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| Your reference | Our reference | Date |
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| Mr J Ramrock | PSG Leon/ J Veeran<br>1834365 | 3 June 2008 |

Dear Mr Ramrock

**SUBMISSION IN RESPECT OF THE DRAFT CONSUMER PROTECTION BILL, 2008 PUBLISHED ON 6 MAY 2008 – BILL NUMBER B19-2008 ("the Bill")**

1. **Background to MasterCard Scheme and four party payment model**

1.1 We represent MasterCard International Incorporated ("**MasterCard**"), a global payment and transaction processing company which facilities the processing of domestic and international transactions through its four party payment system, referred to in this submission as "**the MasterCard scheme**." The MasterCard scheme encompasses a network of financial institutions, cardholders and merchants which utilise MasterCard's four party payment scheme, typically by way of transactions initiated with a payment card displaying the MasterCard®, Maestro® or Cirrus® brand (collectively, "**MasterCard cards**").

1.2 The parties involved in a four party payment system transaction are the merchant, the acquirer (ie the merchant's bank), the issuer (ie the cardholder's bank) and the cardholder. MasterCard, as the system provider, is not a party to the payment transaction, but provides a "**co-operation enabling service**" which allows the transaction to take place, through the obligations which each of the financial institutions owes to MasterCard, and, in certain circumstances, guarantees the transaction.

1.3 The MasterCard scheme provides a payment service to two groups of customers, cardholders and merchants. A principal function of the MasterCard scheme is to facilitate the payment for goods and services by MasterCard cardholders at merchants who accept MasterCard cards for payment. This service is offered within countries and between countries, ie domestically and globally, in accordance with the same broad principles.

1.4 For the cardholder, MasterCard cards offer a simple and secure means of payment with significant advantages over payment by cash. For the merchant, acceptance of payment cards means guaranteed and timely payment, irrespective of the solvency of the cardholder, or, in certain circumstances fraudulent card use.

1.5 The MasterCard scheme provides cardholders with choice, merchants with value and economies with a far superior and more efficient payment mechanism than cash. MasterCard leads in developing ever more innovative payment solutions for its customers in 210 countries and territories including initiatives supporting mobile commerce, remittance programs and the burgeoning increase in e-commerce transactions.[1]

[1] ie where a cardholder purchases over the internet. Research conducted by World Wide Worx (reported in: "South Africa; Making the Internet a Safer Place to Shop", Africa News, 29 September 2006) shows growth in the value of internet transactions by South Africans at South African retailers in 2005 of 25%-30% to R540 million, excluding the value of air tickets, accommodation and car rentals. South African retailers reported to be leading this evolution include Pick 'n Pay Online, Edgars and Woolworths. Euromonitor International: Country Market Insight "Financial Cards: South Africa" March, 2007 anticipates a 35% increase in 2006 to an estimated value of R9.5 billion with a volume increase to 14.5 million transactions.

## 2. Rationale for electronic payments and prepaid products

2.1 Consumers, merchants and regulators around the world have shown a preference for electronic payment methods over paper-based products such as cheques or cash.

2.2 Prepaid consumer cards ("**prepaid cards**")[2] provide an alternative to cash and cheques for those consumers who are unable or prefer not to use credit or debit cards for their expenses. Prepaid cards:

2.2.1 are critically important for mail order, telephone and internet based commerce,

2.2.2 provide greater security than carrying large amounts of cash; and

2.2.3 may result in lower card fees for the consumer than receiving and cashing cheques or using cash.

2.3 Prepaid cards play an important role in stimulating economic growth and improving financial welfare of people around the world. Prepaid cards are particularly useful in promoting the financial inclusion objectives of emerging markets' governments, including South Africa, in servicing unbanked and underbanked communities while providing an opportunity to access banking services at a reasonable cost.

2.4 Governments globally are leveraging electronic payments solutions, specifically prepaid solutions to disburse child support, unemployment assistance, social security and other benefits to the unbanked and thereby providing these unbanked individuals with financial choice, convenience and security. The following MasterCard programmes allow previously unbanked citizens access to financial services:

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[2] MasterCard estimates there are significantly over 1 million MasterCard prepaid cards in issue in South Africa today.

2.4.1 U.S Department of Treasury's Direct Express programme that delivers Social Security Benefits by means of a prepaid card;

2.4.2 American Red Cross Disaster Relief Effort during Hurricane Katrina (US) by means of a prepaid card;

2.4.3 One Smart Social Services Card in the Russian Federation which uses prepaid cards with an EMV chip to distribute social entitlements;

2.5 The South African Government is currently delivering unemployment and welfare benefits on a debit-card based platform[3] and MasterCard is pursuing other payment card opportunities which will benefit all segments of South African society.

## 3. Problematic clauses

3.1 MasterCard wishes to address two clauses in the Bill that would have an adverse impact upon promoting the migration from cash payments to electronic payments and, in particular, to prepaid payment cards:

3.1.1 first, clause 51, specifically sub-clauses 51(1)(j)(ii) and 51(2)(b)(ii) of the Bill insofar as they may relate to the use of payment cards for which the cardholder's authentication is verified by way of a Personal Identification Number ("**PIN**"); and

3.1.2 secondly, clause 63, specifically sub-clauses 63(2) and 63(3) of the Bill,[4] insofar as it relates to prepaid card programmes.

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[3] According to Mercator Research Report (Oct 06)

[4] The term prepaid program typically connotes that the cardholder accesses value, rather than a line of credit. There are many possible permutations of the prepaid program. Prepaid cards can serve as rewards, gifts, or the delivery mechanism for regulated benefits such as a medical savings card and flexible spending account. There are generally two categories of prepaid card programs, closed loop and open loop. Closed loop prepaid cards are redeemable only at specific locations. Closed loop prepaid cards are often retailer specific gift cards which have replaced paper gift certificates and are used for specific purposes. An open loop system is one in which prepaid cards can be used for a variety of purposes. Open loop prepaid cards are branded with the mark of one or more of the payment networks such as MasterCard and are generally redeemable at any point of interaction (ATM or Merchant) accepting the network's card. Open loop solutions can be further classified as being either "consumer" solutions that consumers can choose to acquire as an alternative to paper. These include gift and consumer

3.2 Clause 51(1)(j)(ii) of the Bill reads as follows:

> **"A supplier must not make a transaction or agreement subject to any term or condition if-**
>
> **(j) it expresses an agreement by the consumer to –**
>
> **(ii) provide a personal identification code or number to be used to access an account."**

3.3 Clause 51(2)(b)(ii) of the Bill reads as follows:

> **"A supplier must not-**
>
> **(b) request or demand a consumer to –**
>
> **(ii) reveal any personal identification code or number contemplated in sub-section (1)(j)(ii);..."**

3.4 These clauses are presumably aimed primarily at the micro-finance industry where the retention of Automatic Teller Machine ("**ATM**") cards and provision to the lender of the PIN to that card has been widespread and is the cause of understandable concern. However, in light of the Bill's definitions of "**supplier**", "**market**", and "**services**"[5], this clause may be interpreted to prohibit a bank from making a payment programme or facilitating a payment transaction which would require a cardholder to agree to provide a Personal Identification Number ("**PIN**") in the course of verifying the cardholder's authentication. This is an essential security feature for most card payment transactions. Sub-clauses 51(1)(j)(ii) and 51(2)(b)(ii) may therefore prohibit the use of PIN based payment products in South

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reloadable solutions. Commercial prepaid products consist of solutions issued to businesses, sole proprietorships, corporations, governments etc., the most common being a payroll solution which provides an employee access to his or her wages.

[5] "**supplier**" is defined in Clause I of the Bill as "**a person who markets any goods or services**". "**market**" when used as a verb, means to promote or supply any goods or service. "**service**" includes financial services

Africa leading to substantial interoperability problems when foreign cardholders come to South Africa with PIN based payment cards issued abroad.

3.5 The unintended consequence that may arise may be addressed by incorporating an exemption in both sub-clauses 51(1)(j)(ii) and 51(2)(b)(ii) in respect of transactions where a supplier (either a "**Bank**", "**Mutual Bank**" or "**other financial institution**") requires a consumer to provide such an institution, directly on indirectly[6], with a PIN.

3.6 In order to protect the consumer, MasterCard has specific requirements that govern the way a PIN must be handled by issuers and their agents. These requirements apply to the storage and conveyance of a PIN and include the cardholder's use of the PIN.

## 4. Prepaid certificates, credits and vouchers

4.1 Clause 63 (2) reads as follows:

> **"A prepaid certificate, card, credit, voucher or similar device contemplated in subsection (1)[7] does not expire until the earlier of –**
>
> **(a) the date on which its full value has been redeemed in exchange for goods or services or future access to services; or**

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[6] The concept of "**directly or indirectly**" is important to address the fact that a PIN is often keyed into a machine that is not owned by the bank that issued a card and often the PIN is processed by a third party on behalf of such a bank

[7] Clause 63 (1)(a) and (b) of the Bill reads as follows:

**"This section applies only to a transaction in which a supplier-**

**(a) accepts consideration from a person in exchange for a prepaid certificate, card , credit, voucher or similar device; and**

**(b) expressly or implicitly agrees to provide goods or service to any person who subsequently presents that certificate, card, credit , voucher or similar device, up to the clause represented by it,**

**but does apply with respect to such a device, or value represented by it, after the value of the device has been exchanged for goods, services, or future access to services."**

**(b) five years after the date on which it was issued, or at the end of a longer, or extended period, agreed by the supplier at any time."**

4.1.1 This clause appears to prohibit the issuer of a prepaid card from imposing an expiration date of less than five years on a prepaid card.

4.1.2 MasterCard requires expiration dates on all payment cards. A validity period of three to five years or less helps mitigate the risk of card fraud and allows for new security features to be incorporated periodically into card programmes. At present, the average validity period for a prepaid card is eighteen months which, in part, is a reflection of the comparatively low value MasterCard permits to be loaded on prepaid cards.

4.1.3 In addition to expiration dates, MasterCard requires that issuing banks provide consumers with the ability to access their funds by reissuing the card with a new expiration date.

4.1.4 It may be that the primary motive of clause 63(2) to regulate unregulated entities as opposed to banks which are already regulated (whether by legislation or scheme rules which have been developed with the benefit of international experience). However, clause 63(2) covers banks owing to the overtly broad:

4.1.4.1 description of "**prepaid certificate, card, credit, voucher or similar device**"; and

4.1.4.2 manner in which the provision covers these products irrespective of who sells or uses the product.

4.2 Clause 63(3) reads as follows:

**"Any consideration paid by a consumer to a supplier in exchange for a prepaid certificate, card, credit, voucher or similar device contemplated in subsection(1) is the property of the bearer of that certificate, card, credit, voucher or similar device to the extent that the supplier has not redeemed it in exchange for goods and services"**

4.2.1 This clause implies that a bank may be obliged to reimburse any unspent value to the original payer or cardholder (or both) if requested to do so[8]. With regard to very low residual values or surpluses, the cost of processing a reimbursement could outweigh the residual value or surplus.

4.2.2 In addition, the residual values or surpluses on prepaid cards, which are often microscopic, are used to make the prepaid card program economically viable for the issuer and, in particular, fund the costs of card issuance, card authorisation, card network participation and the benefits of bank issuance (lost/stolen card protection, operation of customer service operations)[9]. These are benefits that a cardholder typically does not receive from a merchant that issues prepaid cards for use at the merchant.

4.2.3 To ensure that the consumer enjoys the maximum benefit of the prepaid card programme and recognising the need to ensure that cardholders are not effectively faced with an undisclosed fee, MasterCard has introduced a policy to ensure that the reimbursement of residual values or surpluses is economically viable, depending on the manner in which the card programme is funded. Card programmes are funded in two ways: card programmes in which the funds are deposited by the cardholders are referred to as "**consumer-funded card programmes**"; card programmes in which the funds are deposited by some other party are referred to as "**non-consumer funded card programmes**". The holder of a consumer funded prepaid card

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[8] *In Europe the validity of prepaid cards is governed by Article 3 of the ELM Regulations, Directive 2000/46/EC, which states that*

1. A bearer of electronic money may, during the period of validity, ask the issuer to redeem it at par value in coins and bank notes or by a transfer to an account free of charges other than those strictly necessary to carry out that operation.

2. The contract between the issuer and the bearer shall clearly state the conditions of redemption.

3. The contract may stipulate a minimum threshold for redemption. The threshold may not exceed EUR 10.

[9] **MasterCard Policy for Prepaid Card Programs March 2008** -MasterCard requires that the issuer disclose clearly and conspicuously all application or other fees the customer must pay. All fees must be made payable to the issuer and not to any other person or entity.

has a minimum of twelve months, from the date of the last value load or thirty calendar days after the expiration date, whichever is later, to request the return of residual values or surpluses (less any applicable fees imposed by the issuer or any other lawful offsets). The holder of a non-consumer funded prepaid card has a minimum of six months, from the date of the last value load or thirty calendar days after the expiration date, whichever is later, to request the return of residual values or surpluses (less any applicable fees imposed by the issuer or any other lawful offsets). The issuer is required to disclose how and when the cardholder may request the return of the residual values or surpluses, as well as any fees that apply to the programme.

4.2.4 Banks are not geared to reimburse any unspent value to the original payer or cardholder. The reimbursement of residual values or surpluses below an economically viable threshold, could seriously impact the viability of prepaid programmes in view of the complexity of proving whether or not the value has been spent, particularly if the transaction takes place offline.

4.2.5 Although MasterCard requires all its issuing members to have robust anti-money laundering policy, procedures and controls in place for their MasterCard products, providing a cardholder with access to funds other than through card usage, such as point of sale purchases or ATM/cash withdrawals, by means of reimbursing the card account balance by cheques or cash may put the card issuer's anti-money laundering and fraud controls and monitoring processes (eg velocity limits, behavioural transaction patterns, signs of suspicious activity) at risk. It may also assist criminals and money launderers in their attempts to conceal or disguise the source of the funds through layering techniques.

4.3 We respectfully suggest that promoting transparency in fee structures, as members of MasterCard are required to do under MasterCard's rules, is a more effective tool to protect consumers than the creation of a burdensome process to repay unused value. Prepaid cards which display the MasterCard brand can be used at over 25 million locations worldwide. The high level of acceptance of

MasterCard cards in South Africa should ensure that consumers are not in a position that they cannot extract the value loaded on a prepaid MasterCard card.

4.4 As they stand, clauses 63(2) and 63(3) may have the effect of unnecessarily over-regulating the prepaid card business and have the unintended consequence of making such programmes less attractive for issuers to promote to the extent that we witness a reduction or even the elimination of prepaid cards in South Africa. This would have an adverse effect on consumers as bank-issued prepaid cards, under a payment scheme's rules, offer card acceptance choices and card protection that cannot be offered with traditional retailer gift certificates, gift cards and other prepaid cards.

4.5 This issue, in MasterCard's view, could be addressed by exempting banks, mutual banks and other financial institutions from the application of the clause, in the same manner that such institutions are excluded from the parameters of clause 65. The activities of banks, insofar as they relate to payment cards, are already extensively regulated and any additional restriction imposed by clause 63 is not necessary and amounts to legislative overreach.

Yours faithfully

**WEBBER WENTZEL**