The profile of retail payment services and models in South Africa

FINMARK TRUST

Making financial markets work for the poor

Focus note 2: Towards a common understanding of terms

About the focus note series

This is the second in a series of six focus notes based on the full FinMark Trust report titled **The Profile of Retail Payment Services and Models in South Africa: Assessing the potential to increase financial inclusion and market participation,** by Insightworx (Colin Donian; Maire Eltringham). The full report can be downloaded from: **www.finmark.org.za**.

The study aimed to sketch the landscape of retail payment services in South Africa that have a positive impact on financial inclusion and market participation. It also aimed to start to develop a typology of models based on shared characteristics witnessed across various services. The prime inputs to the study were a series of interviews with market participants, desktop research, mystery shopping excursions, as well as feedback received during a stakeholder workshop in March 2011[1]. The models are not *"final"* or cast in stone; rather, they are intended to form the basis for discussion and to identify issues and trends in this market segment.

The focus note series draws out the key findings on a thematic basis. The full list of focus notes are:

- Focus note 1: The SA retail payment services landscape: key findings and issues
- Focus note 2: Towards a common understanding of terms
- Focus note 3: The regulatory framework for retail payment services in South Africa
- Focus note 4: Retail payment system market participation framework
- Focus note 5: The landscape of retail payment services in South Africa
- Focus note 6: Towards retail payment services models in South Africa

In the arena of financial services there are many fundamental concepts, phrases and terms (including "deposits", "payments", "retail payments" and "the payment system") that are often given different meanings in different contexts by different people. The manner in which these terms are defined and interpreted is an essential element to a common understanding of the subject matter. However, there are no inherent universal definitions. This focus note assesses various definitions used and then develops a working definition for the purpose of this focus note series and report. In doing so, it aims to contribute to the broader debate towards a common understanding of terms.

1. Payments' verses 'deposits'

A payment is not necessarily the same financial transaction as a deposit. In fact, by law, they are distinct.

1 Please note that the information contained in the notes was current at the time of research, namely February to March 2011, and therefore does not necessarily account for all recent developments in this rapidly changing market

A **'deposit'** is defined as follows in the South African Banks Act: "when used as a noun, (it) means an amount of money paid by one person to another person subject to an agreement in terms of which -(a) an equal amount or any part thereof will be conditionally or unconditionally repaid, either by the person to whom the money has been so paid or by any other person, with or without a premium, on demand or at specified or unspecified dates or in circumstances agreed to by or on behalf of the person making the payment and the person receiving it; *et seq.*"[2]

Only banks may be in the business of deposit-taking, *'the business of a bank'* means – "(a) the acceptance of deposits from the general public ...as a regular feature of the business in question; *et seq.*"[3]

A **payment**, in contrast, is a more specific concept denoting a transaction between two people or institutions to *pay for goods* or services. Given the technical nature of the definition of a deposit, a payment sometimes, but not always, will entail a deposit. The implication is that, in instances where a payment is not regarded as a deposit, it may also be provided by a non-bank. Different jurisdictions adopt different definitions of what exactly a "payment" entails, ranging from narrow to quote broad:

- The Bank for International Settlements (BIS) defines a **payment**[4] as "the payer's transfer of a monetary claim on a party acceptable to the payee. Typically, claims take the form of banknotes or deposit balances held at a financial institution or at a central bank."
- In a South African context, in instances where there is no latent claim, the 'payment' is a deposit and only a bank can intermediate it. A 'payment' that is associated with a claim on a third party is not necessarily a deposit and can also be provided by third party payment providers. Particular rules apply as to how such payments are intermediated[6].
- In the USA, the Federal Financial Institutions Examination Council's (FFIEC) examination handbook (2010)[7] defines a **payment** very simply as "a transfer of value".

> We suggest a broad working definition of the term "payment", namely: **a transfer of value between two parties where an obligation may exist between the parties; and where value is defined as value in exchange.**
>
> This working definition speaks to the intuitive meaning of the word "payment" and does not limit it to only those instances where the payment represents a claim on a third party. Therefore, according to our working definition, a payment can be either a deposit or a "non-deposit" payment to third party. Crossing this demarcation divide is not usual practice in regulation. This route was chosen for the working definition because it speaks to how a payment would be seen from the individual or consumer perspective.

2 The Banks Act, 1990. Section 1.
3 Ibid.
4 Bank for International Settlements. *A glossary of terms used in payments and settlement systems*. Revised Edition. March 2003.
5 The SARB applies this definition. Discussion with member of the SARB, National Payment System Department. 10 April 2011.
6 See Section 7 of the NPS Act and Directive No. 1 of 2007.
7 Federal Financial Institutions Examination Council. Retail Payment Systems. IT Examination Handbook. February 2010.

2. 'Retail' payments

Not all payments as defined above will be retail payments. The FFIEC describes **retail payments** as those that, "...usually involve transactions between two consumers, between consumers and businesses, or between two businesses. Wholesale payments are typically made between businesses. Although there is no definitive division between retail and wholesale payments, retail payment systems generally have higher transaction volumes and lower average dollar *(rand)* values than wholesale payment systems."[8]

The BIS defines retail payments as "all payments which are not included in the definition of large-value payments. Retail payments are mainly consumer payments of relatively low value and urgency", whereas 'large-value' (wholesale) payments are defined as "payments, generally of very large amounts, which are mainly exchanged between banks or between participants in the financial markets and usually require urgent and timely settlement."

It can be concluded that the essential factor that separates retail from wholesale payments is size, and thus level of systemic risk.

Building on the previous working definition for 'payments', **the working definition for a 'retail payment'** is: **a transfer of relatively small value between two parties where an obligation may exist between the parties; and where value is defined as value in exchange.**

This working definition once again includes instances where there is a 'no obligation transfer of value' between parties (that is: combines elements of payments and deposits in a single definition).

3. Retail Payment 'Services'

The South African Reserve Bank defines 'payment services' as "...being the services whereby a bank enables its clients to:

(a) Make third-party payments by providing its clients with the means to issue payments to the clients of another bank or the other bank itself, through direct access to their (the bank's clients') bank accounts.

(b) Receive payments directly into their (the bank's clients') accounts from clients of another bank or the other bank itself.

(c) Withdraw cash at another bank.[9]

The essential elements contained in the above expression are set out below.

i. The **institutional dimension**: A service rendered by a **bank** to a person or entity that is a client of the bank. Non-banks cannot be involved in payment services, other than through a particular kind of relationship with a bank, i.e., as third party payment providers that have been sponsored by a bank.

8 Ibid. P. 4.
9 SARB. National Payment System Department. Bank Models in the National Payment System. Position Paper number 01/2007. Emphasis added.

ii. **Making payments:** The bank provides enabling capability to its clients so that they can make payments to other people or entities who are also that bank's clients or clients of another bank, or simply to another bank.

iii. **Bank account access:** The enablement is done through direct access to the various parties' bank accounts. It is assumed that clear rules and protocols govern the accessing of bank accounts.

iv. **Receiving payment:** The converse of initiating a payment is to receive a payment from another client of the bank, or the client of another bank, or another bank itself.

v. **Cash may be withdrawn:** From a client's account, via another bank.

In our view, while a 'payment' could include two individuals exchanging cash, a 'payment service' excludes a direct cash to cash exchange as there is no intermediation in the exchange. In any instance where cash enters the formal banking system and becomes either (i) a deposit – as defined by the Banks Act, or (ii) passes through the banking system directly or indirectly, it is a 'payment service'.

Retail payment services can be defined as (i) small value payments, (ii) made through formal intermediation, (iii) whose backbone is the banking (payment) system, and (iv) include 'no obligation' payments (money transfers aka deposits).

To enable a practical appreciation of what the above definitions imply, a range of illustrative retail payment services are set out in Table 1 below. These examples test the application of the working definition adopted for the purpose of this report.

Table 1: Illustration of the working definition of Retail Payment Services

ITEM	TRANSACTION	IS THIS A RETAIL PAYMENT SERVICE?
1	Person 'a' physically hands over a R100 note to person 'b', it is a gift	N
2	Person 'w' sends R100 in value to person 'h' via airtime on a mobile phone; it is part repayment for a loan	N
3	Person 'e' buys pre-paid electricity from a local re-seller operating a roadside kiosk	Y
4	Person 'e' on-sells some of their prepaid electricity to a neighbour	N
5	Person 'd' obtains their weekly wage in the form of airtime – mobile phone-to-mobile phone	N
6	Person 'd' re-sells the airtime he received as wages to fellow taxi commuters on the way home, he doubles his earnings for the week	N
7	Person 'd' is paid in cash for the re-sale of his airtime	N
8	Person 'x' pays their clothing account electronically via a third party payment provider (TPPP) at a retail store	Y
9	A township shop owner ('homeshop' or 'spazashop') pays their assistant's (person 'j') weekly wage via a mobile e-money service – owners' mobile phone to the assistant's mobile phone. The owner has a bank account linked to the e-money function. The assistant has no bank account	Y
10	Person 'j' sells some of their airtime to a friend for cash	N
11	Business 'k' (an airtime reseller) pays their wholesale airtime provider via their own point of sale device	Y
12	Person 'z' uses their smart card to buy groceries and draw cash from a retailer	Y
13	Person 'f' does an electronic funds transfer for R100 from their current account to a family member's savings account	Y
14	Person 'v' pays for a movie ticket at an electronic device via credit card	Y
15	Business 'm' pays its staff via a TPPP who specialises in payroll processing	Y
16	Person 's' uses the internet channel to transfer R1,2 million from their money market account to the car dealer where they have bought a new SUV	Y
17	A hospital consortium makes an electronic funds transfer to a supplier for new medical equipment to the value of R250 million	N

4. The Payment 'System'

The payment system is the backbone to retail payment services. According to the South African National Payment System Act, a payment system is "...a system that enables payments to be effected or facilitates the circulation of money and includes any instruments and procedures that relate to the system"[10].

The FFIEC states that it is the "mechanisms, rules, institutions, people, markets, and agreements that make the exchange of payments possible"[11].

The BIS states that "...a payment system consists of a set of instruments, banking procedures and, typically, interbank funds transfer systems that ensure the circulation of money." This is the definition used by the SARB[12].

The Payment Association of South Africa (PASA) unpacks the term into digestible bits as follows: "In order for a payment stream to function, it requires customers to access it via instruments and channels, such as bank cards, branches, Automated Teller Machines (ATMs) and Point of Sale terminals (POSs). A payment stream combined with these access mechanisms and channels, as well as its technical specifications, legal and business agreements and the related risk mitigation procedures that enable the end-to-end transfer of funds as well as the origination and finalisation of non-value transactions (e.g. balance enquiries), jointly form a payment system"[13].

In summary, a payment system can be defined as the collection of regulations, rules, institutions, processes, payment instruments, channels and so forth that make it possible for payments to take place in a secure, predictable and auditable manner.

10 NPS Act (No. 22 of 2004), op cit.
11 Federal Financial Institutions Examination Council, *op cit.*
12 SARB. *Oversight of the South African National Payment System, op cit,* P 1.
13 PASA. *Overview of the payments environment.* May 2008.

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