



Update on Regulation of Branchless Banking in South Africa
January 2010

Note: This update of CGAP's 2008 "Notes on Regulation of Branchless Banking in South Africa" incorporates research conducted by CGAP in January 2010 regarding relevant legal and policy changes through the end of 2009. It is one of 11 similar country updates produced by CGAP as a part of the work plan of the Access through Innovation Sub-Group of the G-20 Financial Inclusion Experts Group. However, CGAP alone is responsible for its content. Corrections may be forwarded to yseltzer@cgap.org.



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1. Introduction

There are a number of branchless banking models and financial inclusion initiatives underway in South Africa. The introduction of Mzansi account, a simplified savings account with basic transaction capability offered by the four big banks and Postbank, has been the most significant contributing factor to the recent increase in the number of banked adults. Mzansi clients can use the entire network of automated teller machines (ATMs) and debit card-accepting point-of-sale (POS) devices for transactions as well as any branch of any of the participating banks.

All of the large retail banks offer mobile phones as an additional access channel for existing bank accounts (including Mzansi accounts) managed on traditional bank systems. However, in 2004 and 2005, respectively, WIZZIT and MTN Banking (a joint venture of the mobile operator MTN and Standard Bank) each developed a mobile phone-based transaction banking product with the specific intent of providing financial services to low-income customers. In both cases, the bank account application was fully integrated, with the customer using the mobile phone itself as a payment instrument. (Each also issued cards, thus blurring the borders between different types of branchless banking models.) However, these two businesses, which have been lauded by branchless banking advocates worldwide as solutions for the unbanked, have not grown as expected. In fact, MTN Banking ceased signing up new customers in early 2009, although it continues to service its active customer base and its bank partner, Standard Bank, is signing up new customers using a version of the mobile banking platform developed by MTN Banking. WIZZIT continues to sign up customers but at a slow rate due to the strict interpretation of anti-money laundering and combating the financing of terrorism (AML/CFT) regulation by its alliance partner bank.

There are also nonbank payment networks that have been operating for a number of years, using both POS terminals and smartcards that have facilitated third-party payments and the distribution of welfare payments.

¹ The 2008 "Notes on Regulation of Branchless Banking in South Africa" was based on an analysis of existing legislation and regulations relevant to branchless banking approaches and on the CGAP research team's insights from interviews with a range of stakeholders. The original diagnostic assessment was carried out under the auspices of CGAP's Technology Program, which is co-funded by the Bill & Melinda Gates Foundation. The South African diagnostic assessment was one of seven that provided evidence for CGAP & DFID's Focus Note 43, *Lyman, Timothy, Mark Pickens, and David Porteous. 2008. "Regulating Transformational Branchless Banking: Mobile Phones and Other Technology to Increase Access to Finance."* Washington, D.C.: CGAP & DFID, January."

² The research involved (i) a review of new regulations and other government documents as well as significant secondary sources and (ii) interviews and written exchanges with the following people: Hennie Bester (Director, Genesis Analytics), Professor Louis de Koker (Deakin University School of Law), Jenny Hoffman (Director, Riskfrontier Consultants), David Porteous (Founder and Director, Bankable Frontiers), Brian Richardson (Co-Founder and CEO, WIZZIT), Terence Timson (CEO, MTN MobileMoney South Africa).

³ In September 2009, the G-20 called for the establishment of a Financial Inclusion Experts Group with two subgroups, one of which is the ATI Sub-Group. CGAP is a member of an experts group assembled to assist the ATI Sub-Group in its work, which includes updating information previously published on the policy and regulatory framework for branchless banking in various developing countries.



Policy makers and regulators have been engaged in the development of branchless banking. However, the most significant advance—developing a proportionate regulatory approach applied to AML/CFT standards—resembles the game of two steps forward, one step back. In 2004, the Minister of Finance issued Exemption 17, which reduced the documentary evidence needed to open an account (provided that the account would be subject to balance and transaction limits). Two years later, the South African Reserve Bank (SARB) issued Circular 6, which enabled non-face-to-face account openings for accounts meeting the requirements of Exemption 17, but subject to an even lower (perhaps exceedingly low) transaction limit. These exemptions established South Africa as a model for addressing financial security concerns while allowing low-income individuals greater access to financial services, including savings. Unfortunately, a 2009 amendment to a law permitting interception of information passed over electronic channels requires operators and distributors of mobile phones to perform full AML/CFT customer due diligence procedures on any person to whom they provide a mobile phone or SIM-card, thus reducing the benefits of the AML/CFT measures and highlighting the importance of interagency coordination.

2. Sector Overview

2.1 Financial Inclusion

South Africa has a vibrant and sophisticated financial sector, the strength and stability of which have provided the foundation for over 10 years of uninterrupted economic expansion. However, during the apartheid years, much of the population was excluded from banking services. Following the post-apartheid transition, the new government placed increasing emphasis on financial inclusion and consumer protection, while maintaining strong policy insistence on financial sector stability.

Since 2002, when the government, business, community, and labor constituencies convened at the Financial Sector Summit hosted by Nedlac (National Economic Development and Labour Council), 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 was the Financial Sector Charter, which required banks to provide effective access (defined in terms of physical proximity and nondiscrimination 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 percent of the low-income population by 2008.⁴ The government committed itself in the Charter to amend regulations that hinder the extension of financial access by private financial institutions.

The government also committed itself at the Financial Sector Summit to prepare new legislation enabling second and third tier deposit-taking financial institutions to provide additional avenues for extending financial services. This approach is in line with the government's preferred policy of restricting any form of deposit-taking to 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

⁴ Due to a deadlock in the Charter council, the structure became dysfunctional, and in November 2009, the Banking Association of South Africa (BASA) gave notice of its withdrawal from the Charter. Following a public airing of dissatisfaction by various parties, public statements were withdrawn (including BASA's notice of withdrawal), and there have been recent reports of a possible revival of the Charter.

to reduced entry requirements.⁵ An anticipated amendment to the Banks Act is expected to create new categories of banks subject to reduced minimal capital requirements, thereby facilitating the entrance of new branchless banking actors.⁶ However, the ability of a mobile operator to operate a mobile payments platform as a savings bank would turn on whether the law permitted dedicated banks to issue electronic money.

In November 2009, the National Payment System Department of SARB issued a Position Paper on Electronic Money⁷ that restated its position (pronounced in earlier papers) that only South African banks are permitted to issue electronic money. The paper defines e-money as “monetary value represented by a claim on the issuer” that “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.*”⁸ The paper indicates that to facilitate the development of e-money products, SARB will “participate in initiatives aimed at providing secure payment instruments for the general public, including the unbanked and rural communities of South Africa and the south African region.”⁹ The paper points out that many of the e-money applications deal with person-to-person payments and distinguishes these payments from payments to third parties that may be made by nonbanks pursuant to the National Payment System (NPS) Act (see Section 3.4).

Access by nonbanks to the national payments and settlement system as well as the fees and charges on payment services are key issues that will affect the development of branchless banking in South Africa. SARB is aware of this and has explicitly stated that participation by nonbanks in the payment system is one of its objectives.¹⁰

2.2 The Banking Sector, the Mzansi Account, and Other Bank Financial Access Initiatives

The banking sector is tightly regulated and supervised. Only banks can accept deposits from the public and access the national payments and settlement system. In fact, access to these systems is controlled by the four big banks (mentioned below), which control the Payments Association of South Africa (PASA), the self-regulatory body for the payment system appointed by SARB. PASA has appointed Bankserv as the payment clearinghouse for the South African banking industry. Bankserv provides interbank electronic transaction switching services to the banking sector and is majority owned by the big four banks.¹¹

⁵ Section 70 of the Banks Act, Act 94 of 1990, requires banks to maintain a minimum capital of ZAR 250 million (approximately US\$35 million). The 2007 Co-operative Banks Act, enacted in response to such commitment, provides for the establishment of community-based cooperative banks that offer either savings only, or savings and loans to members. The minimum capital requirements are to be set by regulation.

⁶ A 2004 draft “Dedicated Banks Bill” proposed the creation of two new categories of banks—savings banks and savings-and-loan banks (jointly referred to as “dedicated banks”). Savings banks would be limited to taking deposits, offering savings accounts with transaction functionality, and providing payment services. Savings-and-loan banks would 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. The bill recommended that savings banks maintain a minimum capital of ZAR 10 million (approximately US\$1.4 million) and savings-and-loan banks a minimum capital of ZAR 50 million (approximately US\$7 million).

⁷ SARB Position Paper, Electronic Money, National Payment System Department, NPS 01/2009, November 2009.

⁸ Id. p. 3 (emphasis in the original).

⁹ Id. p. 4.

¹⁰ See SARB’s 2006 policy paper on the National Payment System Framework and Strategy (Vision 2010).

¹¹ Participation in the payment clearinghouse requires permission from each incumbent, confirming that the applicant has met the technical requirements (Executive Overview, p. 25). A nonclearing bank (as well as a nonbank) can introduce payment instructions into the system only under the auspices of a clearing bank (Executive Overview, p. 28).

The banking sector is highly concentrated with the four big commercial banks—ABSA Bank, First National Bank of South Africa (FNB), Nedbank, and Standard Bank—having over 90 percent of the retail banking market.¹² At the end of January 2007, the country (with a population of 48.7 million people) had 2,397 bank branches, 8,785 ATMs and no fewer than 109,454 POS devices.¹³ 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.¹⁴

In response to concern regarding the level and structure of bank fees and access to retail banking services, South Africa's Competition Commission¹⁵ conducted a public enquiry in 2006. In its June 2008 report, the enquiry panel found that transaction and interbank charges were higher than would exist at competitive levels, a function of the concentrated banking sector that gives large banks the opportunity to abuse market power. The panel made a number of recommendations, including opening up the payment card schemes to nonbanks and permitting nonbank payment service providers to participate in clearing and settlement activities "in appropriate low-value or retail payment streams" if (in both cases) a proper regulatory and supervisory framework were in place.¹⁶

In October 2004, the big four banks together with Postbank collectively introduced the Mzansi account as a key initiative under the Financial Sector Charter. The Mzansi account is a simplified savings account with basic transaction capability and limitations on frequency of use. Intended for low-income clients, the Mzansi account's great benefit is that a client can use any branch of any of the participating banks as well as the entire network of ATMs and debit card-accepting POS devices.¹⁷

By virtue of the Mzansi accounts, banks met the 2008 Financial Sector Charter goals regarding geographic penetration. According to a 2009 report, more than 6 million Mzansi accounts had been opened by December 2008 (although it is estimated that only 3.5 million are "active"¹⁸). Thus, due in large part to the Mzansi accounts, the proportion of the population that is banked increased from 45.5 percent in 2004 to 63.5 percent in 2008 (but then declined to 60% in 2009).¹⁹

Individual banks have also launched their own initiatives. FNB has rolled out mini-ATMs in 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

¹² Executive Overview of the Report to the Competition Commission by the Enquiry Panel, p. 12, June 2008, http://www.compcom.co.za/banking/Documents/sum%20docs/screen_sum.pdf.

¹³ Information obtained from SARB.

¹⁴ Postbank is a savings institution that is operated as a division of the South African Postal Office.

¹⁵ The Competition Commission is an independent statutory body under the Competition Act, No. 89 of 1998, that investigates, controls, and evaluates restrictive business practices, abuse of dominant positions, and potential mergers to achieve equity and efficiency in the economy.

¹⁶ Executive Overview of the Report to the Competition Commission by the Enquiry Panel, p. 41, June 2008, http://www.compcom.co.za/banking/Documents/sum%20docs/screen_sum.pdf.

¹⁷ More than 90% of the service points for Mzansi clients are outside of traditional bricks-and-mortar bank branches.

¹⁸ Bankable Frontier Associates, 2009. "The *Mzansi* Bank Account Initiative in South Africa," report commissioned by FinMark Trust. For the private banks, whether an account is "active" is determined by whether there has been a transaction in the account within the preceding 12 months. According to a 2008 FinScope survey, of the 3.8 million Mzansi accounts opened at the four private banks, only 2.2 million were reported as active as of December 2008. There are no comparable data on the approximately 2.2 million accounts opened by Postbank. However, based on various data, Porteous estimates the number of active Postbank accounts at 1.3 million.

¹⁹ Id., p. 76; FinScope South Africa, 2009 http://www.finscope.co.za/documents/2009/Brochure_SA09.pdf. The decline may have been due in large part to the global recession although some argue that the decline is in part attributable to the banks' overly strict application of AML/CFT rules.

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 (approximately US\$140), balance inquiries, and prepaid purchases. The mini-ATM does not physically dispense cash; it instead prints out a voucher that 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.

2.3 Banks and Mobile Phone Banking

Of the developing countries for which data are available, South Africa has the largest percentage of banked customers accessing banking services through their mobile phone.²⁰ All of the large retail banks already offer mobile phones as an additional access channel for existing bank accounts (including Mzansi accounts) managed on traditional bank systems. However, in the case of WIZZIT, MTN MobileMoney, and Standard Bank’s mobile banking service introduced by its community banking initiative (discussed in further detail below), the bank account application is fully integrated with the mobile phone, enabling the customer to use the mobile phone itself as a payment instrument. 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.

WIZZIT was founded in 2004 and launched in December of that year by two independent entrepreneurs to target the almost 50 percent of unbanked South African adults. It operates in partnership with the Bank of Athens.²¹ As of January 2010, WIZZIT had signed up approximately 300,000 customers. Customers are primarily recruited by Wizzkids—formerly unemployed people who are trained by WIZZIT to conduct know-your-customer (KYC) procedures, to issue clients their new Maestro-branded debit card, and to familiarize clients with the use of the application.²² Customers can use their mobile phone (WIZZIT is “mobile phone agnostic,” meaning 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 3,500 sites for deposits. Since WIZZIT clients are issued a debit card, cash withdrawals can be done at all South African ATMs. Employers can pay their staff by making payment directly into employees’ WIZZIT accounts electronically. Notwithstanding these benefits, WIZZIT has not been able to scale up due largely to the strict compliance standards imposed by the Bank of Athens—specifically with respect to AML/CFT procedures.

²⁰ Interview with David Porteous, January 14, 2010.

²¹ WIZZIT refers to itself as a “division of The South African Bank of Athens Limited” although WIZZIT is a separate legal entity. We use the term “partnership” loosely and without having reviewed the written agreement entered into by WIZZIT and Bank of Athens.

²² As of January 2010, WIZZIT had trained approximately 4,000 Wizzkids. The number of active Wizzkids is a moving target. Interview with Brian Richardson, 14 January 2010.



In 2005, MTN, one of South Africa's two largest mobile operators, and Standard Bank launched their joint venture, MTN Banking, with its mobile banking product, MTN MobileMoney. MTN Banking has its own system (Fundamo), which is housed at Standard Bank, and its own back office. MTN is the bearer channel pursuant to an outsourcing agreement with Standard Bank. The banking application is fully integrated into the mobile, and every MTN SIM card distributed already has an embedded banking application. (Only MTN subscribers can open MobileMoney accounts.) Account holders can use their mobile phone for similar services as those provided by WIZZIT. Account holders are also issued a MobileMoney cash card with which they can make cash withdrawals at Standard Bank branches and ATMs and deposits at Standard Bank branches and Standard Autobank machines as well as any EasyPay pay point located at a number of retailers. Almost all account holders take the option of a Mastercard with which they can make cash withdrawals at all ATMs in South Africa.

To satisfy AML/CFT requirements, MTN Banking uses a special application on the phone to enter the required information, including the new clients' identity number (which is then verified against a third-party database),²³ and then photograph the client and his or her identity book to be sent back to the office. Daily transaction limits of ZAR 5,000 (approximately US\$500) are placed on the account to comply with Exemption 17, while a daily transaction limit of ZAR 1,000 (approximately US\$100) applies to accounts that are opened without direct client interaction to comply with SARB's Guidance Note 6 (which replaced Circular 6). (For a discussion of Exemption 17 and Guidance Note 6, see Section 3.2.)

MTN envisioned MobileMoney as a means to reduce customer churn; however, this was not achieved, due perhaps to the failure to persuade MTN South Africa channels that they should distribute the product and possibly also to early marketing efforts that portrayed MobileMoney as an "aspirational" product. In early 2009, MTN Banking ceased signing up new customers (although it continues to service its active customer base), and Standard Bank's community banking initiative began offering its own mobile banking service, using field agents to assist in account opening and using a version of the MobileMoney platform developed for it by MTN Banking. The underlying features of the joint venture arrangement do, however, continue.

2.4 Banks and Retailers

The two largest South African retailers have also entered the banking space, further extending the financial services that 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. More recently, Shoprite, the largest food retailer in Africa, has joined forces with Capitec, a bank specializing in microfinance, to offer a money transfer service. Due to exchange controls, this service can currently be offered only within South Africa and in rand (see Section 3.5).

²³ As a substitute for using the database of the Department of Home Affairs (DHA), which was unable to respond on a timely basis, MTN Banking used Experian to facilitate the verification. Experian would have the information for those people who had applied for credit and communicated with DHA.

One of the largest retail distribution networks currently operating in South Africa is the prepaid airtime distribution network. The potential of using this network to distribute financial services is already being tapped. Discovery Life, a large South African long-term insurer, launched its prepaid 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 shops²⁴ 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 prepaid airtime. Airtime vendors provide buyers of the insurance policy with a starter pack, which instructs the prospective policyholder on how to register with Discovery. Registration is conducted via the mobile phone, with the policyholder inserting his/her identity number, the personal identification number contained in the starter pack, the nominated beneficiaries, etc. Once registered, policyholders buy a voucher from the vendor. When the voucher number is submitted via the handset, the policy is activated. This process is repeated monthly to continue coverage.

2.5 Nonbank Payment Services

Not all the branchless banking models in South Africa involve banks. A large proportion of payment services are provided by nonbanks, as permitted under the National Payment Systems Act. (See Section 3.5.) 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 an agent to handle bill payments for municipalities, utility companies, financial institutions (including banks and insurance companies), medical practitioners, and many others. 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; retailers reconcile with EasyPay; and EasyPay reconciles with the utility or other intended recipient of the payment. EasyPay also facilitates Internet-based payments, but this channel is currently accessible only to credit card holders.

For years, various provincial subsidiaries of Net1 have used a smartcard system to make social welfare payments on behalf of the South African Government. Net1's nonbank character and the size of its business (3.8 million customers²⁵ using its smartcard) make it significant from a branchless banking perspective. The smartcard operates as a closed-loop system that does not interact with other bank-based payment systems but rather requires the amounts loaded on the smartcards to be redeemed at Net1 mobile cash payment points or used to transact with other smartcards in the Net1 system. 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 from the government. However, the government has now indicated that, for security and welfare reasons, it wishes to move away from cash-based welfare payments in favor of account-based payments.

²⁴ Spaza shops are informal businesses in South Africa usually run from home. They typically serve as convenience shops and sell everyday, small household items.

²⁵ <http://www.net1.com/main.aspx?ID=160>

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. As of January 2009, there were 742,000 Sekulula account holders.

2.6 Prefunded Payment Schemes

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

2.7 Postbank

Postbank is positioning itself to play an increasing role in banking the unbanked in South Africa. The core mandate of Postbank is to provide savings products;²⁶ it is not permitted to provide credit. Over one-third of the Mzansi accounts were opened by Postbank, and it acts as a cash-in cash-out point for WIZZIT clients. With its large and growing presence and a direct link to the payments network, Postbank is well positioned to support branchless banking.

3. Current Legal Framework for Branchless Banking

3.1 Use of Agents

The South African regulatory framework gives wide discretion to banks to use nonbank third parties to offer banking services beyond their traditional branch network, either as agents or through outsourcing arrangements.²⁷ The Banks Act allows a bank to contract agents “to receive on [the bank’s] 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.”²⁸ 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, losses (including any loss suffered from a sale of assets), and bad debts.²⁹

A 2004 SARB circular was issued in response to questions by banks regarding proposed outsourcing arrangements. It provides guidance for outsourcing arrangements that could (i) have a bearing on the risk profile of a bank, (ii) affect the systems and control of a bank, (iii) be classified as being of strategic importance, or (iv) have implications for SARB and its supervisory duties.³⁰ The circular does not specify which bank functions

²⁶ Postbank is currently governed by the Postal Act and has a specific exemption in the Banks Act. The South African Postbank Bill published in the Government Gazette in November 2009 would incorporate the Postbank division of the South African Post Office as a separate legal entity to registered as a bank under the Banking Act (thus bringing it under the supervision of SARB).

²⁷ A bank agent is generally an entity who has been authorized by the bank to enter into agreements that 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.

²⁸ Definition of “agency”, Banks Act, Section 1(1).

²⁹ Banks Act, Section 78(1) (f).

³⁰ Banks Act Circular 14/2004 on Outsourcing of Functions within Banks.

may be outsourced, but it does prohibit the outsourcing of a bank's compliance function and permits the outsourcing of the internal audit function only on a case-by-case basis. Furthermore, any outsourcing arrangement covered by the circular will be subject to SARB scrutiny. A bank is therefore left with wide discretion, provided that it:

- Enters into a detailed outsourcing agreement that is legally scrutinized by the bank
- Ensures outsourced services are performed adequately, in accordance with internal policies and standards and in accordance with the outsourcing agreement³¹
- Ensures 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
- Provides SARB, when requested, with any required information on the outsourced functions or activities.

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

The wide discretion accorded to banks in their 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 that 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.

3.2 AML/CFT

The Financial Intelligence Center Act (FICA) and its regulations govern anti-money laundering. FICA provides that an accountable institution "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."³² Accountable institutions must keep a record of the identity of the client and any documents obtained in verifying that identity.

FICA regulations initially posed major obstacles to customer acquisition in the low-income market by requiring individuals to produce (i) a national identity document to verify personal details and (ii) documentary proof of residential address when opening a bank account.³³ It was soon realized that about one-third of adult South Africans, most of

³¹ 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 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."

³² Financial Intelligence Center Act (No. 38 of 2001), Section 21(1). An accountable institution is defined as, 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; or (v) the Postbank. If an MNO offers financial services, then it will have to register with the Financial Services Board and will become "accountable" with respect to such services.

³³ Common law required (and still requires) banks to identify and verify prospective clients who want to open bank accounts. See De Koker, L. (2009), "The money laundering risk posed by low risk financial products in South Africa:

whom live in informal housing, could not provide such documentary proof of residential address. This caused banks to request an amendment to the regulations to facilitate the roll-out of the Mzansi account to these low-income clients. In 2004, the Minister of Finance issued Exemption 17³⁴ to the AML regulations to allow banks to open accounts, subject to balance and transaction limits,³⁵ upon the presentation of only a South African national identity document.³⁶ Each bank is required to put in place measures to prevent a person from opening more than one such account with the same institution.

Two years later, in 2006, SARB issued Bank Circular 6³⁷ (replaced by SARB in 2008 with Guidance Note 6) allowing banks to open mobile phone-operated bank accounts (within certain transaction and balance limits) that satisfy Exemption 17 requirements without having to undertake face-to-face know your customer (KYC) procedures—i.e., without any documentary evidence. Specifically, the client must provide his or her identity number, which the bank must then cross-reference with third-party databases that include information on the names and identity numbers sourced from the Department of Home Affairs (the issuer of identity numbers). The account opening procedures mandated by Guidance Note 6 apply only to bank accounts that comply with Exemption 17 and are available only to South African citizens and residents with valid identity numbers. The transactions on such an account are limited to ZAR 1,000 (approximately US\$100) per day, which some industry participants have indicated are too low to render the dispensation useful.³⁸ 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. As with Exemption 17, the Guidance Note requires banks to put in place measures to prevent a person from opening more than one such account.³⁹ Banks must also perform enhanced scrutiny of the activity on these accounts to identify suspicious and unusual transactions.

The report published by the Financial Action Task Force (FATF) of its 2008 mutual evaluation of South Africa⁴⁰ reviewed Exemption 17 and Guidance Note 6 and their impact on AML/CFT and had no negative comments. In addition, a study into the nature and level of criminal abuse of Exemption 17 products indicated that the abuse was proportionally lower in incidence and much lower in value than the abuse of standard products.⁴¹

Findings and guidelines," *Journal of Money Laundering Control*, Vol. 12, No. 4 (forthcoming). Compliance with FICA identification and verification requirements may not satisfy the common law requirements. *Id.*

³⁴ The Ministry had issued an exemption in 2002 but its requirements were too rigid to assist the majority of low-income persons (De Koker, L., 2009).

³⁵ The balance may not exceed ZAR 25,000 (approximately US\$2,500); the daily transaction limit is ZAR 5,000 (approximately US\$500), and the monthly limit is ZAR 25,000 (approximately US\$2,500).

³⁶ Exemption 17 also applies to an individual providing legal assistance to a customer who lacks legal capacity.

³⁷ Banks Act Circular 6/2006, 13 July 2006. In 2008, SARB withdrew the circular and reissued the text as Guidance Note 6/2008, South African Reserve Bank, 2008.

³⁸ To date, Guidance Note 6 has been used only in connection with the MTN MobileMoney product. As MTN Banking is no longer opening new MTN MobileMoney accounts, it appears that Guidance Note 6 is currently not being utilized.

³⁹ Although the wording of the Guidance Note may be ambiguous regarding whether a bank is expected to prevent a person from opening more than one account in the bank or one account across all South African banks, the intent was to impose the same requirement as Exemption 17. (Interview with Jenny Hoffman, 19 January 2010.) Even if the Guidance Note intends to prohibit the latter (Exemption 17 prohibits more than one account with any one institution), it is not clear how banks could implement this given that there is no national register of bank accounts.

⁴⁰ Financial Action Task Force, *Mutual Evaluation Report: Anti-Money Laundering and Combating the Financing of Terrorism—South Africa*, 2009, <http://www.fatf-gafi.org/dataoecd/60/15/42432085.pdf>. The mutual evaluation is the process that FATF uses to evaluate the level of compliance by a country with FATF's AML/CFT recommendations.

⁴¹ De Koker, 2009.

However, the benefits of this proportionate (i.e., risk-appropriate) approach to AML/CFT have been eroded by recent developments. First, some banks interpreted the recording requirement regarding identification documents to require photocopying.⁴² The Banking Ombudsman sided with the banks and then, together with the Financial Intelligence Centre (FIC), issued a joint statement in July 2009 affirming that photocopying is “the most prudent and practical manner to comply with” the recording obligation.⁴³ As a result of this and a 2008 amendment to FICA giving FIC the right to levy personal penalties on bank compliance officers for violations of AML/CFT rules, some bank officers are erring on the side of safety and following the conservative approach.

More significantly, a recent amendment to the Regulation of Interception of Communications and Provision of Communication-related Information Act (RICA)⁴⁴ requires 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 (including existing clients). Clients will therefore need to visit agents of operators in person (which will be inconvenient or expensive for some due to travel) and produce the required documents, which some may not have, as noted.⁴⁵ Thus, many will be excluded from mobile phone communications and mobile banking not because they are criminals but because they lack the necessary documentation. MTN Banking has simply ceased opening mobile phone accounts for customers without a SIM; for such customers, MTN Banking issues a card account only without mobile access.

3.3 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.⁴⁶ Accordingly, retailers, mobile operators, and entrepreneurs wishing to offer branchless banking services that entail taking deposits from the public 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 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.

As noted above, the National Payment System Department of SARB recently issued a new Position Paper on Electronic Money that restated its position (pronounced in earlier papers) that only South African banks are permitted to issue electronic money.⁴⁷

⁴² While this requirement makes it difficult for agents in the field, the requirement can be satisfied if the identification documents are photographed using a mobile phone.

⁴³ <http://www.fic.gov.za>.

⁴⁴ The amendment was effective 1 August 2009. RICA is intended to assist law enforcement agencies trace criminals by permitting the interception of information passed over electronic communication channels, including mobile phones.

⁴⁵ The customer’s personal information (full name, identity number, and address) must be verified by means of a current national identity document, an identity card, a temporary identity certificate, or a valid passport (or, for anyone who is either not a South African citizen or not a permanent resident, a passport or travel document). The value of this verification is questionable given that the reliability of the South African national identity cards and passports today is questionable, as acknowledged by the South African Government.

⁴⁶ Banks Act, Section 1.

⁴⁷ SARB Position Paper, Electronic Money, National Payment System Department, NPS 01/2009, November 2009.

3.4 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 system only through joint ventures with banks that are members of the payment system or through co-branding programs with such banks. Under the 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, SARB has delegated control to PASA pursuant to this regulation.

Section 7 of the NPS Act states that “a person may as a regular feature of that person’s business accept money or payment instructions from any other person for purposes of making a payment on behalf of that other person to a third person to whom a payment is due if (a) the first-mentioned person is the [SARB], a bank, a mutual bank, a co-operative bank, a designated clearing system participant, branch of a foreign institution, or designated settlement system operator, (b) [the postal company or the Postbank] or (c) the money is accepted or payment in accordance with directives issued by the [SARB].” SARB distinguishes such payments, which involve an obligation that must be settled, from person-to-person payments or transfers. The former type of activity would be classified as “deposit-taking” under the Banks Act.

In 2007, SARB issued two directives pursuant to the NPS Act that permit nonbanks to make payments to third parties (such as bill payments and the distribution of social welfare grants).⁴⁹ The directives require, *inter alia*, that (a) the nonbank system operators (i) meet the criteria recommended by the relevant payment system management body and approved by SARB and (ii) have a written agreement with each person to whom payment services are rendered and (b) the service provider be appointed as agent by the entity on whose behalf it is receiving payments (e.g., a utility) or making payments (e.g., an employer).

3.5 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.⁵⁰ Only persons authorized by the National Treasury can deal in foreign exchange. With the exception of nonbank authorized dealers with limited authority (who may buy and sell foreign exchange for travel-related purposes only), only banks have been authorized to deal in foreign exchange. Banks are required to maintain a complex and costly reporting system in which every transaction in foreign exchange, irrespective of its size, must be categorized according to the manual of transactions prepared by the Exchange Control Department (at SARB) and electronically reported to SARB.

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, 6 September 2007, in GG30261; SARB Directive for Conduct within the National Payment System in respect of payments to third persons, Directive 1 of 2007, 6 September 2007, in GG30261.

⁵⁰ Act 9 of 1933.

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 be performed only at bank branches (there is no possibility of outsourcing this activity) 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.