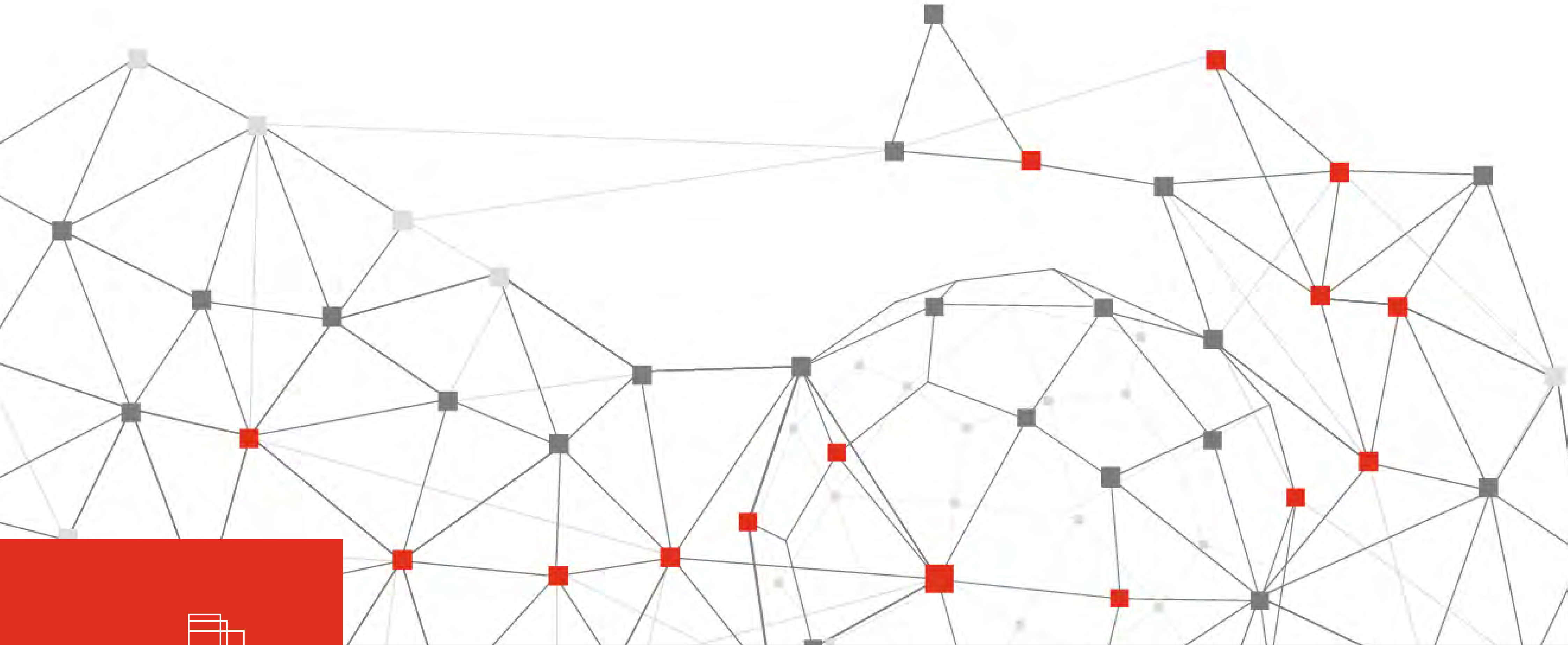
COVID-19

South Africa's catalyst for change towards a rapid and reliable digital payment system

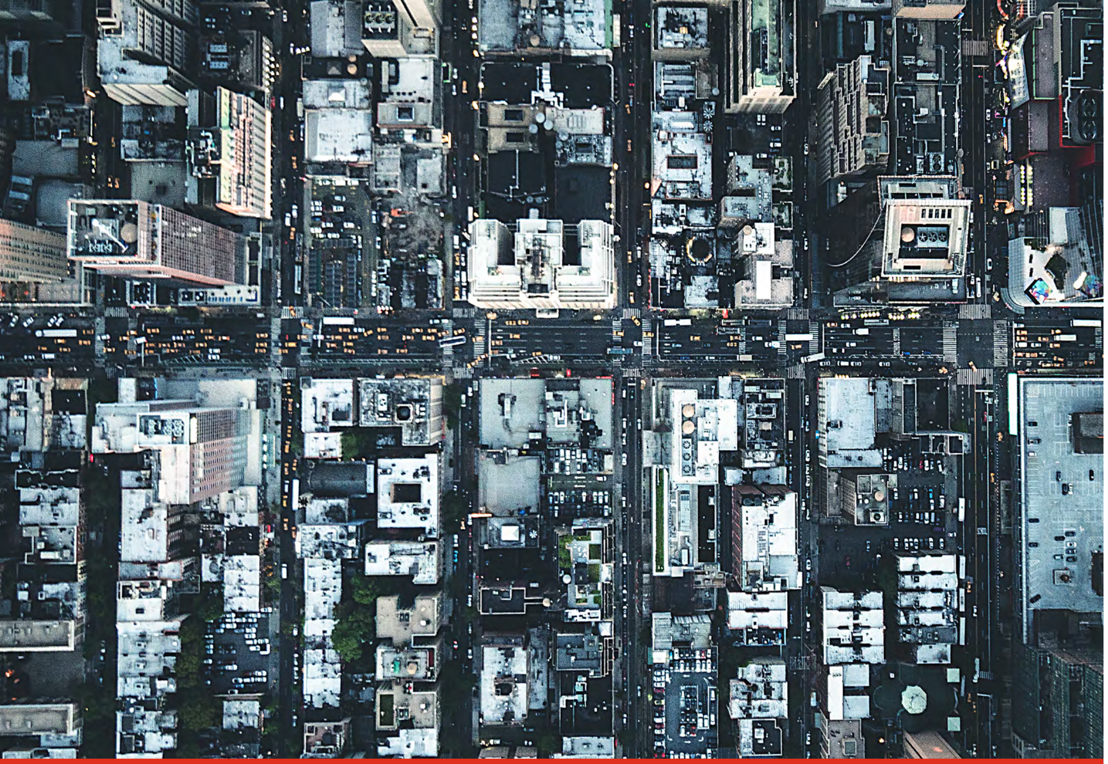


The purpose of this thought leadership is to illustrate how COVID-19 – as a catalyst for change – has reignited the race to deploy rapid payment services in South Africa. The dire circumstances being experienced across the country have prompted the need for greater innovation and collaboration among financial sector players.

South Africa is striving towards a payments future that promotes financial inclusion, reduces costs and helps stimulate the economy. To realise this, the country's payment platforms will have to evolve from commoditised propositions into strategic solutions that complement and add value to people's lives.

As an emerging market, unencumbered by huge amounts of legacy technology, South Africa has the opportunity to develop a modern payments infrastructure and a cutting edge payment platform that places customers at the core. This endeavour has to be about more than actual payments, rather it should be about enabling unique customer experiences.

Contents



The impact of COVID-19 on South Africa

The COVID-19 pandemic has left many South Africans uncertain and confused about the future. South Africa remains one of the most economically unequal societies in the world, with many citizens living in densely populated areas and unable to practice social distancing. More than 17 million South Africans are social grant beneficiaries and some have to go to South African Social Security Agency (SASSA) collection points to redeem the grants. Unfortunately, many people are forced to wait in long queues for hours due to high volumes.

“We are aware that the impact of COVID-19 will be felt much harder by the most vulnerable in society – especially the elderly, hence we have decided for earlier payments for older persons and persons with disabilities to ease congestion and overcrowding. I also wish to thank sectors – most importantly, the banking and retail sectors, for working with us in this regard,” said Social Development Minister Lindiwe Zulu.

The unbanked (those without bank accounts) and underbanked (those who do not fully utilise the functionality available to them in bank accounts) are at greater risk of infection because they regard cash as their only alternative. According to a survey conducted by the national treasury in 2019, over 90% of people that receive social grants electronically withdraw all funds and convert them into cash as soon as they become available. The World Health Organisation reports that COVID-19 is mainly transmitted from symptomatic people to others who are in close contact through respiratory droplets, by direct contact with infected persons, or by contact with contaminated objects and surfaces. This leaves many grant beneficiaries vulnerable to infection as they are largely financially excluded and heavily reliant on cash.

With social distancing having become one of the necessary precautions taken in order to limit the spread of COVID-19, many customers have, understandably, become reluctant to exchange cash or cards for fear of infection. As cash and point-of-sale devices require an exchange of hands, those items may become contaminated and cause multiple infections. Currently, many middle-class citizens are opting to have cashiers keep the change in order to avoid handling contaminated money. However lower income citizens, who typically require every rand and cent, are not in a position to do this. This potentially places them at higher risk of being exposed to COVID-19.

The president’s call for a countrywide lockdown, has forced some companies to rapidly adopt virtual engagement and remote working practices. Most companies have been temporarily shut down unless they are essential services providers. The ramifications of the lockdown will be endless. The impact is most severe on the likes of informal traders, hawkers and gig economy workers as they are predominately cash businesses that rely on foot-traffic and face-to-face engagements for their livelihood. Government has erected the COVID-19 Temporary Employer-Employee Relief Scheme (TERS) in an effort to ease financial distress caused by the pandemic. The scheme was instituted on behalf of UIF contributors and will run for up to 3 months. TERS is not linked to UIF’s normal benefits and will only pay employees’ salaries during the temporary closure of businesses over the lockdown period. Employees can expect to receive a replacement income equal to the minimum wage in their respective sector. Salaries will be capped at a maximum of R17 712.00 per month, per employee. Although financial relief schemes, such as the TERS, are providing some much needed relief, they sadly exclude people that receive cash wages or are not banked. Payment holidays and debt relief schemes all focus on formal merchants, banked and middle-class citizens. Schemes like the SASSA Social Relief of

Distress grants, aimed to help the man on the street, bring experiences similar to those of collecting other SASSA grants. This calls for more to be done in an effort to digitally include the unbanked and underprivileged.

South Africa has overcome countless challenges – its most prominent victory being the celebration of freedom in 1994. COVID-19 is the latest obstacle. As a collective, South Africans have great dreams and aspirations. Now is the time to band together and grow in the face of adversity, as we have done before. The people of South Africa deserve an intervention; a tool to help them in times of crisis.

> “The need for a fast, reliable and digital payment system is now greater than ever.

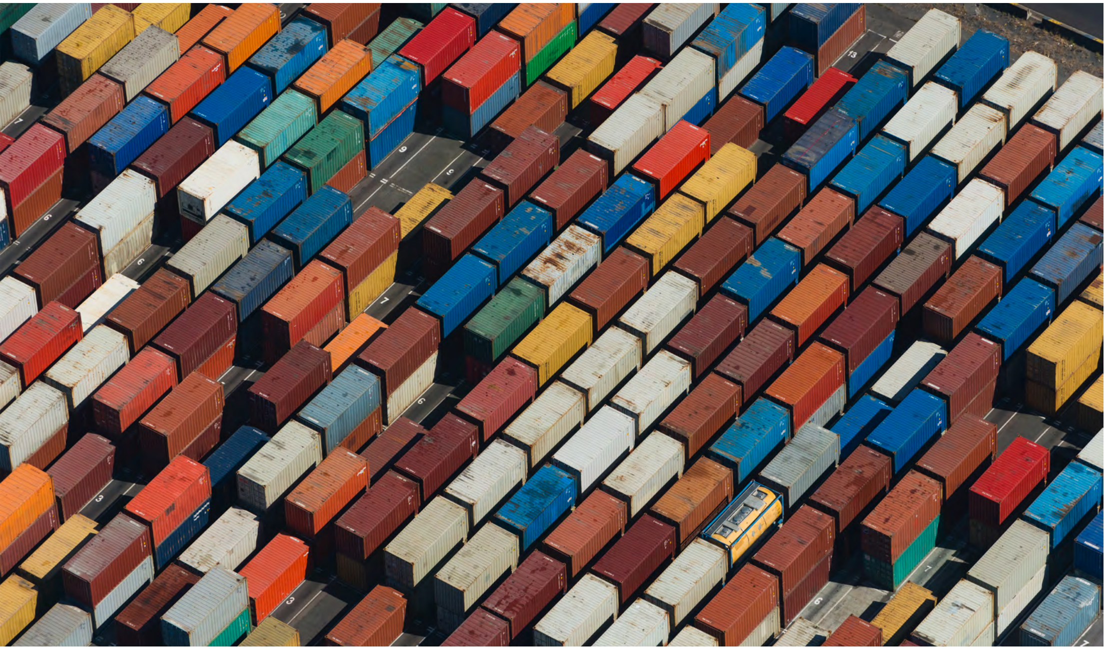
A digital payment system that only requires access to a mobile device before users can complete instant funds transfers should be regarded as a viable alternative to cash.

Broadening financial inclusion has been a priority in South Africa since social, economic and political emancipation was realised in 1994. However meaningful inclusion goes beyond ensuring that someone simply has a bank account. Digital channels and transactions hold the promise of democratising the financial system for the benefit of all. In order to successfully implement digital payments, enabling infrastructural elements like mobile network access and fibre need to be rolled out nationally and at an affordable price.

A major challenge is South Africa’s predominantly cash-based economy, wherein the use of cash is continuously growing. Currently more than 50%[1] of transactions are completed using notes and coins. This heavy reliance on cash is largely due to distrust in the banking system, convenience and transaction fee avoidance. Financial literacy can go a long way towards ensuring that South Africans are aware of various payment options and that they trust the rigour of inherent safety features. The objective here is to drive the use of electronic payments and enable the economy to become less cash dependent.

1 *https://www.pwc.co.za/en/publications/payments-study-tour-report.html*

> If South Africa's payments modernisation journey is to have a meaningful impact, the government and regulators will need to collaborate closely with banks.



While the participation of banks is required from a commercial perspective, the initiative must be owned and driven by government and regulators if we hope to achieve a paradigm shift of this scale.

Government and regulators will need to set the direction for payments modernisation as well as help drive and coordinate initiatives across the ecosystem. Their buy-in will help ensure that necessary changes to the regulatory framework are easily made. Fintechs, third-party payment players and retailers should be allowed to participate equitably in the payment system (both from a commercial and risk perspective). The regulatory framework should enable innovation while still preserving customer protection and risk elements at the core. Also, telecommunication and technology companies should be approached and included to enable the development of a system that is financially inclusive.

Fintechs should be granted freedom to work and innovate in the payments area. The payments industry should aim to establish enablers that will pave the way for fintechs to add value; such as standard APIs, standard QR codes, proxy databases, low-cost real-time payments and affordable data services; while also effectively regulating their activities to mitigate against any subsequent risks.

Broadly speaking, digitising payments (even small transactions) can play a major role in the reduction of costs associated with cash. The cost of cash contributes significantly to overall banking costs and strains the economy. Cash also causes ripple effects in South Africa's social environment. These effects include theft, cash in transit heists and poverty tax.

Lessons learnt: Payments modernisation in India and Thailand

Payments transformation as a catalyst for economic growth has been witnessed in a number of emerging markets. Two examples relevant to South Africa are India and Thailand.

When the Government of India withdrew INR500 and INR1 000 banknotes from circulation in November 2016, this demonitisation initiative resulted in cash shortages and forced India to ride the wave of digitisation and roll-out instant payment alternatives across the country. This significantly accelerated the adoption of digital payments and the regulator played a fundamental role in this transformation by providing incentives and supporting the development of telecommunications infrastructure in remote areas.

Initiatives implemented to drive the country's modernisation journey included the adoption of the 12-digit unique identification number from the national biometric identification system, which acts as a financial address for the unbanked, zero-rated bank accounts as well as real-time and integrated bill payment systems. The India example clearly illustrates digital inclusion is a fundamental step in achieving financial inclusion. Digital inclusion is more than the Digital ID it is about creating the network environment across enablement from an infrastructure perspective (lower data costs and devices) to additional services and players into this ecosystem to create opportunities for growth.

On top of the benefits accrued by government and businesses, India's most vulnerable citizens gained easier access to basic and affordable financial services.

With a focus on financial inclusion, India's regulatory environment was enhanced to provide non-traditional financial services providers to be more actively involved in the financial sector. India licensed 11 payments banks to provide basic remittance and banking services to underserved sectors, including migrant workers, low-income households and small businesses.

> In addition to the benefits accrued by government and businesses, India's most vulnerable citizens gained easier access to basic and affordable financial services. According to PwC's *Payments Study Tour Report 2019*[2], India experienced a 50% increase in transactions due to the implementation of proxy payments. Most of these transactions were totally new to the system.

2 *https://www.pwc.co.za/en/publications/payments-study-tour-report.html*

India has gone from strength to strength during its five-year payments modernisation journey. This significant progress is largely due to the country's collective patriotic problem-solving capability, which has seen the government and socially responsible businesses acting as driving forces in facilitating rapid change.

In Thailand, the cost of cash transactions became unsustainable and the banking industry had to ramp up digital payments to manage the shift towards a digital economy. The government, together with the Bank of Thailand (BOT), launched a national e-payment master plan. The aim was to create an integrated digital payment infrastructure that catered for consumer, business and governmental transactions, as well as tax and social welfare disbursements. Here again, we see the government becoming the main driver behind major change projects and encouraging customer adoption through incentives like price discounts and tax rebates through digital channels.

Between 2016 and 2018, Thailand managed to reinforce its digital economy, improve social welfare, significantly reduce cash handling and transaction costs, and enhance the efficiency and transparency of payments.

The implementation of a national e-payment system made the integration of tax and social security disbursement systems possible and enabled the low-income population to receive their disbursements faster and more accurately.

PromptPay, a real-time proxy payment system, introduced convenience by using national citizen IDs and mobile numbers as the basis for transactions. Additional benefits to citizens included lower banking costs through the open-access payment platform and VAT rebates for digital payments. Thailand serves as a perfect example of how a government's unrelenting focus on financial inclusion can significantly improve the lives of the most vulnerable citizens.

It is evident from the two case studies that the key success factors needed to drive change and implement payments transformation in South Africa will be cross-industry collaboration and unwavering commitment from government and regulators.

COVID-19 as a catalyst for change

Although the circumstances are unfortunate, COVID-19 may be the long-awaited catalyst needed to spark growth and motivate the industry to overcome some of the biggest challenges facing South Africa's payment sector.

The South African Reserve Bank's (SARB) Vision 2025 sets out the strategic objectives behind building a world-class national payment system (NPS) to better serve South Africans and the economy as a whole. The SARB wants to ensure that the country's payment systems are capable of meeting customers' evolving needs while overcoming infrastructural challenges.

Some of the Vision 2025 strategic objectives and requirements include financial inclusion, transparency and public accountability, financial stability and security, promoting competition and innovation and cost-effectiveness.

In an effort to boost innovation and competition, the SARB is reviewing the NPS Act to level the playing field through the fair application of regulation to all participants. This would give new players the opportunity to get involved in the development of new payment products and services.

In support of Vision 2025, the Payments Association of South Africa (PASA) has launched Project Future. Through a series of industry discussions, PASA was able to articulate its vision on the future state of payments. The first step in the modernisation of payments will be the implementation of a Unified Payments Service (UPS) – a platform that enables solution providers to develop competitive offerings.

As part of the South African modernisation journey, PASA and BankservAfrica approached PwC to host an industry study tour to India, China, Thailand and Singapore to learn how these markets overcame infrastructural challenges and leveraged new technologies to the benefit of their respective countries. The delegation wanted to understand how each participant – whether bank, regulator, system operator or fintech – took part in the payments ecosystem, how they were regulated and which learnings (positive or negative) could be applied back in South Africa. Some of the key findings included:

1

The need for a strong national imperative driven by government in collaboration with all relevant industry players

2

Socially responsible and commercially viable solutions

3

Leveraging of fintechs and non-banks to drive consumer adoption.

Upon returning from the tour, in response to Project Future and aligned to Vision 2025 aspirations, BankservAfrica commenced its endeavour to contribute to the modernisation of South Africa's national payments infrastructure through the Rapid Payments Programme. Even before the advent of COVID-19, the programme has not been without its challenges. The recent review of the NPS's management model has caused uncertainty among industry members on what their future roles and day-to-day routine will look like. As seen in India and Thailand, commitment to financial inclusion is the cornerstone of any payments modernisation initiative.

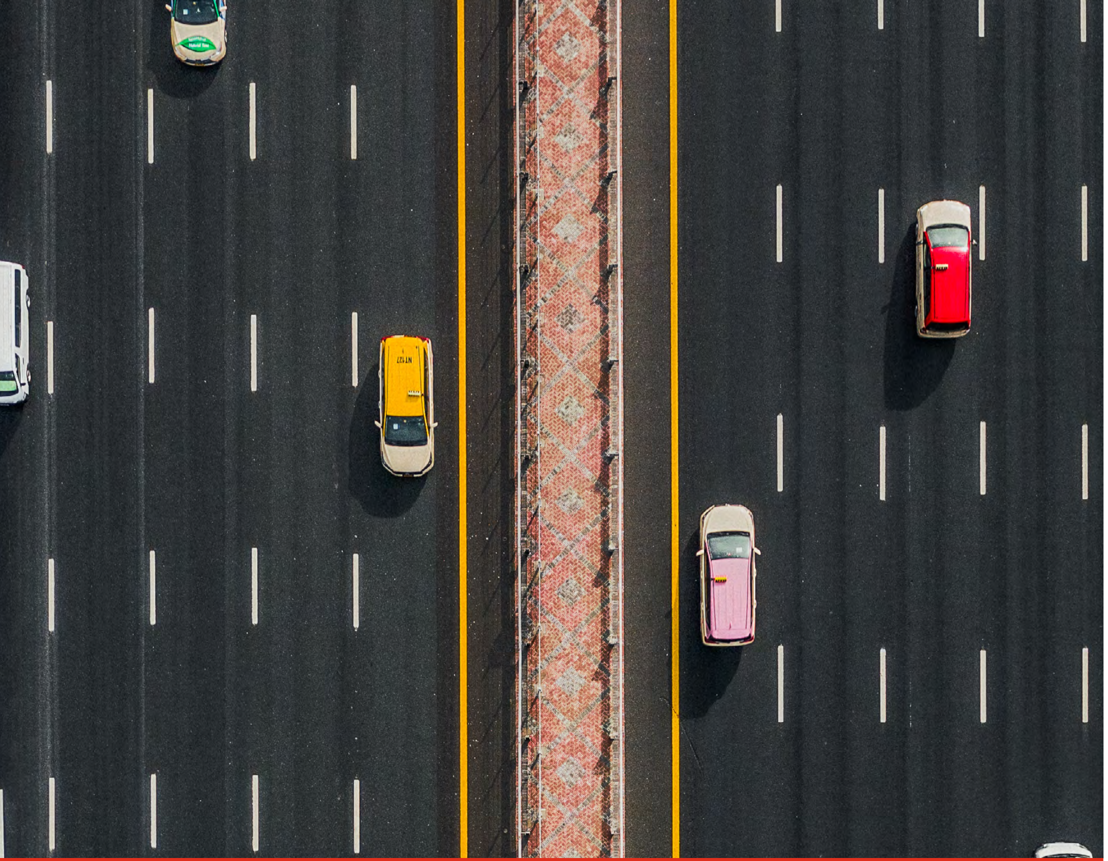
As a signal of its commitment, the SARB has recently placed the NPS Act under review. The purpose of the Act is to safeguard the country's national payment system and enforce strict risk measures around participation. Historically, direct participation in the NPS has mostly been limited to banks. The review of the Act may provide the opportunity for greater non-bank participation in future.

Indian banks can be commended on how they accepted and magnified their pivotal role in society. A statement taken from the large banks, sums up the patriotism seen there:

> "This is our country, our people, our communities, we are commercial entities with a social responsibility.

South African banks have taken the first step by joining the programme and are currently working individually and collectively to build their individual cases for change.

In both India and Thailand, the government was a driving force behind changes enabling payments modernisation. We have already seen strong collaboration between relevant industry bodies in South Africa, however, we will need to match the momentum witnessed in India and Thailand if we hope to drive the journey forward. To limit the effect of potential implementation delays brought about by COVID-19, industry players will have to join hands now more than ever.



Driving South Africa forward

COVID-19 has forced South Africa's financial sector players to re-evaluate their existing operational systems and way of keeping the wheels turning. To make matters worse, the country now has to shoulder Moody's recent downgrade to junk status while it grapples with complications emerging from the lockdown. Moody's said that "unreliable electricity supply, persistent weak business confidence and investment as well as long-standing structural labour market rigidities continue to constrain South Africa's economic growth". As all economic activities, except essential services, are suspended during the lockdown, the government's budget shortfall and debt burden are likely to deteriorate even further over this period. South Africa, as an emerging market, is in desperate need of a catalyst to stimulate economic growth.

In closing, we would like to share a profound quote from one of the Indian banks on the PwC Payments Study Tour. In response to a state of crisis in India, the regulator set a non-negotiable deadline to implement a digital payment system. Industry members were concerned and felt the timeline was unrealistic. Afterwards, when asked about how they managed to achieve the deadline, an executive at one of the country's banks replied:

> "It is amazing what can be achieved when you are in mission mode.

South Africa will need to keep the momentum going and fully get into mission mode in order to successfully deploy a rapid and reliable digital payment system geared towards making life easier for everyone, especially the unbanked and underprivileged.

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