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The Expanding Role of Non-banks in South Africa

NPS Act Review: Unpacking Recommendation 13

Contents

1. Introduction

This article specifically focuses on Recommendation 13 which looks at expanding the retail payment services/activities allowed by non-bank participants.

As the payments industry moves towards the digital age and becomes increasingly innovative, and financial technology becomes more advanced, the development of new payment methods, technologies, services, risks, participants and 'payment systems' have become increasingly prominent and a challenge to the traditional payments regulatory landscape. It follows that the accompanying regulatory and legislative framework needs to be flexible and adaptable to these developments and provide an enabling environment which fosters innovation.

The National Payment Systems Act 78 of 1998 (NPS Act), which came into effect in October 1998, provides for the: management, administration, operation, regulation and supervision of payment, clearing and settlement systems in the Republic of South Africa.

The South African Reserve Bank (SARB), through the National Payment System Department (NPSD), regulates and oversees the safety, efficiency, and integrity of the National Payment System (NPS) while implementing measures to reduce systemic risk in the payment system.

In December 2018, the SARB published a policy paper titled "Review of the National Payment System Act 78 of 1998" resulting from several developments which encouraged a rethink of the robustness and resilience of the NPS legislative and regulatory framework in the rapidly evolving, technologically advanced and highly innovative payments landscape. The paper highlights 21 recommendations including global policy developments relating to financial inclusion, financial stability, effectiveness, integrity, competition, international standards, best practice and recommendations from global policy and standard setting bodies.

This article specifically focuses on Recommendation 13 which looks at expanding the retail payment services /activities allowed by non-bank participants (including e-money and mobile money) and the direct participation of non-banks in clearing and settlement. This recommendation was proposed in support of transformation and financial inclusion, enhancing access and competition, and reducing payment services costs in the NPS. However, non-bank participants potentially also bring more risks into the NPS that need to be effectively managed, as payments are a critical component of any economy.

As of April 2022, the NPS Act amendments are being refined and finalised by the SARB and National Treasury for tabling at Parliament. There will be an opportunity to comment on the tabled version of the Bill in the Parliamentary process.

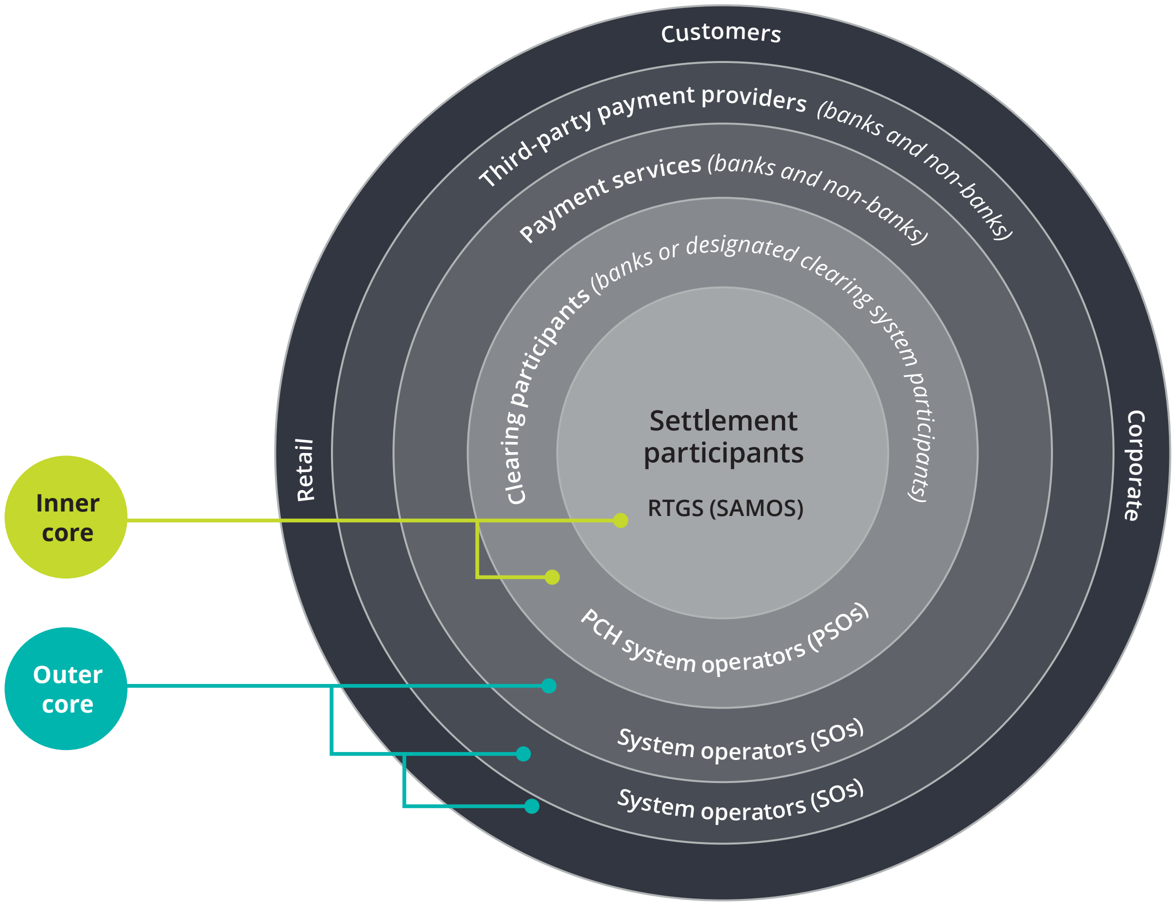
[1](South African Reserve Bank, 2018)

2. South African Payments Landscape

2.1 Payments Landscape Overview

A country's payment and settlement systems are often described as the backbone of its financial system. The default by one participant can have knock-on effects and may, in turn, cause the failure of other participants in the system. Robust payment and settlement systems are therefore crucial for financial stability. The key role players in the South African NPS are depicted in Figure 1, starting from a highly regulated inner core, becoming less regulated with each layer thereafter.

Figure 1: Key role players in South Africa's NPS (Source: PASA)



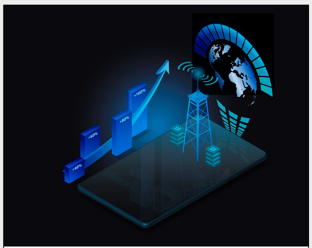
The inner core consists of settlement and clearing participants. Settlement participants are *registered banks* who hold settlement accounts with the SARB. A registered bank is defined as "a public company registered as a bank in terms of the Banks Act" [2]. Settlement refers to the final and irrevocable discharge of an obligation of one bank in favour of another bank, in central bank money, i.e. the respective debiting and crediting of the bank's accounts in the books of the SARB[3]. Settlement of payment obligations between participants is achieved through the South African Multiple Options Settlement (SAMOS) system, a Real-Time Gross Settlement (RTGS) system, which is owned and operated by the SARB. Banks or designated participants who do not have settlement accounts may be sponsored by settlement participants. **As per the NPS Act, non-banks are currently excluded from directly accessing the settlement system, therefore requiring a bank sponsor to settle transactions.**

[2](University of Pretoria, 2015)
[3](Payments Association of South Africa, 2016)

Clearing refers to the exchange of payment instructions between the payer's bank and the payee's bank[4]. Clearing participants may be banks or designated clearing system participants and must be members of the Payments Association of South Africa (PASA) and at least one Payment Clearing House (PCH) agreement. A PCH agreement contains the clearing rules for a specific payment stream. Clearing of these payment instructions is achieved through authorised PCH System Operators (PSOs).

The outer core consists of non-bank entities including System Operators (SOs), Third Party Payment Providers (TPPPs), customers, corporates and retailers.

Figure 2: For the purposes of this article, a non-bank can be defined as: Any institution who participates in financial service activities but does not have a formal banking license including:



Mobile Network Operators (MNOs)

Fintechs

Retailers

Insurance companies

There are two categories of non-bank role-players catered for under the NPS Act framework that provide payment services - SOs and TPPPs. These entities are defined in Figure 3. In September 2007 the SARB issued two directives, Directive No. 1 of 2007 (Directive for Conduct within the National Payment System in Respect of Payments to Third Persons) and Directive No. 2 of 2007 (Directive for Conduct within the National Payment System in Respect of System Operators) to define the minimum criteria that should be applied by regulated non-bank participants. TPPPs are required to be registered with PASA and SOs are authorised by PASA with SARB approved SO criteria.

In its current form, the NPS caters largely to the banks with limited involvement from non-bank participants. Recommendation 13 proposes greater involvement of non-banks to foster innovation and competition.

2.2 Non-bank Payments Landscape

South Africa's financial services market has historically been dominated by banks, in line with global trends[5]. However, due to changes in regulations, new technologies and customer demands, more non-banks are offering or facilitating payment services. While South Africa's fintech market is relatively small, it is growing at an accelerated rate as providers are targeting niche customer sectors. Most payment fintechs must register, be authorised as a TPPP and/or an SO with PASA. Criticism has been levelled against the NPS Act for impeding access and competition in the NPS, thereby stifling innovation[6].

The inclusion of non-banks in the NPS is a pertinent topic in South Africa with strides already being made. In June 2021, the SARB requested PASA to facilitate the co-design of a new Payments Industry Body (PIB) by an inclusive community of payment system stakeholders. One of the main objectives of the PIB is to create a more inclusive industry structure to pursue common goals across banks and non-banks.

Furthermore, retailers are gradually becoming the face of the banks by offering services like cashback at Point-of-Sale (POS), bill payments, bank account opening, money remittances, etc. There are an increasing number of retailer and bank partnerships arising to reach more customers including TymeBank's partnership with Pick n Pay and Standard Bank's instant money partnership with PEP.

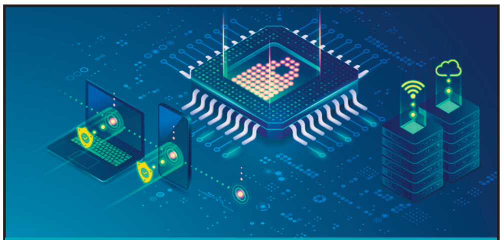
With the growth and acceptance of mobile payments, MNOs are also targeting the payments environment. This is partly due to decreased revenues caused by pressure on the cost of mobile data, as well as the number of mobile money success stories in rest of Africa and Asia. As of October 2021, there were 171 TPPPs and 87 SOs registered with PASA and only 34 bank members[7].

[4](Payments Association of South Africa, 2016)
[5](Genesis, 2019)
[6](South African Reserve Bank, 2018)
[7](PASA, 2020)

2.2.1 Non-Bank Permitted Payment Activities

Non-banks require partnerships to perform certain activities. Figure 3 below outlines the non-bank regulated activities and non-bank regulated activities requiring bank partnership in South Africa. It should be noted that there is an exception whereby non-banks may participate without bank sponsorship. As per the definitions in Figure 3, payment services where money is 'not due' (i.e. the organisation does not hold money) are excluded from the NPS Act. Participants wishing to provide other payment services involving the pooling of funds from consumers are required to partner with banks. An example of this would be retailers and MNOs that are enabled to conduct person-to-person (P2P) money transfers using their bank partnerships. The sponsoring bank and the non-bank must apply for authorisation from the Prudential Authority[8].

Figure 3: Current payment activities performed by non-banks under the NPS



Non-bank regulated activities not requiring a bank partnership

TPPP (Beneficiary Service Provider (BSP)) – payments due to third persons, where money or the proceeds of payment instructions are accepted by a person, as a regular feature of that person's business, from multiple payers on behalf of, and due to, a beneficiary.

E.g. acceptance of money or proceeds of payment instructions by a retailer or other outlets for payment of utility bills.[9]

TPPP (Payer Service Provider (PSP)) – payments due to third persons where money or the proceeds of payment instructions are accepted by a person, as a regular feature of that person's business, from a payer to make payment on behalf of that payer to multiple beneficiaries.

E.g. payment of salaries on behalf of employers to their employees.[10]

SO - provides services in relation to payment instructions, i.e. it provides electronic means (including the delivery to and/or receipt of payment instructions) to two or more persons to allow such persons to make payments and/or to receive the proceeds of payment instructions.[11]

Acquiring services provided by a designated clearing system participant e.g. accept payment for goods and services.

Non-bank regulated activities requiring bank partnership

Money transfer operators for domestic remittances – non-banks are required to partner with banks.

e-Money issuance - non-banks are required to partner with banks.

Third parties performing card acquiring services.

Currently, the NPS Act restricts PASA membership to only the SARB, a bank, a mutual bank, a cooperative bank or branch of a foreign institution, and designated clearing system participants, **therefore excluding non-banks**. Designated clearing participants need to partner with a bank for settlement sponsorship. Additionally, members' responsibilities and limitations are rigorously defined. An example is SOs can provide the technology and technical infrastructure for payment transactions, but only South African-registered banks can issue cash and electronic money (e-money).

[8] (Finmark Trust, 2011)
[9] (South African Reserve Bank, 2007)
[10] (South African Reserve Bank, 2007)
[11] (South African Reserve Bank, 2007)

2.2.2 Mobile Money

The SARB defines e-money as the "Monetary value represented by a claim on the issuer. This money is stored electronically and issued on receipt of funds, is generally accepted as a means of payment by persons other than the issuer and is redeemable for physical cash or a deposit into a bank account on demand"[12]. This definition includes mobile money.

The NPS Act currently makes provision for services offered by TPPP's, however, payments without any underlying obligation, such as money remittances and e-money payments, are excluded from the scope of the NPS Act, therefore limiting the types of payment services that may be provided for. As a result of this limitation, and the statement in the SARBs 2009 e-money position paper which reads "Due to the nature of e-money, as described in this Position Paper[13], only South African registered banks may issue e-money", issuance of e-money and provision of remittance services is restricted to banks, unless non-banks partner with a bank. Non-banks may enter into arrangements with licensed banks such that they can offer payment-related services[14].

What historical challenges did mobile money previously face in South Africa?

Mobile money was first introduced in South Africa through Vodacom's mobile money service, M-Pesa, in 2010 with limited success. Unlike many other African countries, South Africa has marked differences to countries where mobile money has been successful. The main reason is that non-banks, such as MNOs, cannot issue e-money due to the restrictive definitions of "banking", "deposits" and "e-money". This restriction stems from the Banks Act which prohibits non-banks from taking deposits unless exempted by the Registrar of Banks. However, other factors contributed to the failure of mobile money, as outlined below[15]:

- A well-established banking sector with high bank account penetration, with 80% of South Africans with a bank account[16]
- A highly competitive banking market with various options for consumers
- A consumer preference for cash
- Easy access to ATM and retail branch networks for cash withdrawal
- Access to banking services through mobile channels
- Lack of access to the right target market
- The comparatively high cost of data
- A lack of interoperability
- Stringent Know Your Customer (KYC) requirements

Despite the historical challenges faced in mobile money, MNOs still see value in a solution for South Africa. In 2020, Vodacom announced plans to create a 'super app' in partnership with Chinese technology giant and digital payment provider Alipay, that will allow consumers in South Africa to shop online, pay bills and send money to other people domestically.

Vodacom is not the only player attempting to enter the mobile money space. In January 2020, MTN launched its Mobile Money (MoMo) services in South Africa in partnership with Ubank Limited. The agreement enables customers to transact and make payments using their mobile phone via Unstructured Supplementary Service Data (USSD) or smartphone applications.

2.2.3 Clearing and Settlement

The NPS Act states:

1. "No person may clear payment instructions unless that person is a:
   a. Reserve Bank settlement system participant; or
   b. Bank, mutual bank, a designated clearing system participant, a co-operative bank or branch of a foreign institution that is allowed to clear in terms of section 4 (2)(d)(i)."[17]
2. "No person may participate in the Reserve Bank settlement system unless:
   a. Such person is the Reserve Bank, a bank, a mutual bank or a branch of a foreign institution and, in the case where a payment system management body has been recognised by the Reserve Bank as contemplated in subsection (1), such person is a member of the payment system management body so recognised; or
   b. Such person is a designated settlement system operator."[18]

Non-banks are allowed to clear in their own name however, they require a bank to sponsor settlement of their transactions. Other entities not mentioned are currently excluded from direct settlement. Non-bank participation in the NPS has been steadily growing since 2002, however their participation in clearing and settlement has been less progressive, as until recently, only three non-banks (Postbank (SOC) Ltd, Diners Club SA (Pty) Ltd and Retail Assist (Pty) Ltd) were designated as clearing participants. In 2021, a further two non-banks (Efficacy Payments (Pty) Ltd and Yoco Technologies (Pty) Ltd) were designated as clearing participants. The lack of progress can largely be attributed to the regulatory requirement for non-banks to be sponsored into settlement by banks and that only banks can settle in the SAMOS system[19].

The 2014 Financial Sector Assessment Program (FSAP) report by the International Monetary Fund (IMF), found that access to clearing and payments was biased against new entrants and there was a lack of competition among financial institutions in the South African payment system[20].

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[15](FinMark Trust, 2017)
[16](Deloitte South Africa, 2019)
[17](SARB, 1998)
[18](SARB, 1998)

3. Unpacking recommendation 13

The SARB has recognised the need to include non-banks in the payment system as highlighted in the NPS Act review and the SARB's Vision 2025 document. Vision 2025 sets out nine goals which provide guidance on the general safety and efficiency of the payment system[21]. Of these nine goals, the two that relate to non-banks that warrant consideration are goal four – Promoting competition and innovation, and goal six – Interoperability.

- ***Promoting competition and innovation –*** Competition in a payment system is important to guarantee high service levels to end users and to prompt innovation. The SARB's vision is for banks and non-banks to compete for the full range of payment services across the entire payments value chain under the same legal and regulatory frameworks. Furthermore, stakeholders in the payment system (banks and non-banks) are to collaborate in the planning, building and maintenance of shared structures which will help in the payment process[22]
- ***Interoperability –*** Interoperability is an important policy objective for the South African NPS. Interoperability prevents fragmentation and connects disparate payment systems i.e. multiple, disparate payment systems providing similar payment offerings, where such offerings are available only to a select set of customers[23]

However, the introduction of non-banks also brings additional complexities. Technological innovations, such as digital currencies, may have stability repercussions that need to be managed[24]. The risks brought by non-banks can be grouped into six categories, for which different regulatory frameworks would be required to address [25]:

- ***Financial stability risk –*** Non-banks are currently outside the ambit of the Banks Act and thus are not expected to adhere to prudential requirements. The NPSD is currently reviewing the TPPP Directive in order to remove bank sponsorship and introduce prudential i.e capital requirement elements for supervising non-banks
- ***Concentration risk –*** Where non-banks are able to specialise and develop economies of scale (e.g. M-Pesa in Kenya), the situation may arise where a significant portion of operations are highly concentrated in a relatively small number of non-banks
- ***Outsourcing risk –*** Non-banks may get involved in the NPS through outsourcing arrangements with direct participants such as banks, who could choose to outsource critical functions, such as information technology services, to specialised providers
- ***Fraud risk –*** Adding more participants at various points in the payment chain increases the number of touchpoints for potential security and data breaches, which could potentially increase the risk of fraud transpiring. Non-banks are not currently subject to the same level of stringent fraud and compliance requirements as banks. If non-banks are brought into the NPS, they may be subject to increased fraud and compliance related regulations
- ***Customer protection risk –*** Involving non-banks in the custodianship of customer data could raise privacy concerns regarding the use of the data, particularly if it is used without consent
- ***Legal risk –*** A result of increased complexity along the value chain

As a result of the outlined goals, Recommendation 13 was put forward and is detailed below as per the NPS Act Review document[26]. The development of narrow activity-based licenses and changes in mobile money regulation sub-sections specifically address 13.1(a) and the non-bank inclusion in clearing and settlement activities sub-section addresses 13.1(b), 13.1(c) and 13.1(d). All recommendations are made as per 13.2, with a view to maintain the stability of the NPS.

Recommendation 13:

"13.1 The following should be adopted in support of transformation and financial inclusion, to enhance access and competition, and to reduce payment services costs in the NPS:

a. The provision of retail payment services/activities (e.g. remittance services, e-money, mobile money) where money is not due to a third party should be allowed, whether the entities providing such services are banks or non-banks. Such entities should be exempted from the definition of the business of a bank in the Banks Act and be subject to a risk-based and proportionate regulatory, supervisory and oversight framework. This could also be effected through an amendment to the Banks Act and necessary provisions in the NPS Act, while at the same time maintaining financial stability.
b. Any entity (including non-banks) should be allowed to provide clearing services, provided they make the necessary arrangements for the settlement of their transactions, either through another settlement participant or by settling in their own name
c. Any entity (bank or non-bank) should be allowed to settle in the SARB settlement system, provided the applicable requirements (i.e. risk-reduction measures, including capital, liquidity and collateral or pre-funding requirements) are met by such entity
d. The NPS Act must contain empowering provisions to designate non-banks in settlement. Thereafter, the details must be contained in the subordinate legislation

13.2 The NPS Act should enable (a), (b), (c) and (d) above, with a view to maintain the stability of the NPS."

[21](South African Reserve Bank, 2010)
[22](South African Reserve Bank, 2018)
[23](South African Reserve Bank, 2010)
[24](South African Reserve Bank, 2018)
[25](BIS CPMI, 2014)
[26](South African Reserve Bank, 2018)

3.1 Development of Narrow Activity-based Licenses

As a result of the non-bank limitations of the NPS Act, provision of payment systems or services in South Africa such as e-money, mobile money, remittances, pre-paid services, Quick Response (QR) codes, pay by proxy, wallets, etc., have been restricted to banks or bank partnerships[27]. Non-banks are reliant on the sponsorship model to participate in these services which could potentially be remedied with narrow activity-based licenses.

In a bid to foster non-bank inclusion globally, many countries have introduced narrow activity-based licenses which allow non-banks to provide specified payment services while being exempt from obtaining a formal banking license. Payment Banks are a new model of banks conceptualised by the Reserve Bank of India (RBI). As of 2021, India has granted 11 Payment Bank licenses. These banks function differently from conventional banks, with the overall objective of broadening financial inclusion and providing banking services to the underserved population. People and small businesses who are underserved may use payment banks to open savings accounts and current accounts, with associated Automated Teller Machine (ATM)/debit cards. Payment banks cannot issue loans and credit cards however, they can provide online banking and mobile banking facilities.

There has been debate regarding the success of payment banks which aim to achieve financial inclusion while still being competitive and profitable[28]. Figure 4 provide some of the pros and cons of introducing payment banks which must be considered[29]:

Figure 4: Pros and cons of a payment bank (Suja, 2018)

Pros

- **Enhanced Financial Freedom**
  Enhanced freedom to perform fast, secure transactions without having to rely on tedious bank procedures
- **Reduced Frequency of Banking Frauds**
  Payment Bank accounts only accept small deposits, therefore reduced risk of fraud
- **Freedom to have a Zero Balance Account**
  No requirement to maintain a minimum balance, therefore allowing accounts for online transactions rather than deposits
- **Perform a Variety of Transactions Seamlessly**
  Can be used for a range of online transactions including mobile recharges, bill payments, sending money internationally etc

Cons

- **No Loans or Credit Cards**
  Payments banks can only offer payment services, which may result in less usage of the account
- **High Competition**
  Payment banks may lead to high competition in the deposits sector and lead to reduced margins
- **Minimal Incentive**
  Payments banks have a 0 net interest margin, leaving no room to cover costs, resulting in the cost of funds being significantly higher than that of commercial banks
- **Cross-selling Fee**
  There are limitations in using a 'cross-selling fee' as a way to generate profits

[27](South African Reserve Bank, 2018)
[28](Economic and Political Weekly, 2020)
[29](Suja, 2018)

Table 1 compares the different non-bank licenses available in India, Brazil and Nigeria, with each permitting different services, depending on the intended objective of the license. Adoption of activity-based licenses, similar to that in India, may drive non-bank inclusion by allowing non-banks to participate in the NPS while ensuring more stringent supervision.

Table 1: Comparison between the activity-based licenses in India, Brazil, and Nigeria

	India	Brazil	Nigeria
Name of license	Payment Bank License	Payment Institution License	Payment Service Bank License
Rationale for license	Introduced to address the need for niche banking services such as transactions and savings accounts for the underserved population.	Facilitating non-bank entry by fast-tracking the license application process, which previously took up to 2 years.	Enhancing financial inclusion by increasing access to deposit products and payment/remittance services to small businesses, low-income households, and other financially excluded entities through high volume low-value transactions in a secured technology-driven environment.
Activities/ Services permitted	• Acceptance of demand deposits • Issuance of debit cards • Payment and remittance services • Distribution of financial products such as mutual funds and insurance • Issuance of a prepaid payment instrument • Internet banking services • Acting as a business correspondent of another bank • Utility bill payment on behalf of the customers[30]	• Management of payment accounts • Issuance of payment instrument • Payment instrument acquiring • Provision of cash-in and cash-out services of the funds held on payment accounts • Other activities related to the provision of payment services, regulated by the Banco Central do Brasil (BCB)[31]	• Accept deposits from individuals and small businesses • Carry out payments and remittances services • Sale of foreign currencies realised from inbound cross-border personal remittances • Issue debit and pre-paid cards • Operate electronic wallet or render financial advisory services • Invest in Federal Government of Nigeria (FGN) and Central Bank of Nigeria (CBN) securities[32]
Types of non-bank participants	• Individuals/professionals • Non-Banking Finance Companies (NBFCs) e.g. fintechs • Corporate Business Correspondents (BCs) • Mobile telephone companies • Supermarket chains • Companies • Real sector cooperatives owned by residents • Public sector entities	• A legal person that adheres to one or more payment schemes, having a main or ancillary activity[33]: – providing cash-in and cash-out services of the funds held on payment accounts; – performing or facilitating payment instructions related to definite payment service, including transfers originated from or intended for a payment account; – managing payment accounts; – issuing payment instrument; – acquiring payment instrument; – remittances; – converting physical or book-entry currency into e-money, or vice versa, acquiring the acceptance or managing the use of e-money; and – other activities related to the provision of payment services, designated by the BCB • Direct Credit Society fintechs; and • Peer-to-Peer Loan fintechs	• Banking Agents • Telecommunications companies (Telcos), through subsidiaries • Retail chains • Postal services providers and courier companies • Mobile Money Operators • Switching Companies • Financial technology companies (Fintech) • Financial Holding Companies • Any other entity on the merit of its application subject to the approval of the CBN
No. of licensed participants	11 licenses granted as of 2021[34]	549 fintechs operating as of June 2019[35]	3 licenses granted as of 2021[36]
License issuer	Reserve Bank of India (RBI)	Banco Central do Brasil (BCB)	Central Bank of Nigeria (CBN)

[30](RBI, 2015)
[31](BCB, 2021)
[32](Central Bank of Nigeria, 2020)
[33](BCB, 2020)
[34](Kaur, 2020)
[35](Thomson Reuters, 2019)
[36](Central Bank of Nigeria, 2021)

What would this mean for key role players?

Regulators

- The SARB will need to take an activity-based view, ensuring that the same rules apply to similar payment activities and services, irrespective of whether the participant is a bank or non-bank
- The SARB may need to develop appropriate regulatory frameworks to cater to new participants who require regulation and supervision
- The SARB may need to amend existing regulation to ensure regulatory alignment
- The SARB's goal to stimulate innovation and competition in the NPS may be achieved through increased non-bank participation
- The SARB may need to provide additional capacity and skills to handle influx of non-bank participants

Banks

- Banks may face increased competition due to new market entrants which may impact revenue and customer base
- Banks may need to review their strategy and current partnership models as non-banks will no longer require a bank partner to offer certain payment services
- Banks may need to review current business models to establish new or enhance existing capabilities to remain competitive e.g. payments as a service, outsourcing payment capabilities etc.

Non-banks

- Non-banks may have increased opportunities to provide e-money and remittance services, among others, which may lead to increased revenue and a growing customer base
- Non-banks may require increased operational capacity to address new complexity brought by new regulatory requirements
- Non-banks may need to review their strategy and current partnership models as they will no longer require a bank partner to offer certain payment services
- Non-banks will need to review the regulatory landscape and ensure their operating model caters to it

3.2 Changes in Mobile Money Regulation

Mobile money has seen explosive growth in Africa, with 562 million registered users on the continent in 2021, and is often the use case for mobile money success globally[37]. With the renewed interest in providing mobile money and payment services, Recommendation 13 could have a significant impact on the current mobile money landscape in South Africa. The services which can be offered through mobile money, including remittance and mobile payments (bill payments, P2P and merchant payments) are primarily restricted by regulation in South Africa. Implementation of Recommendation 13 would allow non-banks, such as MNOs, to issue e-money and provide remittance services without the requirement for a bank partnership. To enable this, the SARB will need to develop appropriate mobile money legislative and regulatory frameworks to enable convenient, efficient, and safe retail payment and fund transfers, by non-banks, independently of banks.

With the continued growth in mobile money across Africa, regulators have had to adapt. The Central Bank of Kenya (CBK) has adopted a functional approach to regulation but has included provisions in the NPS regulations that stipulate that a certain level of reporting and oversight is required by the CBK, enabling them to manage and supervise mobile money[38]. To effectively manage mobile money, the SARB will need to define oversight and reporting requirements for potential participants within the NPS Act.

The Bank of Ghana (BoG) requires MNOs to separate their financial and payment services business from their communications businesses. Ghana has set the precedent in this space by requiring non-banks to establish separate entities responsible for owning, hosting and managing all payment services and e-money related business, which are directly supervised by the BoG. By establishing these entities, called Special Purpose Vehicle (SPV) entities, non-banks are permitted to participate in Ghana's NPS through specific payment services licences, allowing for simplified and clearly delineated regulatory activities between the BoG and the National Communications Authority[39]. The SARB could explore similar requirements for SPVs and specific payment service licences as a potential solution to enable the participation of MNOs in South Africa's NPS.

[37](GSMA, 2021)
[38](GSMA, 2014)
[39](Central Bank Payments News, 2018)

Banks in other countries where mobile money is prevalent have developed new products aimed to compete with those offered by MNOs, despite the fact that banks have seen a general rise in profits since the introduction and mass adoption of mobile money. This is primarily due to the increased circulation of money in the broadening formal economy[40].

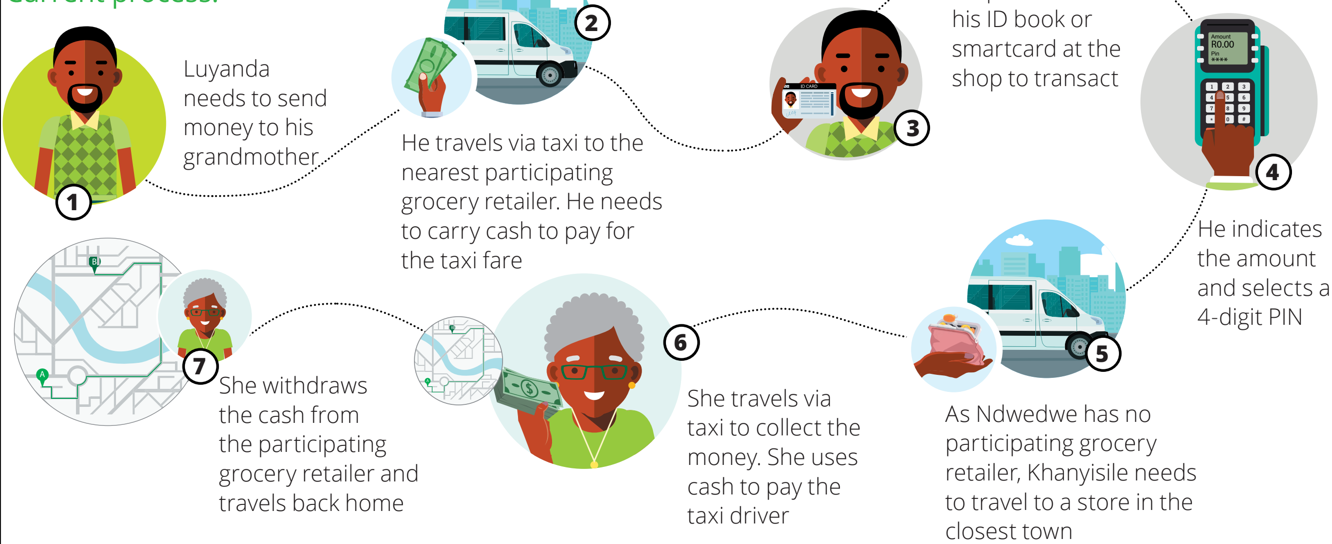
It is important to note that South Africa is different to other markets where mobile money has been successful, in that there is already bank account penetration, an established and effective financial sector and competition for money transfer and payment services[41]. While there are dominant MNO's in the market, no single MNO has market dominance to the extent that Safaricom had in Kenya for M-Pesa. This previously impacted the mobile money adoption as there was no distinct gap that it filled, and a clear use case would need to be developed. According to Finmark's 2017 *Research Report on Mobile Money in South Africa*, consumers placed more trust in banks and retailers than in MNO's, which may become an additional barrier[42].

Case study:

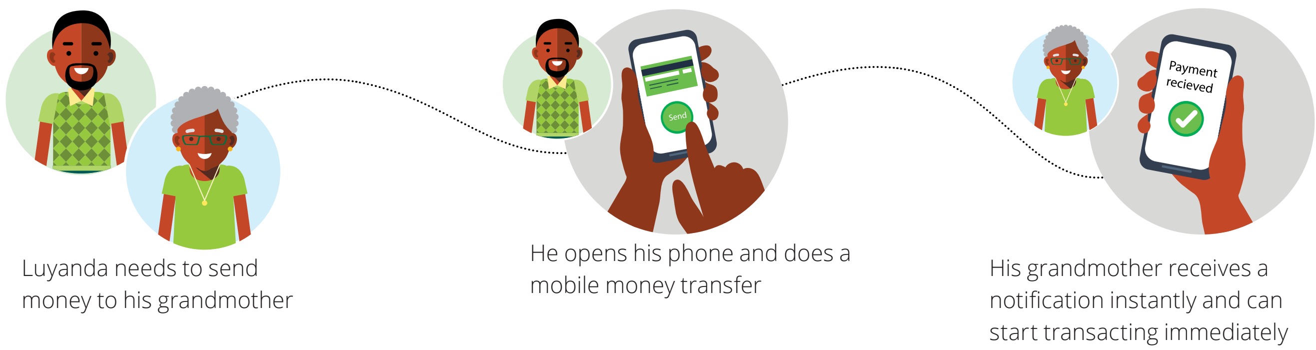
Potential of mobile money in South Africa

Meet Luyanda, a young professional in Johannesburg, South Africa. He sends money to his grandmother, Khanyisile, in Ndwedwe, a village in KwaZulu-Natal. As Ndwedwe does not have any major shopping centres or ATMs, Khanyisile would need to travel far in order to withdraw the money.

Current process:



Mobile money process:



While there are still challenges to mobile money adoption, mobile money brings a number of potential benefits if it is fully interoperable, including:

- Lower cost
- Convenient and instant
- Direct transfers to any cellphone number in SA
- Multi-purpose – Send or receive money, buy prepaid services like electricity, data and SMS bundles, pay for purchases at selected till points and perform 'cash in' and 'cash out' transactions at any store or mobile money agent

[40](Van Coller, 2020)
[41](FinMark Trust, 2017)
[42](FinMark Trust, 2017)

What would this mean for key role players?

Regulators

- The SARB should clearly define mobile money and develop appropriate mobile money legislative and regulatory frameworks
- The SARB should investigate the development of SPVs and clearly define requirements and regulatory activities between the SARB and Independent Communications Authority of South Africa (ICASA)
- The SARBs goal to promote financial inclusion in the NPS may be achieved through mobile money issuance and may lead to a reduction in the usage of cash
- The SARB should consider mandating interoperability to achieve scale

Banks

- Banks may experience increased competition as non-banks provide traditional bank services
- Banks may need to review their strategy and current partnership models or form new partnership models as MNOs will no longer require a bank partner to provide mobile money services
- Banks may need to review their business models to establish new or enhance existing mobile money capabilities to remain competitive
- Banks may need to create mobile money products aimed to compete with MNOs

Non-banks

- MNOs may leverage their footprint to reach rural and peri-rural parts of South Africa better than brick-and-mortar bank branch
- Allowing non-banks to issue mobile money may broaden access to consumers with inadequate access to the formal banking infrastructure
- Non-banks may face increased complexity due to possible enhanced KYC requirements
- Non-banks may need additional capital reserves to float mobile money
- Non-banks need to rethink the regulatory landscape and risk mitigation procedures required

3.3 Non-bank Inclusion in Clearing and Settlement Activities

According to Recommendation 13, non-banks should be allowed to provide clearing and settlement services subject to certain conditions including strict risk-reduction measures (i.e. capital, liquidity and collateral or pre-funding requirements), prudential requirements and regulatory reporting. Currently, some non-banks, as authorised by PASA, use Application Programming Interfaces (APIs) as an indirect method of clearing and without a bank sponsorship.

Globally, consideration is being given to granting access to clearing and settlement systems for non-bank participants. Brazil and the United Kingdom have both introduced regulation which allows non-banks to participate in clearing and settlement. Brazil has emerged as a leader regarding the inclusion of non-banks in the clearing and settlement system. In a drive to spur competition and innovation, direct access to settlement accounts was granted to authorised non-bank payment providers in 2013, under Law No. 12,865/2013[43]. However, uptake has been slow, with few applications received for direct access to settlement accounts. This is due to the fact that most non-banks have a preference to access payment systems indirectly through a financial institution due to the information technology complexity and increased liquidity burden of direct access to settlement accounts.

In 2019, the Bank of England (BOE) published the revised Settlement Account Policy which allows non-bank Payment Service Providers (PSPs) direct access to the UK's interbank payment schemes, including Faster Payments, Bankers Automated Clearing Service (BACS), Clearing House Automated Payment System (CHAPS), Link, Visa, and the new digital cheque imaging system, without relying on a sponsor bank. To become a direct settlement participant of a payment scheme, a non-bank must be authorised by the Financial Conduct Authority (FCA) to provide payment services[44]. The policy articulates eligibility criteria for a BOE settlement account and applicants may include a bank or a non-bank PSP, namely an authorised e-money institution or an authorised payment institution. In April 2018, Transferwise was the first non-bank PSP to join Faster Payments and was followed by iPagoo who in August 2018 was the first non-bank PSP to join CHAPS directly [45].

[43](PASA, 2017)
[44](Bank of England, 2019)
[45](PayUK, 2019)

What would this mean for key role players?

Regulators

- The SARB must be empowered to designate non-banks in settlement
- The SARB should develop appropriate risk frameworks for non-bank participation in clearing and settlement
- The SARB may require additional capacity and skills to provide operational, regulatory and supervision and oversight to non-bank participants accessing clearing and settlement systems

Banks

- Banks may need to review their strategy and current partnership models as non-banks will no longer require a bank partner to facilitate clearing and settlement
- Non-banks may introduce settlement risk that impacts banks

Non-banks

- Non-banks will need to review their strategy and determine whether they will benefit from direct access to clearing and settlement services.
- Non-banks may require increased operational capacity to address increased information technology complexity brought by new regulatory requirements
- Non-banks may face an increased liquidity burden with direct access to the settlement system

4. Conclusion

The recent attention given to the restrictiveness of payments regulation for non-banks has highlighted that expanding access to the NPS is essential to promote financial inclusion and stimulate competition and innovation. The formation of the PIB is a step in the right direction of making the payments industry more inclusive of non-bank participants. While Recommendation 13 has the potential to change the current landscape, global lessons have demonstrated that it is not a silver bullet, and there are various factors for consideration. Non-banks in South Africa have been most successful when providing niche payment services to consumers. Recommendation 13 will allow non-banks increased opportunities to provide retail payment services such as e-money and remittance services, among others, which may lead to increased revenue and a growing customer base. However, this does come with new complexities and risks brought by new operational and regulatory requirements.

Non-bank inclusion may be spurred by the introduction of narrow activity-based licenses which would allow non-banks to perform certain payment activities. Implementation would require an industry consultation to develop a clear business case and criteria for participation. Lessons from global indicate that the pros and cons need to be carefully weighed before implementing these licenses. The SARB will need to work closely with industry to define appropriate, activity-based legislative and regulatory frameworks which apply regardless of whether an institution is a bank or non-bank.

Mobile money probably has the biggest potential for success in South Africa if amendments to mobile money definitions and regulations are made, which will allow non-banks to issue mobile money without the requirement of a bank sponsorship. Other considerations would include driving merchant and consumer adoption in a market with an established banking industry, which differs from the other case studies in Africa. Challenges to mobile money implementation noted in Deloitte's Regenesis of SA Payments paper include the high cost of data, lack of interoperability, unreliable connectivity, the absence of standards and complex apps[46]. Deloitte believes that broader stakeholder engagement, inter-government collaboration and regulatory alignment are needed to facilitate the growth of mobile payments.

A key concern for banks is the competition brought by non-bank competitors. This concern may impact the traditional banking model, forcing banks to reconsider their partnerships, capabilities and service offerings. Despite the competition, including non-banks may increase cash circulation in the formal banking sector, which have resulted in overall higher profits for banks in markets such as Kenya. They will need to assess the potential impact of non-bank entrants to their own landscape. Banks may still choose to partner with non-banks in order to remain competitive, however non-banks will be given more control in this process.

Allowing non-banks direct access to clearing and settlement systems, effectively opening access to the inner core of the NPS, has been discussed at length over the years. However global case studies have shown that implementation and adoption by non-banks may take longer than anticipated. This may be due to the advanced regulatory requirements, increased system complexity and increased liquidity burden for non-banks who currently benefit from a less regulated environment. The SARB will need to develop alignment across a risk-reduction framework, prudential requirements, and regulatory reporting for the safe inclusion of non-banks in clearing and settlement.

The proposed changes to the NPS Act discussed in this article will assist in creating a more levelled playing field between banks and non-banks participating in the NPS, however a structured regulatory framework will be critical to ensuring success. Non-banks and banks alike should engage as far as possible with the SARB during the NPS Act review process and should begin thinking about the implication the proposed changes could have on their business going forward.

[46](Deloitte, 2019)

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