some other small banks relinquishing their banking licenses.

The banking sector is tightly regulated and well supervised. Only banks can engage in deposit-taking from the general public and access to the national payments and settlement system is reserved for banks alone. A regulatory environment that restricts participation of nonbanks does not seem ideal for the evolution of new and innovative branchless banking models. Yet, a number of these models have emerged over the past few years. These have been greatly facilitated by a number of government policy initiatives as well as some regulatory adjustments.

2.1 Financial Inclusion

Probably the most significant government policy to impact the growth of branchless banking has been the push for financial inclusion. Since 2002, when the government, business, community and labor constituencies convened at the NEDLAC[6] Financial Sector Summit, a number of initiatives have been taken to facilitate access to payment and banking services for persons disenfranchised during the apartheid era.

The centerpiece of this process is the **Financial Sector Charter** (the "Charter") which requires existing banks to provide effective access (defined in terms of physical proximity and non-discrimination as well as the availability of a range of affordable and easily understood products) to first order financial services (which include transactions, savings and credit services) to 80% of the low income population by 2008. Since physical proximity is a key dimension of the definition of effective access, developing and facilitating branchless banking is core to the approach of both the government and

[5] Saambou Bank Limited was placed under curatorship in February 2002 and BOE Bank Limited was absorbed by Nedbank Limited (one of South Africa's big four banks) in March 2002.
[6] National Economic Development and Labour Council.

the private banking sector to meet the access targets. The government committed itself in the Charter to amend regulations that hinder the extension of financial access by private financial institutions.[7]

At the Financial Sector Summit, the government also committed itself to prepare new legislation enabling second and third tier deposit-taking financial institutions to provide additional avenues for extending financial services. This is in line with the government's policy approach to reserve any form of deposit-taking for banks only. Rather than allow nonbanks to enter the deposit-taking sphere, the government intends to enlarge the legal space for deposit-taking by creating new categories of banks subject to reduced entry requirements.[8] In early 2007, the Co-operative Banks Bill providing for the establishment of membership-driven community-based co-operative banks was approved by Parliament.[9] In addition, an anticipated amendment to the Banks Act is expected to create "dedicated banks": new categories of banks subject to reduced minimal capital requirements, thereby facilitating the entrance of new branchless banking actors (see Section 5.1 below).[10]

2.2 Consumer Protection

In addition to financial inclusion, a major policy thrust of the government affecting branchless banking in South Africa is **consumer protection**. The government has prepared a draft Consumer Protection Bill, but it has yet to be submitted to Parliament.

Ombudsman. South Africa has an Ombudsman for Banking Services,[11] tasked with resolving disputes between banks and their customers involving a value of up to ZAR 1 million (approx. USD140,000). The operations of the Ombudsman are paid for by banks according to usage. In 2006, the single largest category of complaints (20%)[12] handled by the Ombudsman related to ATM transactions. The number of complaints regarding cell-phone banking was negligible.

Competition. Perhaps the most significant consumer protection initiative impacting branchless banking is the inquiry into banking competition launched by the **Competition Commission**[13] in 2006. The Jali Commission, appointed to conduct the inquiry, is mandated to consider, among other things, the level and structure of bank charges as

[7] Clause 14 of the Financial Sector Charter.
[8] Section 70 of the Banks Act, Act 94 of 1990, requires banks to maintain a minimum capital of ZAR 250 million (approx. USD 35 million).
[9] The Co-operative Banks Bill (clause 63) does not contain a specific minimum capital; rather, the requirement will be set by regulation and will depend on how the sector develops.
[10] A 2004 draft "Dedicated Banks Bill" recommended that savings banks maintain a minimum capital of ZAR 10 million (approx. USD 1.4 million) and savings and loans banks a minimum capital of ZAR 50 million (approx. USD 7 million). Although the bill was recently removed from the legislative process, it is expected that the bill's provisions will be incorporated into the Banks Act.
[11] The Ombudsman is officially recognized under the Financial Services Ombud Schemes Act which requires it, among other things, to act independently.
[12] Ombudsman for Banking Services, Annual Report, 2006. See www.obssa.co.za.
[13] The Competition Commission is an independent body whose head is accountable to the South African Parliament and the Minister of Trade and Industry. The inquiry was launched pursuant to s.21 of the Competition Act.

well as the feasibility of improving access by "nonbanks and would-be banks to the national payments system."[14] In response to the enquiry, a number of banks have already unilaterally adjusted their bank charges. The Commission was scheduled to announce their report by November 2007, but has indicated that the report will be delayed.[15]

2.4 SARB

Although the policy-making body is the National Treasury, the Registrar of Banks (the banking supervisor) is located within the **South African Reserve Bank** (SARB) and much of the policy-making legwork is done by SARB which also issues circulars under the various laws it administers. Besides housing the supervisor of banks, SARB oversees two other areas critical to branchless banking: the payments system[16] and foreign exchange control.[17]

In 2006, SARB issued two documents impacting branchless banking. First, SARB issued a revised Position Paper on Electronic Money[18] which stated that only banks will be permitted to issue electronic money. Stored value payments products in South Africa can therefore only be operated by banks. Second, SARB issued Bank Circular 6[19] allowing banks to open mobile phone-operated bank accounts (within certain transaction and balance limits) without having to undertake face-to-face KYC (know your customer) procedures.[20] (See section 5.3 below.)

3. State of Play: Industry

Driven by the Financial Sector Charter as well as inter-bank competition, innovation and technical sophistication, the South African financial sector has witnessed a proliferation of branchless banking models over recent years.

3.1 Banks and Compliance with Physical Proximity Requirement of the Charter

South Africa has a sophisticated formal banking system with a well-developed infrastructure. At the end of January 2007, the country (with a population of 48 million people) had 2,397 bank branches, 8,785 ATMs and no fewer than 109,454 POS devices.[21] This is amplified by Postbank's network of 2,600 outlets, more than half of which are connected to the Saswitch (real time switching service) ATM switch.[22] However, even this extensive network does not yet meet the Charter goal for 80% of low

[14] Composition and Terms of Reference of the Enquiry into Competition in Banking, accessed on www.compcom.co.za/banking/ .
[15] http://www.fanews.co.za/article.asp?Banking;35
[16] Pursuant to the National Payment System Act.
[17] The Minister of Finance has delegated the administration of the Exchange Control Regulations, 1961, to the SARB Governor.
[18] Position Paper-Electronic Money, NPS 01/2006, April 2006.
[19] Banks Act Circular 6/2006, July 13, 2006.
[20] At least one new cell-phone banking operator, MTN Banking, uses this dispensation.
[21] Information obtained from SARB.
[22] Postbank is a savings institution that is operated as a division of the South African Postal Office.

income South Africans to be within 20km of a service point. South African banks are taking various routes to address this shortfall.

Payments Association of South Africa (PASA), which is controlled by the big four South African commercial banks (ABSA Bank, First National Bank of South Africa (FNB), Nedbank and Standard Bank), is the self-regulatory body for the payment system. Thus, access to the payment, clearing and settlement systems is tightly controlled and effectively in the hands of these four banks. PASA has appointed Bankserv as the payment clearing house for the South African banking industry. Bankserv provides inter-bank electronic transaction switching services to the banking sector and is majority owned by the big four banks (although it is currently up for sale). Since Bankserv's services are charged on both a flat fee and a volume fee basis, usage of the payments and clearing system is significantly more expensive for smaller banks than for larger banks.

In October 2004, the four big commercial banks, together with Postbank, collectively introduced the **Mzansi account** as a key Charter initiative. The Mzansi account is a simplified savings account with basic transaction capability and limitations on frequency of use. Aimed at low income clients, the great benefit of the Mzansi account is that a client can transact against his/her account at all branches of participating banks (as opposed to proprietary banking products which can be transacted against only at branches of the issuing bank) as well as the entire ATM network and debit card-accepting POS devices. Consequently, the existing banking and Post Office infrastructure is leveraged to its maximum to reach low income clients, with more than 90% of the service points being outside of traditional bricks and mortar bank branches. According to the Banking Association, approximately 3.3 million Mzansi accounts had been opened by June 2006.

Individual banks have also launched their own initiatives. FNB has also rolled out 1,400 **mini-ATMs** into low density, low income and predominantly rural areas that cannot sustain a bank branch or normal ATM. The mini-ATMs, described by FNB as an "ATM emulation device", are placed in small retail stores and consist of a POS-type device mounted on an FNB-branded display stand. The mini ATM offers customers three account-based services: cash withdrawals up to ZAR 1,000 (approx. USD 140), balance inquiries and pre-paid purchases. The mini-ATM does not physically dispense cash; it instead prints out a voucher which is then handed to the cashier at the retailer, who then pays out the cash from the till. At the end of every day, the system pays the retailer (into the retailer's FNB account) however much was paid out from the till that day. When a non-FNB customer draws money in this way, the transaction is routed through FNB to the national switch and forms part of the daily settlements between banks.

Both ABSA Bank and FNB are rolling out "**container branches**" -- service centers mounted on vehicles or in movable containers which can be parked or placed for extended periods at convenient locations in communities where there are no bank branches. Accounts can be opened and transactions facilitated by bank staff at these mobile branches.

3.2 Banks and Mobile Phone Banking

All of the large retail banks already offer mobile phones as an additional access channel to existing bank accounts, including Mzansi accounts, often providing transactions free of charge with the client absorbing only the costs of the call. However, South Africa has also seen the emergence of two mobile banking models, WIZZIT and MTN MobileMoney, where the mobile phone is not only used as an access channel to existing bank accounts managed on traditional bank systems (in a similar way to the use of the internet), but where the bank account application is fully integrated with the mobile phone, enabling the customer to use the mobile phone itself as a payment instrument. WIZZIT and MobileMoney users collectively account for 20% of all mobile banking users in South Africa – a significant achievement for mobile banking products targeting low income populations. Although both WIZZIT and MTN MobileMoney were developed and are operated by nonbanks – a private firm and a mobile operator respectively – the Banks Act requires that these businesses, as deposit takers and issuers of e-money, act in conjunction with licensed banks. (Both WIZZIT and MTN refer to themselves as "divisions" of banks although they in fact are separate legal entities and not divisions of banks, in the legal sense.)

WIZZIT is a start-up founded by two independent entrepreneurs to target the almost 50% of unbanked South African adults. It operates in partnership with the Bank of Athens.[23] Launched in December 2004 with the slogan "the bank in my pocket," WIZZIT has already signed up more than 200,000 customers. Customers are recruited by over 2,000 roaming Wizzkids who are trained by WIZZIT (i) to conduct the KYC procedures, (ii) to issue clients with their new Maestro-branded debit card and (iii) to familiarise clients with the use of the application. Customers can use their mobile phone (WIZZIT is a "mobile phone agnostic"; clients can use phones operated by any of South Africa's mobile operators) for a number of services including (i) transferring money to third-party accounts, (ii) checking balances, (iii) loading electricity accounts with prepaid credits and (iv) buying airtime for prepaid mobile phone subscriptions. (The Bank of Athens is liable to the customers for their funds on deposit.) WIZZIT has no branches of its own but has arrangements with the Post Office and ABSA Bank, providing WIZZIT customers with approximately 3,400 sites for deposits (and withdrawals). Since WIZZIT clients are issued with a debit card, cash withdrawals can be done at all South African ATMs. Employers can pay their staff by making payment directly into their WIZZIT accounts electronically.

MTN, one of South Africa's two largest mobile operators, launched MTN Banking and its mobile banking product – **MTN MobileMoney** – in 2005 as a joint venture with Standard Bank.[24] MTN provides the service off its own systems pursuant to an outsourcing agreement with Standard Bank. The banking application is therefore fully integrated into the mobile environment and every MTN SIM card distributed already has an embedded banking application. By implication, only MTN subscribers can open MobileMoney accounts. Account holders can use their mobile phone for similar services as those

[23] WIZZIT refers to itself as a "division of The South African Bank of Athens Limited" although, as noted above, WIZZIT is a separate legal entity. We use the term "partnership" loosely and without having reviewed the written agreement entered into by WIZZIT and BoA.
[24] MTN Banking refers to itself as a "division of Standard Bank" and also describes itself as a joint venture between Standard Bank and MTN.

provided by WIZZIT (as described in the immediately preceding paragraph). Account holders are also issued with a MobileMoney cash card with which they can make cash withdrawals and deposits at Standard Bank branches and ATMs. (For a discussion of EasyPay, see Section 3.4.) Almost all account holders take the option of a MobileMoney Mastercard (for a fee) with which they can make cash withdrawals at all ATMs in South Africa. MTN MobileMoney also offers agent-assisted account opening similar to WIZZIT, but offers the additional option of activating the account via the internet. New clients are required to enter, among other things, their ID number which is then verified against a third-party database. Daily transaction limits of ZAR 5,000 (approx. USD 700) are placed on the MobileMoney account to comply with Exemption 17, while a daily transaction limit of ZAR 1,000 (approx. USD 140) applies to accounts which are opened without direct client interaction to comply with Circular 6. (For a discussion on Exemption 17 and Circular 6, see Section 5.3 below.) MTN MobileMoney currently has approximately 80,000 users.[25]

3.3 Banks and Retailers

The two largest South African retailers have also entered the banking space, further extending the financial services which can be accessed at their retail outlets in South Africa. In 2000, retailer Pick 'n Pay and Nedbank launched **Pick 'n Pay Go Banking**. The Go Account, advertised as no frills low cost banking, is a full transactional account. Its website encourages Pick 'n Pay clients to "use 6,000 till points countrywide as your bank teller."[26] More recently, Shoprite, the largest food retailer in Africa, has joined forces with Capitec, a bank specialising in microfinance, to offer a money transfer service. Due to exchange controls, this can currently only be offered within South Africa (see Section 5.5 below).

One of the largest retail distribution networks currently operating in South Africa is the **pre-paid airtime distribution network**. The potential of utilising this network to distribute financial services is already being tapped. Discovery Life, a large South African long-term insurer, launched its pre-paid funeral plan in November 2006. The product is based on a joint venture agreement with Smartcall, a division of South African mobile operator Vodacom. Smartcall provides a technological platform for vendors and retailers (from spaza shops[27] to large retail chains) to sell airtime. Through the joint venture, this platform can now also be used to sell insurance based on the same principles as pre-paid airtime. Airtime vendors provide buyers of the insurance policy with a starter pack which instructs the prospective policy holder on how to register with Discovery. Registration is conducted via the mobile phone, with the policy holder inserting his/her identity number, the pin contained in the starter pack, the nominated beneficiaries, etc. Once registered, policy holders buy a voucher from the vendor. When the voucher number is submitted via the handset, the policy is activated. This process is repeated on a monthly basis to continue coverage.

[25] MTN is also rolling out their banking application in other African countries, such as the Cameroon, where they have a license to operate.
[26] www.gobanking.co.za/content/at_picknpay.asp
[27] Spaza shops are informal businesses in South Africa usually run from home. They typically serve as convenience shops and sell everyday small household items.

3.4 Nonbank--Led Payment Services

Not all the branchless banking models in South Africa are led by banks. A very large proportion of payment services are provided by nonbanks utilising specific legal provisions or dispensations. The largest nonbank supplier of these services is **Net1/Aplitec**, a private company listed on the NASDAQ stock exchange. Net1 provides two major payments products: bill payments and social welfare payments. The bill payments business of Net1 is handled by a subsidiary, EasyPay, which acts as agent to handle bill payments for municipalities, utility companies, financial institutions (including banks and insurance companies), medical practitioners and many others.[28] Payments using EasyPay can be made at the outlets of South Africa's largest retailers, Pick 'n Pay and Shoprite Checkers as well as many other retail outlets. Customers pay retailers and retailers settle with EasyPay who then settles with the utility or other intended recipient of the payment. EasyPay also facilitates internet-based payments, but this channel is currently only accessible to credit card holders.

Various provincial subsidiaries of Net1 use a smartcard system to make **social welfare payments** on behalf of the South African government and have done so for years. Net1's nonbank character and the size of its business (3 million customers[29] using its smartcard) make it significant from a branchless banking perspective. The smartcard operates as a closed-loop system which does not interact with other bank-based payment systems but requires the amounts loaded on the smartcards to be redeemed at Net1 mobile cash payment points or be used to transact with other smartcards in the Net1 system (not used in the social welfare environment). Net1 has avoided the prohibition on deposit-taking by nonbanks through an arrangement with the relevant government departments pursuant to which Net1 first makes the payments to recipients and then claims payments from the government. However, the government has now indicated that, for security and welfare reasons, they wish to move away from cash-based welfare payments in favour of account-based payments. Accordingly, Net1 has entered into an agreement with Grindrod Bank which will allow Net1 to offer bank accounts to welfare recipients.

Another major player in the social welfare payments arena is Allpay, a wholly-owned subsidiary of ABSA Group Limited (which also owns 100 percent of ABSA Bank). Designed specifically for government grant recipients to access their grants electronically, the AllPay Sekulula Debit Card is a basic transactional bank account accessed via a Visa Electron-branded debit card used at any Visa-certified ATM or POS terminal. In 2006, more than two million pensioners and people receiving child and disability payments accessed their grants via the Sekulula card.

3.5 Pre-Funded Payment Schemes

Aside from one e-money program run by FNB (e-bucks), there are no open network pre-funded payment schemes currently operating in South Africa. (There are various store-specific pre-funded payment schemes, such as gift cards.) The primary reason is that

[28] For the full list see www.easypay.co.za/help.cfm
[29] Information provided by PASA.

banks, the only institutions permitted to issue e-money or other stored value instruments, are heavily invested in the existing payments systems and therefore have little incentive to invest in new systems.

3.6 Postbank

Postbank is also positioning itself to play an increasing role in banking the unbanked in South Africa. The core mandate of the Postbank, which is not governed by the Banks Act, but by the Postal Act, is to provide savings products. Postbank has a specific exemption in the Banks Act – it is allowed to take deposits into savings accounts, but cannot provide credit. With its large and growing presence and a direct link to the payments network, Postbank is well positioned to support branchless banking. About half of the Mzansi accounts opened to date were opened by Postbank, and it already acts as a cash-in cash-out point for WIZZIT clients (see Section 3.2 above).

4. State of Play: Clients

South African customers would seem ready for branchless banking, although not necessarily literate in the usage of branchless banking services. The Finscope 2006 survey found that 49% of adult South Africans are unbanked. Moreover, South Africans at all income levels, but particularly poor people without the means to protect themselves and their cash, are subject to high levels of crime which drives perceptions of increased safety of financial institutions and also adds impetus to the creation of a cashless environment.

The presence of a cell-phone bank dedicated to the low-income population has also presented the opportunity to probe the experience of clients with this branchless banking service. CGAP conducted consumer research with 515 low-income clients and potential clients of WIZZIT. [30] Among potential clients, few had heard of mobile banking, and nearly all had questions about whether mobile banking would be affordable, secure or something they would be able to learn how to use. This is perhaps not surprising for a service such as mobile banking, which is largely new to the South African market and to low-income customers. However, WIZZIT's clients had a largely positive view of the service. Three out of four said mobile banking is closer to their ideal way of banking than bank branches or ATMs; nine out of ten said that WIZZIT is good value for money, citing it as cheaper (70% of survey sample), safe (69%), convenient (68%) and fast (68%). Compared to non-users, WIZZIT clients tend to be slightly better off, better educated, more likely to be formally employed, and use a wider range of functions on their mobile phones.

5. Legal Challenges to Branchless Banking

[30] Ivatury and Pickens, Mobile Phone Banking and Low-income customers: Evidence from South Africa, CGAP, United Nations Foundation and Vodafone Group Foundation, 2006.

In South Africa, branchless banking has the potential to increase poor people's access to financial services if, among other important preconditions,[31] regulation (*a*) facilitates the use of a wide range of agents outside bank branches, thereby increasing the number of service points; (*b*) permits account opening, both on-site and remotely, while maintaining adequate KYC standards; and (*c*) permits a range of players (subject to appropriate regulation and supervision) to provide payment services and issue e-money or other similar stored-value instruments. Given that branchless banking touches upon a number of regulatory domains, it is crucial that the relevant regulators establish an effective means for communicating and coordinating their actions.

5.1 Banks, Nonbanks and E-money

Only banks registered under the Banks Act are allowed to engage in "the business of banking," which includes taking deposits from the general public.[32] Accordingly, retailers, mobile operators and entrepreneurs wishing to offer branchless banking services that entail taking deposits from the public, such as Pick 'n Pay, MTN and WIZZIT, must do so alongside banks (whether in partnership, as a joint venture or as agent). This can be a double-edged sword. On the one hand, South African banking regulation is strict and comprehensive, requiring an expensive compliance function. Nonbanks can therefore benefit significantly from leveraging off the compliance function and infrastructure (such as an existing branch network) of established banks. On the other hand, experience has shown that compliance officers of big banks tend to be very conservative. This, as well as the desire of established players to limit competition, can stifle innovation.

Providing existing players with large distribution networks and the potential to extend access to financial services, and entrepreneurs wishing to roll out new branchless banking services with an alternative to being housed within an existing bank, could therefore spur innovation and market development. This was the intention of the Dedicated Banks Bill which was recently removed from the legislative process. (It is expected that the Bill's provisions will be incorporated into a 2008 amendment to the Banks Act.) The Dedicated Banks Bill proposed the creation of two new categories of banks - savings banks and savings and loans banks (jointly referred to as "dedicated banks"). Savings banks were to be limited to taking deposits, offering savings accounts with transaction functionality and providing payment services. Savings and loan banks were to provide secured loans and checking accounts in addition to the services offered by savings banks. These dedicated banks would be subject to lower minimum capital requirements than the requirement applicable to universal banks.

According to the proposed wording of the bill, a mobile operator wishing to offer a mobile payments platform would have been able to do so as a savings bank which, as stated above, would have been allowed to take deposits and provide payment services. (The response from the private sector to this proposal was lukewarm; in brief, nonbanks were not interested in becoming banks.) However, this would only have been possible if the right to issue electronic money were also extended to dedicated banks. Most of the

[31] The two primary preconditions aside from regulation are: (i) development of successful business models for using technology to provide low-income people with financial services and (ii) understanding and addressing the factors affecting customer adaptation among the unbanked poor.

[32] Section 1 of the Banks Act,.

current services offered by WIZZIT could also have been offered as a savings bank. On the other hand, retailers and mobile operators could offer more extensive services, including credit, if they were formed as savings and loan banks.

An amendment to the Banks Act that would introduce dedicated banks with lower minimum capital may facilitate branchless banking in South Africa (especially if the dedicated banks were permitted to issue e-money) although industry people have not expressed a lot of enthusiasm for this approach. In addition, this route would introduce new regulatory responsibilities for the SARB, an important issue to consider when determining the appropriate initial capital requirement.

5.2 Use of Agents

The South African regulatory framework gives wide discretion to banks to utilise nonbank third parties to offer banking services beyond their traditional branch network, either as agents or through outsourcing arrangements.[33] The Banks Act allows a bank to contract agents "to receive on its behalf from its clients any deposits, money due to it or applications for loans or advances, or to make payments to such clients on its behalf."[34] The only restriction is that a bank may not enter into an agency agreement until it has provisioned for the bank's organizational extensions, purchase of a business, a loss (including a loss suffered from a sale of assets) and bad debts.[35] In practice, banks outsource services well beyond those explicitly listed in the Banks Act, including the conduct of KYC procedures.

An SARB circular provides general guidance for outsourcing arrangements and makes these arrangements subject to SARB scrutiny.[36] Although the circular states that SARB does not support the outsourcing of a bank's compliance function and internal audit function, it does not otherwise specifically address which bank functions may be outsourced. Its scope is limited to those bank functions which (1) have a bearing on the risk profile of a bank, (2) affect the systems and control of a bank, (3) can be classified as being of strategic importance and (4) have implications for the discharge of the supervisory processes followed by SARB. A bank is therefore left with wide discretion, provided that it assumes, among other things, the following responsibilities:

- Entering into a detailed outsourcing agreement that is legally scrutinized by the bank;
- Ensuring outsourced services are performed adequately, in accordance with internal policies and standards and in accordance with the outsourcing agreement;[37]

[33] A bank agent is generally an entity who has been authorized by the bank to enter into agreements which legally bind the bank. In an outsourcing arrangement, an entity contracts with the bank to perform a specific function. Since an agency relationship sometimes emerges from an outsourcing agreement, the distinction between an agency agreement and an outsourcing agreement is sometimes blurred.
[34] Definition of "agency" in section 1(1) of the Banks Act.
[35] Section 78(1) (f) of the Banks Act.
[36] Banks Act Circular 14/2004 on Outsourcing of Functions within Banks.
[37] The circular distinguishes between outsourcing to "external suppliers" and outsourcing to "a particular group of institutions forming part of a banking group," concluding that "it is unlikely that outsourced

- Ensuring processes are in place to identify and deal with any weakness in a supplier's service, which may include access to the supplier by the bank's internal and external auditors as well as external agencies; and
- Providing SARB, when requested, with any required information on the outsourced functions or activities.

In addition, bank management is required to advise SARB of its proposed future outsourcing arrangements prior to finalization of such arrangements and to provide SARB with copies of the minutes of the board risk sub-committee meeting at which the proposed agreements were considered.

The flexible regime for banks' use of agents has enabled banks to provide banking services outside traditional bank branches. However, requiring agents to perform in accordance with the internal policies and standards of the bank may result in the exclusion of smaller establishments which are more likely to be located in low income areas but, unlike larger retailers, do not have the resources to satisfy the bank's internal control and audit standards. If the SARB is amenable to relaxing these requirements for smaller establishments (as it may have done already in the case of FNB), then this should be made clear.

5.3 AML/CFT

The Financial Intelligence Center Act (FICA) and its regulations govern anti-money laundering. FICA provides that an accountable institution[38] "may not establish a business relationship or conclude a single transaction with a client unless the accountable institution has taken the prescribed steps to establish and verify the identity of the client."[39] Accountable institutions must keep a record of the identity of the client and any documents obtained in verifying that identity.[40]

The FICA regulations originally posed major obstacles to customer acquisition in the low income market by requiring individuals to produce (i) a national ID document to verify personal details and (ii) documentary proof of residential address when opening a bank account. It was soon realised that about one third of adult South Africans, most of whom live in informal housing, could not provide such documentary proof of residential address. This caused banks, which were jointly developing a transaction banking product to comply with their access obligations under the Financial Sector Charter, to request an

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functions or activities within a particular group of institutions would pose the same risks to banks as outsourcing arrangements with external suppliers. Nonetheless, the management of a bank has to ensure that the same amount of care and diligence is taken with all outsourcing arrangements." This distinction may have been relevant to the approach taken with respect to WIZZIT and MTN Banking.

[38] Accountable institutions are listed on Schedule 1 to FICA and include, among other things, (i) a person who carries on "the business of a bank" as defined under the Banks Act, (ii) a financial instrument trader, (iii) a person who deals in foreign exchange, (iv) a person who issues, sells and redeems traveller's checks, money orders or similar instruments and (v) the Postbank. Mobile network operators are not mentioned by name.

[39] Section 21(1), Financial Intelligence Center Act (No. 38 of 2001)

[40] Section 22(1), Financial Intelligence Center Act (No. 38 of 2001). Such records may be kept in electronic form.

amendment to the regulations to facilitate the opening of accounts for these low-income clients. In 2004, the Minister of Finance subsequently issued Exemption 17[41] to the AML regulations in order to allow banks to open accounts (subject to balance and transaction limits[42]) upon the presentation of only a South African national ID document.

Two years later, SARB issued **Bank Circular 6** which allows non-face to face account opening for cell-phone banking without any documentary evidence, a concession with significant potential to extend branchless banking since it obviates the necessity for KYC procedures to be performed at branches or in person. Specifically, the client must provide his or her identity number, which the bank must then cross-reference with third-party databases containing information on the names and identity numbers sourced from the Department of Home Affairs (which issues the identity numbers). The account opening procedures mandated by Circular 6 only apply to bank accounts which comply with Exemption 17 and are only available to South African citizens and residents with valid identity numbers.[43] The transactions on such an account are limited to ZAR 1,000 (approx. USD 140) per day. If clients wish to exceed this limit, a face-to-face confirmation of the client's identity must be carried out in accordance with the provisions of Exemption 17.[44] Banks are also required to put in place measures to prevent a person from opening more than one of these accounts. Banks must also perform enhanced scrutiny of the activity on these accounts to identify suspicious and unusual transactions.

Exemption 17 and Circular 6 have successfully removed significant impediments to branchless banking in South Africa. In addition, they are excellent examples of how countries can be flexible with AML standards while remaining security compliant.[45] *There may be significant access benefits to extending the circular to other banking products (in addition to mobile banking products), with any such extension being accompanied by a similarly limited account functionality.*

A potential complicating factor on the KYC front is the Regulation of Interception of Communications and Provision of Communication-related Information Act ("RICA"),[46] which facilitates the interception of information passed over electronic communication channels, including mobile phones, for combating crime purposes. Sections 40 and 62(6) would have required the operators and distributors of mobile phones to perform a full KYC procedure on any person to whom they provide a mobile phone or SIM-card. However, due to practical difficulties posed, these provisions were suspended when RICA went into effect in September 2005.[47] An amendment to RICA, which retained the

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[41] This issuance was in fact a revision of the original version of Exemption 17 issued in 2002.

[42] The daily transaction limit is ZAR 5,000 (approx. USD 700) and the monthly limit is ZAR 25,000 (approx. USD 3,500).

[43] If the client wishes to exceed the limits provided for in Exemption 17, then the "normal" verification process referred to above will apply. Circular 6/2007, para. 6.

[44] Ibid, para. 5.

[45] South Africa has been a Financial Action Task Force (FATF) member since 2003 and served as FATF President 2005-2006. However, South Africa has not yet undergone the mutual evaluation process FATF uses to determine the level of compliance with FATF's AML/CFT recommendations.

[46] Act 70 of 2002.

[47] Proclamation R67 fixed the commencement date of Section 40 as June 30, 2006. However, proclamation R25 of 2006 repealed proclamation R67, effectively suspending the obligation to comply with Section 40.

full KYC procedure, was presented to Parliament and passed the General Assembly but its efficacy was questioned by both the government and private actors and the second house of Parliament referred the bill back to the Department of Justice for revisions. Its future is unclear.

Should RICA's Section 40 be implemented with a burdensome KYC procedure, it will seriously inhibit the extension of cell-phone banking to the low-income market and effectively erase any benefit of Circular 6. It seems very important to the continued success of transformational branchless banking that the KYC procedures included in RICA not contradict SARB's AML/CFT standards.

5.4 Payment Systems

The South African Reserve Bank Act provides that SARB may perform the functions, implement the rules and procedures and, in general, take the steps necessary to establish, conduct, monitor, regulate and supervise payment, clearing and settlement systems. Access to the national payments and settlement system is reserved for banks only; [48] nonbanks can access the payments system only through joint ventures with banks (members of the payment system) or through co-branding programs with banks. Under the National Payment System Act (NPS Act), SARB is permitted to delegate its responsibilities with respect to control of the national payment system to a self-regulatory industry body although SARB retains ultimate control and is responsible for overseeing the system and the actions of the self-regulatory industry body. As noted above, SARB has so delegated control to PASA pursuant to regulation.

Access by nonbanks to the payment system as well as the cost of services provided by Bankserv are key issues that will affect the development of branchless banking in South Africa. These issues are currently the subject of a public enquiry by the Competition Commission, the outcome of which is expected in 2008. SARB and the National Treasury are monitoring the Competition Commission proceedings (see Section 2.2 above) and will await its recommendations before any further action is taken.

In the meantime, SARB has issued a policy paper on the National Payment System Framework and Strategy (Vision 2010) which states expressly that participation by nonbanks is one of SARB's objectives. SARB has since taken concrete steps to regulate the provision of payment services by nonbank operators. In September 2007, the central bank issued two directives: one was in respect of nonbank system operators;[49]the other was in respect of payments to third parties by nonbanks.[50] These directives recognise that nonbanks, in the realm of payments to third parties, add value to the national payment system and require persons operating such payment networks to be subject to the NPS Act as well as relevant risk management procedures issued with respect to payment system participants.

[48] National Payment System Act, 78 of 1998.
[49] *SARB Directive for Conduct within the National Payment System in respect of system operators*, Directive 2 of 2007 published on 6 September 2007 in GG30261
[50] *SARB Directive for Conduct within the National Payment System in respect of payments to third persons*, Directive 1 of 2007 published on 6 September 2007 in GG30261.

South Africa has taken a conservative approach regarding nonbanks' involvement in the provison of banking services. This is evidenced by the two September 2007 directives, which permit nonbanks to be involved in payments to third parties (such as bill payments and the distribution of social welfare grants) but do not permit nonbanks to engage in money transfers or payment instructions attendant upon normal banking transactions. Some countries have permitted nonbanks to deliver payment services of this nature, including stored value payment schemes, subject to appropriate reporting and prudential requirements and to oversight and enforcement. If this approach were to be adopted in South Africa, it may have more success than the dedicated banks route, given industry's lack of enthusiasm for the latter.

5.5 Forex Controls

South Africa maintains a strict exchange control regime. The detailed controls are contained in the Exchange Control Regulations of 1961, issued pursuant to the Currency and Exchanges Act.[51] Only persons authorised by the National Treasury can deal in foreign exchange. With the exception of nonbank Authorised Dealers with Limited Authority (who may buy and sell foreign exchange for travel-related purposes only) only banks have been authorised to deal in foreign exchange. Banks are required to maintain a complex and costly reporting system in which every single transaction in foreign exchange, irrespective of its size, must be categorised according to the manual of transactions prepared by the Exchange Control Department (at SARB) and electronically reported to SARB.

This regime has two primary consequences for branchless banking. First, undertaking cross-border remittances, which normally entail low values, through the banking system (as there is no other option) is very expensive and beyond the reach of most migrants who want to remit money home, especially to countries elsewhere in Africa. Second, such cross-border remittances can only be performed at bank branches – with no "branchless" option in sight.

The Ministry of Finance has indicated that it is unlikely to abolish the costly reporting requirements or the branch-only requirement. Limited access to low-cost, widely available remittance services is therefore likely to prevail in South Africa for some time.

5.6 Data Privacy

The South African Law Reform Commission has prepared a draft Protection of Personal Information Bill[52] which will apply to the processing of personal information, including information relating to financial transactions. The draft legislation envisages a framework for data protection based on the eight core information protection principles contained in the OECD's 1981 Guidelines Governing the Protection of Privacy and Transborder Data Flow of Personal Data. Currently, the Electronic Communications and Transactions Act[53]

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[51] Act 9 of 1933.

[52] The members of the South African Law Reform Commission are appointed by the President of South Africa.

[53] Act 25 of 2002.

sets out principles for electronically collecting personal information, however these principles are not compulsory and persons who collect data can subscribe to them on a voluntary (or contractual) basis.[54]

The final recommendations of the Law Reform Commission, made in response to a large number of comments received on the draft bill, will be published in the form of a Report to the Minister of Justice and Constitutional Development. Should the Commission's recommendations be accepted, the Minister will then introduce legislation in Parliament. This is unlikely to take place before early 2008 and the legislation is therefore unlikely to emerge from the Parliamentary process before the second half of 2008.

[54] Sections 50 and 51 of the Electronic Communications and Transactions Act.

List of Persons Interviewed

South African Reserve Bank (SARB)	Mr Coetzee	Assistant General Manager, Exchange Control Department
	Mr Kirsten	Assistant General manager: Exchange Control Department
	Mr Stroebel	Senior Manager, Exchange Control Department
South African Reserve Bank (SARB)	Mr Michael Blackbeard (Adv)	Dep. Registrar of Banks, Regulation and Support (Bank Supervision Department)
	Ms Jabu Kuzwayo (Adv)	Head, Regulations (Bank Supervision Department)
	Mr Iman van den Bout	Senior Manager, Legal Administration (Bank Supervision Dept.)
	Mr Andre Bezuidenhout	Head of Financial Stability
	Mr Neren Rau	Head, Financial Safety Net Division (Financial Stability Department)
South African Reserve Bank (SARB)	Mr Dave Mitchell	HoD, National Payment Systems Department
	Mr Tim Masela	Assistant General Manager, National Payment Systems Department
	Ms Margaret Olivier	Payment Systems Specialist, National Payment Systems Department
SA Post Bank	Ms Lesley Plaistowe	Group Executive, Shared Services
	Ms. Marietjie Lancaster	General Manager, Strategy
	Ms Totsi Memela-Khambule	Managing Director
	Mr Domingo Dias	General Manager, Information Technology
Financial Intelligence Centre (FIU)	Adv. Pieter Smit (Mr)	Senior Manager, Legal and Policy
	Ms Michelle Sewchuran	Senior Compliance Officer
National Treasury (Ministry of Finance)	Mr Jonathon Dixon	Chief Director, Financial Sector Regulation
	Ms Raadika Sookoo	Director, Financial Stability Special Projects
	Ms Koko Monama	Deputy Director, Financial Sector Policy
	Mr Riaz Ahmed	Senior Economist

Competition Commission	Mr Keith Weeks	Senior Economic Analyst (Heading Banking Enquiry Technical Team at time of interview)
	Ms Jana Louw	Head, Technical and Data Analysis
Ombudsman for Banking Services	Adv. Neville Melville (Mr)	Ombudsman for Banking Services
Payments Association of South Africa	Mr Peter Rawlings	Director, Risk
ABSA (Amalgamated Banks of South Africa)	Mr Gerhard Coetzee	General Manager, Micro Enterprise Finance
Banking Association South Africa	Mr Stuart Grobler	General Manager
	Mr Brad Gillis	General Manager
ABSA Bank	Mr Marius Ungerer	General Manager: Strategy and Planning - Mass Market
	Ms Sonja van Vliet	General Manager: Mass Market CVP - Flexi Banking Services
African Bank	Mr Charles Chemel	Group Credit and Product Executive
Bank of Athens	Mr Dmitrios Koutsadis	Head, Marketing and Public Relations
Bankserv	Mr Lionel Slowe	General Manager, Bankserv Africa
	Mr Anton Rennison	Strategist
Cointel	Mr Gary Nunez	Managing Director
First National Bank	Ms Liz Hazell	Head, Strategic Projects, Self Service Channel
	Mr Brian Small	Head, New Technologies and Solution Strategy
	Ms Charne Yssel	Manager, Sales Enablement, FNB Branch Banking
	Ms Yolande Van Wyk	Head, Strategic Projcets, Mobile and Transact Solutions
Fundamo	Mr Hannes van Rensburg	Chief Executive Officer
Genesis Analytics	Mr James Hodge	Competition and Regulation Practice

MTN Banking	Mr Parrat	Marketing and Sales Executive, MTN Banking
	Mr Bruynse	Technical Consultant
	Mr Okoudjou	Business Analyst, Africa
	Mr Marrie	Product Specialist
Paym8	Mr Craig Kilfoil	Sales and Marketing Director
Smartcall	Mr Kees Snijders	Assistant Architect
Standard Bank	Mr Arthur Cousins	Director, Strategy and Product Development
	Mr Richard James	Risk Professional: Wholesale Banking
	Mr Duncan Arthur	Head, Compliance - Standard Bank Africa
	Mr Peter van der Merwe	Senior Manager, Group Compliance
University of Johannesburg	Prof de Koker (Mr)	Director, Centre for the Study of Economic Crime (CenSEC)
VISA	Mr Nick Essame	Vice President, Head of Business Development, South Africa
Vodacom South Africa	Mr Jacques Voogt	Product Manager: Commerce and Secure Services
	Mr Colin Abouchabki	Executive Head: Products and Services
WIZZIT	Mr Brian Richardson	Chief Executive Officer