Open Banking

South Africa's journey to a more **inclusive banking** ecosystem

OZOW

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1 EXECUTIVE SUMMARY

EXECUTIVE SUMMARY

Strong financial controls, a robust banking system and evolving payment technology are vital to the growth of the South African economy. Without the correct frameworks and systems, accessibility to it becomes a significant challenge – for the public and private sector alike.

This prohibits progress in a world where economies are transforming faster than at any other time in human history. Business digitisation has also shifted transactional behaviour across the value chain. This has led to increased pressure for technological advancements to meet the growing demands of private and public sectors.

This disruption has given fintechs a competitive advantage, largely attributable to their agility and speed at which they innovate. This has also enabled fintechs to provide greater access to financial products and services for millions of bank account holders looking for a more seamless payment experience.

This changing landscape has pushed both the banking sector and government to modernise payment systems, update regulations, and encourage greater competition and collaboration – especially between traditional banking institutions and Third-Party Payment Providers (TPPPs).

2 THE JOURNEY OF DIGITAL PAYMENTS

THE JOURNEY OF DIGITAL PAYMENTS

The shift from traditional to digital payments

Historically, cash, cheques and cards have dominated as the longstanding primary transactional methods. Recently, alternative payments have begun to dominate market share from traditional payment options, with cheques having already become obsolete in South Africa.

The current banking and payment ecosystem has evolved to look significantly different to what it did even a decade ago. Leading this change are alternative or digital payment solutions such as digital wallets, bank-to-bank payments, Buy Now Pay Later (BNPL), cryptocurrencies, stablecoins and central bank digital currencies (CBDCs). While many of these may be in their infancy in South Africa, if more developed markets are anything to go by, it is predicted that these new payment solutions will entrench their position in the market.

According to PwC, consumer banking is the sector most likely to be disrupted by fintech companies, largely driven by rapidly changing consumer needs. Over just the last three years, the proportion of European consumers who plan to **use exclusively digital banking has increased from 49% to 62%.**

FACT

Open banking enables customers to pay straight from their bank account at checkout, instead of using a card. It involves fewer intermediaries, which minimises cost and friction. Payments settle instantly and authorisation rates are high.

Open Banking helps to facilitate financial inclusion, which assists in better serving those on the margins of society by offering a bridge to the formal economy.

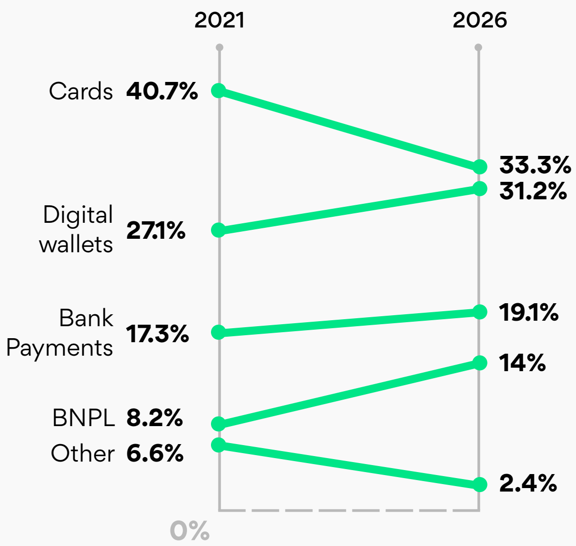
eCommerce **Card Payments** in Europe

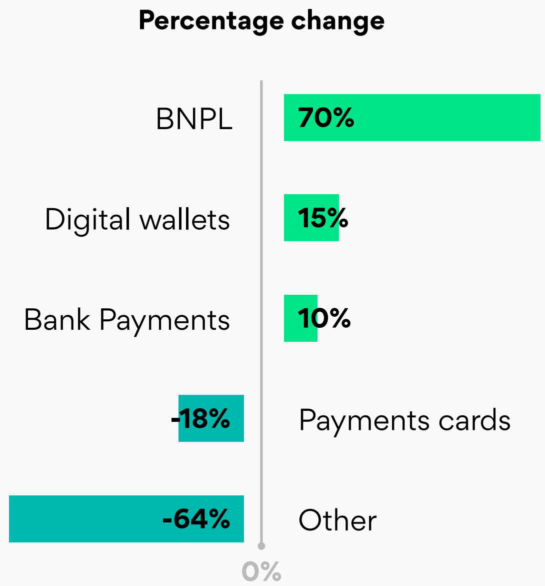
2021 - 41% › 2026 - 33%

In Europe, cards in 2021 are estimated to represent around 41% of eCommerce payments. By 2026 this share is expected to fall to 33%[1].

Globally, the move beyond cards has primarily been a result of open banking initiatives aimed at revolutionising the banking and payments sectors.

European eCommerce payments landscape 2021-2026





1 TrueLayer Beyond Cards Report

Open Banking in Europe

Europe accounts for about one third of global non-cash payment transactions, with more economically advanced states leading this change. While the adoption of debit and credit cards is growing at a faster pace in developing countries in Europe, this is changing rapidly due to the innovation from fintech companies and the open banking regulations that have been promulgated to support this.

The exponential rise in the number of highly valued fintech companies in Europe illustrates the vital role that the continent is playing in disrupting key fiscal sectors like payments, banking, insurance, loans, trading, and eCommerce.

The region's success in driving greater financial inclusion through open banking has been reliant on several key pieces of legislation, which has levelled the playing field for market players.

In 2008,

the European Payment Council (EPC) launched the Single Euro Payments Area (SEPA) Credit Transfer (SCT), requiring that **payments** (if made before the daily cut-off time) **be credited within one working day.**

In 2015,

policymakers in the UK and Europe brought in open banking through several key pieces of legislation. This was further supported by the launch of SCT Inst by the EPC in November 2017, which addressed the demand for instant payments and ameliorated the risk that national solutions would reintroduce fragmentation in the retail payments market. This allows a SEPA credit transfer that requires the **clearing and settlement to take place within 10 seconds**, at any time.

In 2019,

the revised Payment Services Directive (commonly known as PSD2) administered by the European Commission came into effect. The primary goal of the PSD2 directive was to create a more integrated European payments industry. This is underpinned by a mission to **better protect consumers when they pay online**, promote the development and use of innovative online and mobile payments through open banking and fintechs, **and make cross-border European payment services more secure.**

> A lack of APIs in the finance sector has led to reduced innovation and increased costs.

Through this regulatory change, European banks were required to share their data with accredited fintechs, largely through open Application Programming Interfaces (APIs). It also meant that fintechs were better regulated to ensure that consumers and their private information were protected.

Regulators understood that **APIs play a crucial role. They are the best way to open up content-driven access to user data and are ubiquitous in the digital world.** Ecosystem-wide collaboration has emerged from industry-led efforts (with financial incentives) or reciprocity between participants, but widespread global adoption of open data APIs is hindered by several factors. Many of the barriers that regulators identified include a restriction of access to data, control over customer data by private entities, security concerns and commercial alignment between banks and TPPPs.

It was realised that these barriers and lack of APIs in the finance sector have led to reduced innovation and increased costs in many markets.

Along with the various pieces of legislation before it, **PSD2 has had wide-ranging benefits** for the payments sector in the region. In action, PSD2 **allowed TPPPs to initiate payments from a bank account, with permission from the account holder.** While transformative, this has been the catalyst of growth for many fintechs who responded to changing shopping and payment behaviour during the Covid-19 pandemic.

Fintechs are leading innovation

In parts of the world where a large share of the population is excluded from the formal financial sector, including South Africa, fintech services such as mobile money accounts have proliferated. The growth has been **a result of lower infrastructure and transaction costs, along with mobile-first populations** who haven't been reliant on legacy banking systems.

Fintechs have grown their market share against their banking counterparts largely as a result of their agility, which has allowed them to innovate faster than traditional banking players. This resulted in a greater prominence of payment solutions that have disrupted traditional systems, reduced costs, enhanced the customer experience and increased competitiveness.

This innovation can be seen in a wide array of payment solutions, both within and outside of traditional banking and card networks. From international fintechs like Trustly, Klarna and Ayden, through to local market leaders like Ozow, they have researched and determined what consumers and businesses need, and responded by developing a full suite of payment solutions for Point-of-Sale (PoS) and online payments.

As leaders in the respective regions, each of these fintechs provides a variety of alternative payment solutions and payment gateways to handle authentication and security, and process payments through several means – including cards, e-wallets and instant/direct bank-to-bank payments.

Increasingly, Peer-to-Peer (P2P) transactions are becoming more commonplace. But, payment options that bypass traditional card payment schemes are still relatively limited and are generally more widespread in smaller retailers.

Fintechs are also developing tools that help to reduce costs, increase convenience, and detect and prevent fraudulent transactions. As these systems are heavily reliant on information, they have been able to **accurately analyse customer payment data using artificial intelligence,**

> As more fintechs enter the market, the opportunities for collaboration between banks and fintechs have increased.

improve authentication processes through biometrics, and improved security protocols through enhanced tokenisation.

The ease of scalability of some of these solutions also generates incentives to integrate domestic and cross-border payment services. As an example, Fraugsters in Germany provides payment companies and merchants with an AI platform to detect and prevent fraud. While in the UK, Rapyd provides a platform for eCommerce companies and financial institutions to embed local payment methods into their applications, so that they can easily access foreign markets.

These innovations have helped to revolutionise the financial services sector. As more fintechs enter the market, the opportunities for collaboration between banks and fintechs have increased. In Europe, many banks have embraced this change and several traditional banks have adopted fintech instruments, either in-house or by acquisition.

It's also helped them improve data security and authentication. Instead of card numbers, **banks use one-time dynamic security codes, and fingerprint or face recognition technology** – such as Apple Pay. Some of these banks have followed in the footsteps of the fintech companies by developing their own solutions to strengthen their authentication systems. For example, NatWest and RBS have issued biometric fingerprint credit cards, while Barclays offers finger vein reader technology to its corporate customers.

To gain greater market share, companies like iDeal and BLIK in Europe have relied heavily on Automated Clearing Houses (ACHs) to broaden their merchant bases.

How iDeal got it right in the Netherlands

Regulation, a coordinated approach by industry players, a centralised infrastructure and extensive public campaigns over the last decade led to a rapid transition away from cash and towards electronic payment methods in the Netherlands. While this allowed cashless transactions to dominate, it also provided an opportunity for fintech companies to partner with card providers on data security and anti-fraud initiatives.

It also led companies like the Netherlands-based payment provider iDeal to entrench their position as one of the leading players in the market. More than that, because of their integration into the banks, they have become hugely popular among consumers as a trusted payment method for transacting online, which is backed by a real-time payment guarantee.

In the same way that someone would make a payment using Ozow, an iDeal payment is a direct bank-to-bank transaction. However, it has had **two major advantages** that have led to its growth over the last few years: a general **aversion to credit cards from the Dutch,** and (more importantly) **regulation that has allowed it to integrate with the banks** as a trusted payment solution.

BLIK's growth in Poland

iDeal hasn't been the only fintech that has succeeded in the region. Launched in 2015 in Poland, BLIK is an online banking solution that allows consumers and businesses to send or receive money.

BLIK is a one-time 6-digit code generated inside mobile banking apps that is used to initiate payments. It expires after two minutes, after which a new code is generated. The solution is user-friendly, based on the familiar UX of the user's banking app, which has made its adoption that much easier for consumers.

Instant payment clearing was available in Poland prior to the development of pan-European schemes. Through the domestic Automated Clearing House (ACH), BLIK was able to offer instant payments and mobile transfers. Integrated into nearly every bank in the country, it now has **more than 20 million customers, processes more than 150 million transactions** every quarter, and is supported by consumers and the banks themselves.

By late 2019, BLIK's parent company agreed to provide a seventh of its shares to MasterCard. In exchange, MasterCard enabled contactless payments to BLIK users globally through integration with the MasterCard Digital Enablement Service.

During the second quarter of 2020, BLIK executed **over 1 million transactions per day** and was available to **13.1 million** registered users. Users can pay at approximately 110,000 online stores, make instant Peer-to-Peer money transfers, use 540,000 PoS terminals at brick-and-mortar stores, withdraw cash from about 90% of ATMs in Poland, and initiate direct debit payments.

Over three-quarters of BLIK transactions take place online, followed by transactions using ATMs, offline PoS, and P2P transfers. Adoption of the platform led to an exponential increase in the number of average daily transactions, while

Withdraw cash from
90% of ATMs

Available to
13.1 million
registered users

110,000
online stores

540,000
PoS terminals

simultaneously decreasing the average transaction value.

With a stronger primary relationship with users, BLIK supports disintermediation of the payment process, mobile activation of users and increased cross-sell within banking apps.

For both iDeal and BLIK, **their success is largely thanks to the changes to the regulations.** It created access to the banks, helped to foster collaboration, and drive innovation. The true value in this has been the very real benefits the entire industry has seen – not just for the fintechs, but the banks and end consumers too.

3 THE IMPACT OF PRICING ON PAYMENTS

OZOW

THE IMPACT OF PRICING ON PAYMENTS

The cost of traditional payments on the rise

In May of 2022, both Visa and Mastercard increased the fees in the USA for merchants accepting credit cards for payments.

This comes after an increase in fees in the UK and European Union in October 2021. Both Visa and Mastercard raised their fees from 0.3% to 1.5% for online credit card payments.

Traditionally, **most credit card companies don't impose swipe fees on consumers and instead charge merchants.** Card issuers and acquirers pay scheme fees to be part of a payments network and in turn receive interchange or merchant service fees that are based on individual transactions.

The **increased fees saw significant backlash** – especially from lawmakers who have argued that consumers ultimately end up paying these costs through increased prices on goods and services.

Earlier in the year, the UK's Treasury Select Committee and Payments System Regulator (PSR) questioned the ever-increasing fees. They argued that they had seen no significant changes in costs for issuers.

Visa & Mastercard raised their online credit card fees from

0.3% to 1.5%

It has pushed regulators to develop plans to better regulate fees.

While these increases were expected two years ago, this has come at a time when online sales are at an all-time high. With most consumers dependent on cards to make most eCommerce payments, this comes as a massive knock for merchants and online shoppers alike.

According to the National Retail Federation in the USA, the fees, which average 2.22% of transaction amounts for Visa and Mastercard credit cards, are most merchants' highest operating cost after labour.

Transaction fees:

- **2.22%**
  of the total transaction cost
- **2nd**
  highest operating costs after labour

*For Visa and Mastercard credit cards in the USA

In **November 2020, Amazon.com said that it would stop taking payments from Visa credit cards in the UK** from mid-January due to the rising fees.

Well before this increase came into effect, alternative payments grew in popularity. For consumers, they have become easier, **more convenient, faster and more secure than many traditional payment methods.** Merchants have also seen the benefits, particularly as they look to reduce costs.

Fintech helps to drive down the cost of transacting

The expansion of fintech services can also bring benefits such as improved cost efficiencies and wider financial inclusion for previously underserved groups. In particular, innovative uses of digital technology can lead to more efficient and lower-cost delivery of financial services.

The pricing models of most alternative payment solutions have become extremely competitive against card payments[2]. The **absence of a physical presence often results in lower costs** to the provider, which may be passed on to the consumer; digital innovation can lower these fixed costs.

The proliferation of fintech companies and TPPPs in the market is helping to foster competition and lower costs for consumers. It's also helping to incentivise incumbent financial institutions and banks to prioritise market share through sales rather than operating profit[3].

This innovation is also benefitting cross-border payments and remittance transfer systems. Legacy cross-border payment systems tend to be cumbersome, costly, and slow. Whereas, newer business models, such as **innovative payment rails and digital identities, are less expensive and more efficient alternatives** for cross-border payments.

In all, this has become increasingly attractive to merchants looking to reduce overheads in the toughened economy and attract new customers. It's meant that merchants are starting to prioritise alternative payment options, which are significantly cheaper and allow them to reach a wider net of consumers.

[2] Trustly Index, 2022

[3] See Baumol et al (1982), Contestable markets and the theory of industry structure, Rochester and New York: Saunders College Publishing/Harcourt Brace Jovanovich.

4 DRIVING FINANCIAL INCLUSION AND OPEN BANKING IN SOUTH AFRICA

DRIVING FINANCIAL INCLUSION AND OPEN BANKING IN SOUTH AFRICA

South Africa's path to a more inclusive banking ecosystem

Historically, South Africa has modelled many of its systems, financial controls and regulations off of its international counterparts – especially in the UK and European Union. Therefore, a view into how the European banking system is operating has allowed regulators and industry players to better understand what is possible when it comes to any open banking initiatives in the country.

While the progress in this region provides great insight into what is possible, the path was not a simple one. Similar to current efforts in South Africa, the European Union understood that **it had to start with the regulation in order to create an enabling environment for the transformation** that can be seen in the region.

> “Technology and the responding changes to it continue to double every two years.”

The importance of improving regulation

The next few years for South Africa’s payments industry are critical in determining whether the ecosystem is agile enough to adapt to this change. In principle, the industry is aligned on the end goal. However, the biggest challenge (like all other governments) is the speed at which this regulation is formed.

Any regulation developed must go through a level of due diligence to ensure that it does not undermine the very goals and objectives that it tries to achieve. Creating enabling fintech regulations in South Africa is no different.

The National Treasury, the South African Reserve Bank (SARB), the Financial Conduct Authority (FSCA) and the Payments Association of South Africa (PASA) are committed to making open banking a reality in the country. **There has been a concerted effort to develop various bills (e.g. COFI Bill), the reform of regulatory industry and membership models, changes to existing legislation, industry working groups, and sandboxes for testing of innovative tech.**

Moore’s Law has shown that technology and the responding changes to it continue to double every two years. Accelerated by the pandemic, there has been increased pressure and the need to implement the regulatory changes at a faster rate to be agile and responsive enough to the evolving needs of consumers and businesses alike.

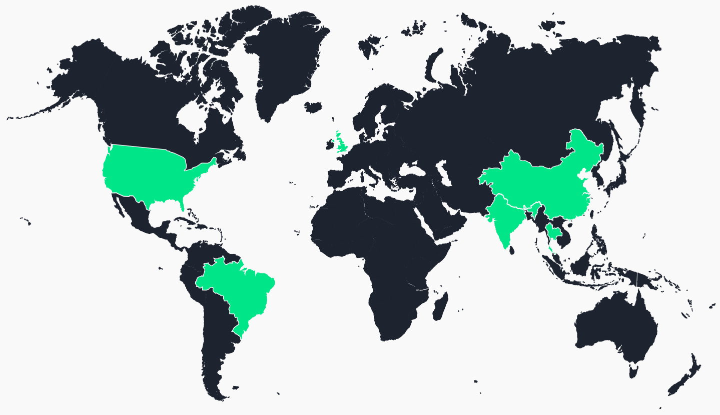
Similar to PSD2 and UK’s improvements in its legislation, with the right approach and faster implementation of regulations, South Africa’s financial frameworks could equally provide the opportunity for market players to quickly develop and launch new functionality, products and services to meet the demand.

Modernising South Africa's payment ecosystem

Regulation is vital to changing South Africa's payment ecosystem, especially legislation in similarity to that seen in Europe, the UK, and several other regions around the world. However, this change is also heavily reliant on frameworks that would enable greater participation and help address inequalities that have left millions of people underbanked and underserved.

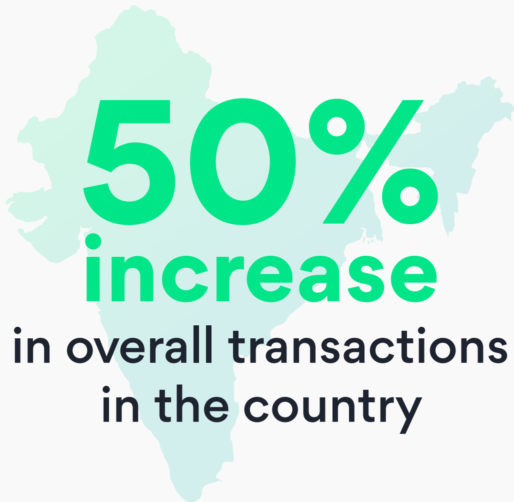
Industry players have recognised the importance of this. Led by BankServAfrica in collaboration with the Payments Association of South Africa (PASA), the Rapid Payment Programme (RPP) is one of these proposed frameworks. This revolutionary banking concept aims to create a simpler, safer instant payment ecosystem that would give people the ability to make real-time payments using simple identifiers, such as mobile numbers or email addresses.

This system and many other initiatives equally aimed at modernising South Africa's payment industry have leaned on the learnings of several international initiatives that have helped to revolutionise the way people pay in countries like **India, Brazil, the US, the UK, Thailand, China and Singapore.**



South-East Asia, in particular, has seen tremendous success with similar large-scale payments modernisation initiatives that saw rapid adoption by consumers over a short period of time – resulting in significant economic and social benefits for the region.

Launched in 2015, India's Unified Payment Interface (UPI) revolutionised the country's payments industry by providing a simple and easy payments solution that uses proxy identifiers, like mobile numbers. This was helped by Aadhaar, a unique nationally developed verified identifier that could be used by Indians to make payments[4].



50% increase

in overall transactions in the country

UPI redefined the way people made payments, resulting in more than a billion transactions being made through the system each month[5]. The system has helped India rapidly expand its entire banking ecosystem to previously untapped markets, which equated to a **50% increase in overall transactions in the country** that were previously non-existent on the system.

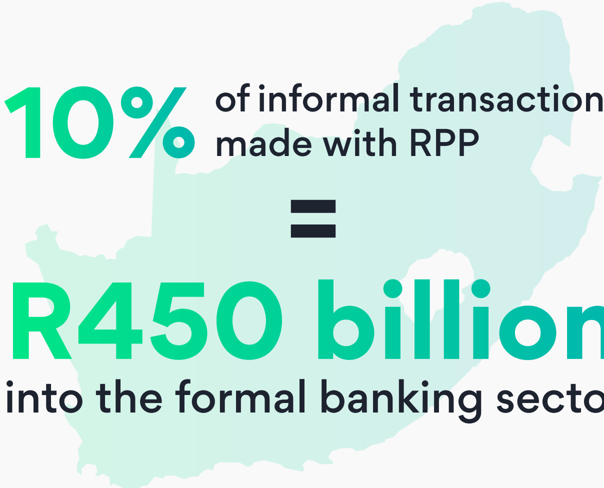
In response to the Covid-19 pandemic, Brazil's Central Bank saw the need to create and regulate a new instant payment system called PIX to improve access to online services.

[4] https: / /www.uidai.gov.in/16-english-uk/aapka-aadhaar/14-what-is-aadhaar.html

[5] https: / /www.aciworldwide.com/blog/indias-unified-payments-interface-breaking-the-billion-barrier

The system is based on the same principles as RPP and UPI, using simple payment identifiers all while ensuring interoperability – meaning **transfers and payments will be allowed from one e-wallet to another in real-time**, 24/7.

Since its launch in November 2020, PIX has had the fastest adoption of a new payment service in the world. In total, 83 million individual users and more than 5.5 million companies registered more than 242 million PIX keys. More than **45% of the country's population now uses this as a payment method.**



10% of informal transactions made with RPP

=

R450 billion

into the formal banking sector

The results of these initiatives have helped to reshape and improve the industry. Like UPI and PIX, RPP has the potential to reduce our country's dependency on cash, simplify payments, help to create an integrated platform for payments, increase financial inclusion and ultimately boost South Africa's annual GDP.

According to BankServAfrica, if only **10% of all transactions** in the informal economy are moved across to a system like RPP, this would **result in R450 billion** flowing into the formal banking sector.

5 THE FUTURE OF PAYMENTS

THE FUTURE OF PAYMENTS

How payments will look tomorrow

Alternative payments go beyond just changing the way people transact. The multitude of benefits have made them a more attractive and sustainable way for people to pay.

Alternative payments are helping to reduce consumer indebtedness, provide more transparent fee structures, enable faster payments, create greater accessibility to everyone who has access to online banking, reduce costs, and reduce fraud.

The shift to a contactless ecosystem is also **accelerating the de-cashing of the economy,** which has primarily been led through mobile usage of these new services.

With a goal of democratising finance, capturing customers and lowering transaction costs, fintech companies are contributing to bank disintermediation and disrupting markets. As more people use alternative payments, reducing their reliance on cash and card, this could help to improve the efficiency and reach of financial intermediation. This shift also contributes to growth opportunities for those fintechs that are positioned to take advantage of the ongoing structural shift in demand toward virtual finance.

With online sales growing with increasing internet access and wider acceptance of eCommerce, fintechs are particularly well-placed to provide a gateway beyond the card network or directly through credit transfers or direct debit.

The technological progress that has been made, and which is also in development, is set to ultimately make financial services more agile, convenient, secure and accessible for customers. In doing so, it will help South Africa improve financial inclusion, grow the formal economy and help the country reach its United Nations' Sustainable Development Goals (SDGs) aimed at strengthening the nation.

6 CONCLUSION

CONCLUSION

Beyond just creating innovation, change is needed in South Africa. With the current battered economy, where unemployment rates have skyrocketed to record highs in recent years, the development of enabling legislation that promotes greater collaboration between the banks and fintechs is vital.

Greater financial inclusion and participation in the digital economy positively impact industries across sectors, drive innovation, and promote more infrastructure development. Aligning with several of the SDGs, open banking and access to financial services have a positive impact on addressing poverty.

Improving regulation is a necessary step in the evolution of South Africa's payment ecosystem. However, the kind of collaboration that PSD2 has created can still be achieved through direct engagements and partnerships between banks and fintechs to enable open APIs.

As the leading payment solutions provider in South Africa, Ozow is committed to demonstrating the importance and benefits of trusted and secure integrations with banks. Ozow continues to partner and work closely with banks to develop secure integrations and open APIs – all of which will **create greater access, drive financial inclusion and ensure that payments are seamless for everyone.**

THANK YOU