



Palestine Monetary Authority

جمعية البنوك في فلسطين
Association of Banks in Palestine

ESAF Program
Expanded and Sustained
Access to Financial Services

CONFIDENTIAL

Palestine Banking Services Company

Background to business plan 2012 to 2016

Submitted to: The Banking Services Company Follow-Up Committee

Prepared by: ShoreBank International Limited and Risk Frontier Consulting Limited
Andrew Lake, Patrick Mowat, Jenny Hoffmann, Oswaldo Mendoza

Edited by: ShoreBank International Limited
Ahmed Jadallah, Frances Toomey

Independent Consultants
Amjad Al-Sadeq

Submitted on: August 7th, 2011



Table of Contents

| | |
|---|-----------|
| 1. Executive Summary | 5 |
| 2. Introduction..... | 6 |
| 3. Context..... | 6 |
| 3.1. <i>Palestinian transactional banking industry trends.....</i> | 6 |
| 3.1.1. Consolidation | 7 |
| 3.1.2. Need for local switching capability and an issuer neutral card acquirer | 7 |
| 3.1.2.1. ATM switching | 7 |
| 3.1.2.2. Card transaction acquiring | 7 |
| 3.1.3. Willingness to assist non-financial institutions into the market space | 7 |
| 3.2. <i>Cooperative vs. competitive space</i> | 8 |
| 3.2.1. Cooperation in switching of ATM and POS transactions | 8 |
| 3.2.2. Cooperation in card transaction acquiring..... | 9 |
| 3.3. <i>Strategic implications for the Palestine banking industry.....</i> | 9 |
| 3.3.1. Example: South Africa – BankservAfrica | 10 |
| 3.3.2. Example: Ghana - GhIPSS | 10 |
| 3.3.3. Example: Visa Jordan Cards Services (VJCS)..... | 11 |
| The VJCS example is closest to the BSC case as well as in terms of environmental factors such as the society, banking behaviour, cultural and demographic architecture. Moreover, around 40% of the banks operating in Palestine are Jordanian banks and most of them switch currently through VJCS and are familiar with its services..... | 11 |
| 4. Opportunity analysis | 11 |
| 4.1. <i>The banked Palestinian market</i> | 11 |
| 4.1.1. Market size | 11 |
| 4.1.2. How the BSC would benefit the banked market | 12 |
| 4.2. <i>The un/underbanked Palestinian market.....</i> | 12 |
| 4.2.1. Market size | 12 |
| 4.2.2. How the BSC would benefit the un / under banked market | 13 |
| 4.3. <i>The market opportunity</i> | 13 |
| 4.3.1. Current Palestinian transactional banking market size | 13 |
| 4.3.2. Retailer market sizing | 14 |
| 4.3.3. Indicative sizing of the opportunity..... | 15 |
| 4.3.3.1. Benchmark Kosovo..... | 15 |
| 4.4. <i>Competitive positioning.....</i> | 16 |
| 4.4.1. ATM switching | 17 |
| 4.4.1.1. Anticipated reactions from JoNet and VISAnet..... | 17 |
| 4.4.2. Card Acquiring..... | 17 |
| 4.4.2.1. Anticipated reactions from Bank of Palestine | 17 |
| 4.4.2.2. Mitigations which BSC should implement | 17 |
| 4.4.3. International Card Gateway | 18 |
| 4.4.3.1. Anticipated reactions from Bank of Palestine | 18 |
| 4.4.3.2. Mitigations which BSC should implement | 18 |
| 4.5. <i>Market research</i> | 18 |

- 4.5.1. Bank interest in using the switching and acquiring capability of the BSC.....19
- 4.5.2. Bank thoughts on the ownership structure of the BSC.....19
- 4.5.3. Bank thoughts on the capital structure of the BSC.....19
- 4.5.4. Bank interest in becoming a shareholder of the BSC20
- 4.5.5. Bank thoughts regarding the pricing policy of the BSC.....20
- 4.5.6. Bank thoughts regarding the future services of the BSC.....20

- 5. Conclusion20**

Glossary of acronyms

| | |
|-----------------------|---|
| ABP | Association of Banks in Palestine |
| ATM | Automated Teller Machine |
| BIN | Bank Identification Number |
| BoP | Bank of Palestine |
| BSC | Banking Services Company |
| DR | Disaster Recovery |
| ESAF | Expanded and Sustained Access to Financial Services |
| MNO | Mobile Network Operator |
| MIP | MasterCard Interface Processor |
| Off us | A transaction in which different banks issue the card and terminal |
| On us | A transaction in which the same bank issues the card and terminal |
| PMA | Palestine Monetary Authority |
| POS | Point of Sale |
| RTGS | Real Time Gross Settlement |
| USAID | United States Agency for International Development |
| VAP | VISA access point |
| EMV | Europay Master and Visa Card |
| PCI-DSS | Payment Card Industry Data Security Standard |
| PA-DSS | Payment Application Data Security Standard |
| VISA-PABP | Visa Payment Application Best Practices |
| HSM | Host Security Module |
| FIs | Financial Institutions |
| Issuer | The Bank who issue the cards to their customers |
| Acquirer transactions | The party who maintains acceptance relationship and receives bank card(s) |
| PIN | Personal Identification Number |
| BIN | Bank Identification Number |

1. Executive Summary

The objective of this work is to provide the PMA, ABP and the banks with a plan for a greenfields banking services company (BSC) for Palestine. An analysis of the financial sector, reviews of previous research reports and current market research indicates that the economic benefits of expanding electronic banking will only be achieved when the cost structure is reduced and the availability more widespread and convenient.

The banking services company will achieve this through establishing and running a local switching capability and playing the role of a neutral card acquirer which is independent of any individual card issuer.

A **local switch** will bring the benefits of reducing operational costs and alleviating the political and operational risks of needing to switch transactions internationally.

A **neutral card acquirer** will ensure that there is no discrimination between card issuers in relation to terms of access to the infrastructure and since any bank may be a member of the BSC, pricing of the service will be competitive.

Customers and other participants in the financial industry achieve the most effective service through competition in many areas of the business but it is clear that in an area where cost effectiveness, and reliability require economies of scale and concentration of skills, everyone is better served through co-operation; and it is into this area that payments processing and switching as well as card transaction acquiring falls. Co-operation will ensure the highest level of inter-operability through the management of common standards.

Although the market in Palestine is still very dependent on the use of cash, trends show a significant increase in the usage of ATMs and a significant proportion of the population who possess some form of formal bank account.

Although the banks have been competing aggressively to increasingly attract new customers, it has become clear that individual bank growth has largely been through winning customers from other banks who are often simply spreading their deposits among more banks. Therefore in order to achieve real and meaningful growth in the banking industry it will be necessary to attract the unbanked and underbanked with newly designed products and services which they will find attractive. The BSC will allow banks to update and increase their line of products and services to meet their customers' needs.

A locally operated switch owned by banks operating locally, provides great scope to use this control and ensure flexibility to look at the participation in the payments space of non-banks in order to design alternative delivery channels and products which could increase the level of financial inclusion in Palestine, to the benefit of the whole economy.

2. Introduction

ESAF is expanding its focus on increasing access to finance more broadly to include both credit and non-credit service expansion to underserved or unserved populations and markets in the West Bank and Gaza. A key challenge is the identification of technological innovations that can be utilized by financial institutions to expand service outreach in an efficient, secure, and cost-effective manner. As part of a new cross-cutting technology initiative ESAF has worked closely with the Association of Banks in Palestine, PMA and other BSC committee members to conclude a Feasibility Study for a Banking Services Company (BSC). It is intended that this company will support the Palestinian economy through services for banks and the community in the Palestinian territories.

This business plan was drafted during the last of three phases of the business planning project under the auspices of ESAF, and follows the high level feasibility study, which was approved by the BSC committee in April 2011. In that study, two company implementation options were proposed, the first option being to acquire the relevant card acquiring assets from the Bank of Palestine, and build the BSC on that foundation, while the second option was to explore a 'greenfields' option, which involves starting a new company from scratch within Palestine.

At the beginning of this phase, the BSC committee instructed the team to explore only the greenfields option. This has been done, and this business plan, supported by its associated financial model and implementation project plan provide the findings of that assessment.

3. Context

3.1. Palestinian transactional banking industry trends

The Palestinian banking sector is currently dominated by six banks with the following market shares.

| Profit/Loss | | Deposites | | Facilities | | Assets | | Bank Name |
|-------------|---------|-----------|----------|------------|----------|--------|---------|------------------------------------|
| 2010 | 2009 | 2010 | 2009 | 2010 | 2009 | 2010 | 2009 | |
| 58.2% | ▲ 34.6% | 35.5% | ▼ 36.6% | 34.5% | ▲ 34.4% | 32.8% | ▼ 33.1% | Arab Bank |
| 21.6% | ▼ 28.3% | 18.5% | ▲ 16.4% | 19.3% | ▲ 16.3% | 18.1% | ▲ 16.6% | Bank of Palestine |
| 7.1% | ▲ 5.8% | 9.6% | ▼ 10.7% | 8.5% | ▼ 8.9% | 9.3% | ▼ 10.0% | Cairo Amman Bank |
| 3.4% | ▼ 7.6% | 7.6% | ▼ 8.2% | 4.6% | ▼ 5.1% | 6.9% | ▼ 7.5% | Bank of Jordan |
| 3.2% | ▲ 2.6% | 4.5% | ▲ 3.5% | 7.1% | ▲ 5.7% | 5.0% | ▲ 4.3% | Quds Bank |
| 2.2% | ▼ 3.4% | 5.1% | ▼ 5.4% | 4.4% | ▼ 6.3% | 4.9% | ▼ 5.3% | Housing Bank for Trade and Finance |
| 1.1% | ▲ 0.4% | 4.2% | ▲ 4.0% | 6.1% | ▲ 4.2% | 4.2% | ▲ 3.9% | Palestine Islamic Bank |
| 1.8% | ▼ 1.0% | 3.4% | ▼ 3.8% | 2.8% | ▼ 4.4% | 3.3% | ▼ 3.8% | Arab Islamic Bank |
| 1.1% | ▼ 2.9% | 2.3% | ▲ 2.1% | 3.4% | ▼ 3.8% | 3.1% | ▼ 3.2% | Palestine Investment Bank |
| 2.4% | ▲ 2.3% | 2.4% | ▼ 2.5% | 2.2% | ▼ 3.1% | 2.7% | — 2.7% | Jordan Ahli Bank |
| 1.3% | ▼ 2.0% | 1.6% | ▲ 1.4% | 1.8% | ▲ 1.6% | 2.0% | ▲ 1.7% | Palestine Commercial Bank |
| 0.2% | ▼ 1.8% | 1.2% | ▼ 1.3% | 1.5% | ▼ 2.2% | 1.8% | ▼ 2.1% | Al-Rafah Microfinance Bank |
| 0.8% | ▼ 4.3% | 1.3% | — 1.3% | 2.7% | ▲ 2.2% | 1.7% | ▼ 1.8% | Arab Egyptian Land Bank |
| 1.4% | ▼ 4.5% | 0.8% | — 0.8% | 0.8% | ▼ 1.1% | 1.3% | — 1.3% | Jordan Commercial Bank |
| 0.5% | ▼ 0.3% | 0.7% | ▼ 0.8% | 0.1% | — 0.1% | 1.1% | ▼ 1.2% | Jordan Kuwait Bank |
| 0.5% | ▼ 0.6% | 0.5% | — 0.5% | 0.3% | — 0.3% | 0.7% | — 0.7% | Union Bank |
| 0.4% | ▲ 1.0% | 0.7% | ▲ 0.6% | 0.2% | ▼ 0.4% | 0.7% | ▲ 0.6% | HSBC |
| 0.1% | ▼ 1.2% | 0.002% | — 0.002% | 0.002% | — 0.002% | 0.2% | — 0.2% | Arab Palestine Investment Bank |

Source: Association of Banks in Palestine, December 2010

3.1.1. Consolidation

Challenges similar to those of European banks are facing the Palestinian banks i.e. low growth and customer migration between banks, rather than growth of the sector as a whole. This means that growth is most likely to come from serving the un (under) banked market in addition to the currently banked market.

The banking market in Palestine is currently undergoing consolidation. Mergers and acquisitions are likely to reduce the current 18 banks to 16 within the 2011 calendar year.

3.1.2. Need for local switching capability and an issuer neutral card acquirer

3.1.2.1. ATM switching

There is currently no local interbank switch service within the borders of Palestine, which allows for the direct switching of card transactions between Palestinian banks.

There are two off-shore channels; the first being switching via VISANet and the second being that of the Jordanian owned banks which switch their transactions via JoNet in Jordan. This therefore exposes the Palestinian banking sector to potential political disruption of its services, as well as driving unnecessary costs into the transaction landscape of Palestine.

3.1.2.2. Card transaction acquiring

Palestine currently has a single card acquirer serving both its local acquiring and international transaction switching needs.

There have been reports that the acquirer advantaged some issuers over others using this dominant position. Moreover the structure provides the merchants with limited scope to negotiate an acquiring rate with the acquirer.

High acquiring costs are inevitably passed on to the consumer either as an increased cost of the transaction, or by way of reduced discounts being offered to card users. The likely consequence of this is a reduced willingness by consumers to use their cards for purchases. It is therefore in the interests of the banking industry, the retail industry and the consumers that an 'issuer independent' card transaction acquirer is established within Palestine, to address the current monopoly position as well as the conflict of interest.

3.1.3. Willingness to assist non-financial institutions into the market space

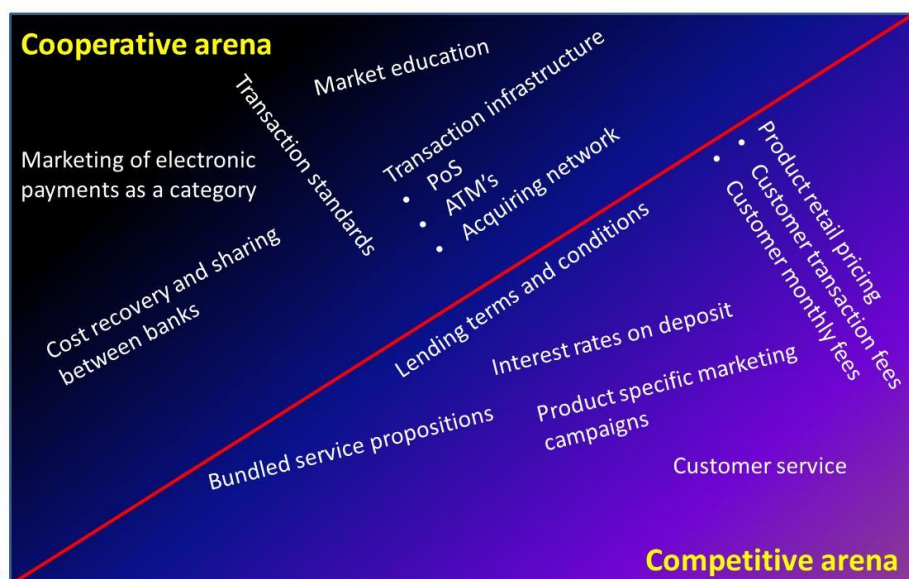
Some of the Palestinian banks have indicated a willingness to assist non-banks, such as the telecom operators and super markets to enter the banking services arena, so that the reach of these businesses can be leveraged to both deepen market penetration of banking services as well as providing cost effective alternate channels to existing customers.

The formation of a new banking services company, with the potential to ultimately allow for the possible inclusion of non-banks in its equity structure, could service this need very well.

3.2.Cooperative vs. competitive space

In establishing a payments industry, it is key to define which arenas are competitive and which are cooperative. Doing this allows for industry wide cooperation in setting the environment in which the necessary infrastructure is established, based upon which the industry as a whole is able to service the community in which it operates.

The following split between cooperative and competitive spheres is proposed:



The payments service space between banks is an area in which it is generally in the interests of banks that all participants cooperate and collaborate to generate a central payments industry in which all banks are able to trade. VISA and MasterCard have become industry standards globally upon this fundamental principle.

Once established, the banks will use this platform as the basis upon which they develop their competitive services and product offerings; while at the same time providing the customer with a cost effective and reliable transactive service.

3.2.1. Cooperation in switching of ATM and POS transactions

Transaction switching is at the heart of all transactive banking as it allows the banks to operate together for the benefit of their customers, both in the consumer as well as the retail sectors. This is the mechanism by means of which all banks interconnect and is fundamental to a stable and efficient transactional service environment.

Given its core nature, the industry should treat switching as a basic necessity for all participants. Therefore all banks should be provided with switching on equal terms, and at equal cost. This provides a level playing field in regard to the infrastructure on

which banks can then compete on service and product. The switching relates to all transactions emanating from all possible channels and payment instruments.

3.2.2. Cooperation in card transaction acquiring

Palestine is a small economy, with a poor population relative to many other countries in the region. From a transactional perspective, this environment implies lower volumes of transactions per capita and in total and lower than average ticket values; both of which affect the economics of providing the payments infrastructure.

In many countries, there is more than one player providing card transaction acquiring and merchant management competing in the space. Given the small size of the Palestinian economy; the ideal model would be to have one 'issuer independent' acquirer. This would allow a single operation (owned jointly by the banks) to serve the needs of all issuers at the lowest possible, industry wide, operational cost through optimizing the economies of scale while also avoiding any conflicts of interest involved in a sole acquirer competing as an issuing bank.

3.3. Strategic implications for the Palestine banking industry

By global standards, Palestine's electronic payment industry is relatively underdeveloped. As can be seen in the table below, the proportion of cash in the economy in Palestine is around five times that of the UK and about four and a half times that of Turkey.

Value of cash as a % of real GDP

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|-------------------|-------|-------|-------|------|--------------|
| UK | 3.38 | 3.36 | 3.37 | 3.40 | 3.81 |
| Turkey | 3.11 | 3.63 | 3.34 | 3.42 | 4.12 |
| Brazil | 3.26 | 3.62 | 3.87 | 3.85 | 4.20 |
| Mexico | 4.11 | 4.33 | 4.41 | 4.76 | 5.34 |
| India | 11.59 | 11.77 | 11.94 | 12.4 | 12.83 |
| Palestine* | | | | | 19.43 |

*Based on PMA estimate

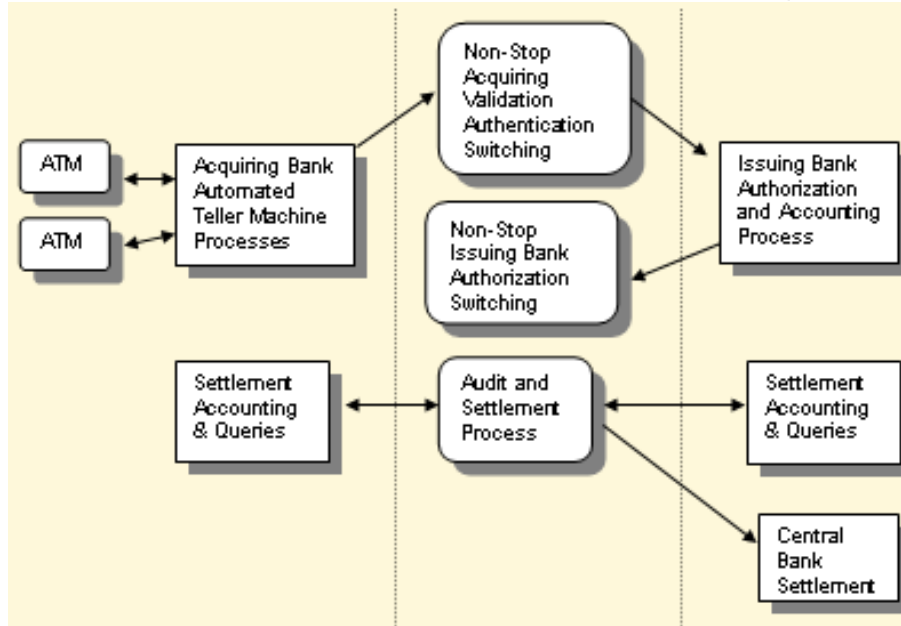
The proportion of wealth outside the banking system means that the banking sector has less funding to intermediate and aggregate for capital investment projects. Resolving this requires the development of a pervasive electronic funds industry, which is supportive of the banks and which encourages consumers to use electronic payment instead of cash.

Other countries have tried running a multitude of switches to serve the various needs of the industry, but have ultimately found that it better served the interests of an industry so clearly driven by volumes, to combine them into a single, industry wide company.

The following are examples of other countries, which have implemented a single national switch.

3.3.1. Example: South Africa – BankservAfrica

Prior to the establishment of BANKSERV in the first half of 1993, the banking industry



in South Africa jointly owned several companies that provided shared services to the banks in a number of different payment channels. The companies in this sector each followed their own direction and operated in their separate silos. There was clearly a need to consolidate them into a single structure. An Inter-bank task group was appointed to investigate the feasibility of this proposal and in March 1993, the banking industry reached agreement and founded BANKSERV.

The following companies were incorporated into BANKSERV:

- The ACB (Automated Clearing Bureau)
- Saswitch (Pty) Ltd. (South African real time switch)

Subsequent consolidation helped streamline the non-competitive operations of banks and the resultant benefit in economies of scale has significantly contained payment related costs.

The following graphic depicts the role that the Bankserv real time switch (Saswitch) plays in the process of switching interbank ATM transactions.

3.3.2. Example: Ghana - GhIPSS

The Ghana Interbank Payment and Settlement Systems Limited is a subsidiary of the Bank of Ghana, which was set up in 2007 with the following mandate:

1. To set up and operate the National Switch with smartcard payment system and the provision of smartcard services
2. To manage the Cheque Truncation system

3. To operate an Automated Clearing House (GACH) for direct debit and direct credit
4. To operate a help desk to assist the payment system in general

GhIPSS responsibility is to manage, develop and promote these systems on an ongoing basis.

3.3.3. Example: Visa Jordan Cards Services (VJCS)

The VJCS example is closest to the BSC case as well as in terms of environmental factors such as the society, banking behaviour, cultural and demographic architecture. Moreover, around 40% of the banks operating in Palestine are Jordanian banks and most of them switch currently through VJCS and are familiar with its services.

VJCS has operated in Jordan since 1991 and serves most banks (17) in Jordan issuing Visa cards and connecting around 20 Member banks on JoNet. VJCS Paid up Capital is 3.9 M JOD with a total number of 10 shareholders/owners.

VJCS and its Switch Management Subsidiary (JoNet) provide the following services:

- 1) Switching services: Switch ATM between VJCS/JoNet member banks
- 2) Switch POS transactions to VJCS/JoNet member banks and International Gateways.
- 3) Interface with International Gateways.
- 4) CMS: Card Management System for all type of Cards (Debit, Credit, Charge, Prepaid)
- 5) POS Acquiring Including POS/Terminal Management, Operating around 15,000 POS Terminals
- 6) Merchant Management.
- 7) Daily Clearing and Settlement with Merchant and Issuers-Banks.
- 8) Call center 24/7 for VJCS/JONET Services Including Merchants and Member banks
- 9) ATM Driving Outsourcing services (No Field Services)
- 10) E-Commerce Acquiring

4. Opportunity analysis

4.1. The banked Palestinian market

4.1.1. Market size

Table 1. Bank Accounts, as of 31 December, 2010.

| | |
|-----------------------|------------------|
| Savings Accounts | 1,061,609 |
| Time Deposit Accounts | 215,107 |
| Current Accounts | 796.242 |
| Other Accounts | 112,836 |
| Total Accounts | 2,185,794 |

| | |
|--|------------|
| Total Bank Clients (December 2009) | 1,228,414 |
| Population, Total | 4,225,710 |
| Population, ages 15-64 | 2,439,756 |
| Bank Clients as % of Population aged 15-64 (est.) | 50% |

Sources: PMA; World Bank, *World Development Indicators* 2009.

Most Palestinian adults have access to a deposit account. As of the end of 2010, over 1.2 million Palestinians held bank accounts, nearly all of which were savings, current, or time deposit accounts. Many clients held more than one account. Assuming that children held few of these accounts,¹ approximately half of working-age Palestinians (ages 15-64) had at least one bank account.

Of the more than 2 million bank accounts in Palestine, less than 20% are connected to electronic channels. As of the end of 2010, there were just over 308,962 debit/VISA Electron cards, 71,698 ATM (non-debit) cards, and about 37,488 credit cards.²

Use of ATMs is growing rapidly. In 2009, over 4.6 million transactions valued at USD 867 million were conducted at ATMs and in 2010 the number of cash withdrawals at ATMs had grown to 11.3 million transactions valued at USD 1,295 million – a growth of 146% and 49% respectively.

Use of PoS networks remains low. While each of the 333 ATMs in Palestine processed an average of 34,000 transactions in 2010 (15,000 in 2009), each of the 2314 PoS devices only processed 164 transactions in that year (170 per PoS in 2009). Of the number of transactions conducted at the PoS, about 90% were credit card transactions and only about 10% were debit/VISA Electron cards.³

4.1.2. How the BSC would benefit the banked market

The BSC would provide the banked market with more convenient and lower cost access to their accounts and credit facilities. They would be able to use their cards on the ATMs and PoS of other banks. A local national switch should also reduce the costs of switching for the banks which should be reflected in pricing to their customers. This should play a significant role in encouraging a greater acceptance of electronic banking in Palestine.

4.2. The un/underbanked Palestinian market

4.2.1. Market size

There are approximately 2.4 million adults in Palestine of which 1.2 million hold some form of bank account but the majority of these are savings accounts. Many institutions do not support customer transactions over savings accounts using a card. It is therefore likely that more than a million adults are effectively excluded from transactional banking.

¹ The population aged 65 or older only constitutes approximately 3% of the total population in Palestine. See CIA World Factbook, [West Bank](#) (2010); CIA World Factbook, [Gaza Strip](#) (2010).

² PMA statistics.

³ PMA statistics.

4.2.2. How the BSC would benefit the un / under banked market

The BSC would encourage the banks to offer products which may be more appropriate to the needs of the population who they currently do not serve. They would be able to do this because their costs would be lower and the switch would be able to be more flexible in being able to accommodate new products. These could include, for example; prepaid cards for low income and temporary employees; cards that can be used to receive contributions from the Department of Social Services, Zakah Fund payments or insurance payments, cardless ATM cash withdrawals. These would all add greater security and convenience to customers.

4.3. The market opportunity

4.3.1. Current Palestinian transactional banking market size⁴

As of the end of 2010, there were 308 962 debit/VISA Electron cards, 71 698 ATM (non-debit) cards, and about 37 488 credit cards.⁵

Credit/Debit Cards⁶ 31/12/2010

| Total | Unit | Description |
|------------|--------|--------------------------------------|
| 333 | No. | ATMs |
| 2,314 | No. | POS |
| 37,488 | No. | Credit Cards |
| 71,698 | No. | ATM Withdrawal Cards |
| 308,962 | No. | Debit Cards & Visa electron |
| 11,318,416 | Volume | Cash Withdrawal Transactions on ATMs |

⁴ Source: PMA

⁵ ABP statistics.

⁶ Source: ABP statistics

| | | | |
|-----------------|--------|--|--------------------------------------|
| \$1,295,796,312 | Value | | |
| 36,037 | Volume | Through Debit Cards | POS Transactions in Palestine |
| \$2,030,939 | Value | | |
| 344,079 | Volume | Through Credit Cards | |
| \$72,761,451 | Value | | |
| 2,519,003 | Volume | Registered transactions using: (Debit Cards & Visa electron) | |
| \$610,058,412 | Value | | |
| 614,416 | Volume | Registered transactions using: (Credit Cards) | |
| \$77,342,141 | Value | | |

4.3.2. Retailer market sizing

In the merchant environment, the addressable market is the 28,951 merchants who have a monthly turnover in excess of \$1,800. These merchants operate in the following sectors⁷:

| Economic Activity | No. of Est. | Total No. of workers | Total Turnover(in thousand USDs) |
|--------------------------------------|--------------------|-----------------------------|---|
| Retail Total | 15052 | 38522 | 686,479 |
| Post and Telecom Services Total | 81 | 4441 | 658,292 |
| Education Total | 1101 | 15340 | 195,766 |
| Healthcare and Social Services Total | 1709 | 11171 | 184,753 |
| Restaurants and Hotels Total | 2217 | 9040 | 156,544 |
| Car Fixing Total | 2959 | 9010 | 121,847 |
| Other Trading Activities Total | 1547 | 5550 | 82,356 |
| Land Freight Total | 409 | 3356 | 67,767 |

⁷ Source: Palestinian Central Bureau of Statistics.

| | | | |
|---|---------------|----------------|------------------|
| Cars Trading Total | 312 | 999 | 57,313 |
| Petrol Stations Total | 257 | 1460 | 46,751 |
| Other Services Total | 1245 | 3052 | 41,463 |
| Vehicles-Related Retail Total | 763 | 2201 | 41,431 |
| Recreation, Culture and Sports Total | 608 | 3312 | 35,522 |
| Tourism Agencies and Support Services Total | 230 | 889 | 29,467 |
| Research and Development Total | 33 | 367 | 10,207 |
| Computer trading and services Total | 134 | 417 | 8,824 |
| Business and Personal equipment leasing Total | 142 | 474 | 8,780 |
| Real Estate Services Total | 92 | 224 | 8,589 |
| Bicycles Trading and Fixing Total | 60 | 227 | 2,001 |
| Grand Total | 28,951 | 110,052 | 2,444,161 |

Above table is sorted by total turnover value in descending order

4.3.3. Indicative sizing of the opportunity

The Palestinian electronic funds industry has developed relatively quickly over the past 3 years, and has demonstrated robust growth, particularly in the ATM cash withdrawal arena. There is still significant scope for growth, particularly in the field of PoS transactions. The central European country of Kosovo has been selected as a comparable benchmark for Palestine.

4.3.3.1. Benchmark Kosovo

Kosovo is a small country in the Balkans with a population of approximately 2 million inhabitants or 1,192,407 adults. The literacy rate is 91%. GDP per capita for 2010 was estimated to be \$6,600.

Due to similarities in terms of number of: adult population, literacy rate and Per capita GDP, it is assumed that it is meaningful to benchmark Palestine against Kosovo. It can be seen that Kosovo has more than four times the number transactions at PoS but Palestine has nearly twice the number of ATM cash withdrawals.

The Central Bank of Kosovo owns and operates a central switch which provides the interbank clearing for both small and large value payments, establishes the rules and procedures and sets the standards. The system is called the Electronic Interbank Clearing System (EICS) and includes a system for bill payments called the KosGiro system. The participants consist of 8 commercial banks and the government Treasury department.

The following tables depict the current and recent history of electronic banking in Kosovo relative to current activity in Palestine.

| | Kosovo | | Palestine | |
|----------------------|------------------|----------------------|--|---------------------------|
| | As at March 2011 | Per 1000 inhabitants | At same ratio of service to population | Current actual (Dec 2010) |
| Cash cards | 577,479 | 484.26 | 576,309 | 71,698 |
| Debit cards | 516,946 | 433.5 | 515,901 | 308,962 |
| Credit cards | 45,520 | 38.17 | 45,425 | 37,488 |
| Active e-money cards | 9,233 | 7.74 | | |
| ATMs | 425 | 0.36 | 428 | 333 |
| PoS | 6195 | 5.2 | 6,188 | 2,314 |

| | Kosovo | | | Palestine | | |
|----------------------|-------------|---------------|------------------|-------------|---------------|------------------|
| | Number 2010 | Value \$ 2010 | Avg ticket value | Number 2010 | Value \$ 2010 | Avg ticket value |
| ATM cash withdrawals | 6,960,469 | 929,924,663 | 133.60 | 11,318,416 | 1,295,796,312 | 114.49 |
| PoS cash withdrawals | 35,574 | 37,792,139 | 1,062.35 | - | - | - |
| Card payments at PoS | 1,813,399 | 137,698,176 | 75.93 | 380,116 | 74,792,390 | 196.76 |

4.4. Competitive positioning

The proposed services of the BSC can be divided into those that are in a competitive arena within Palestine, and those that are not. To clarify this point, the services are separated as below:

1. Pure switching of ATM transactions has no Palestinian competitors, but has international substitutes: JoNet and VISAnet
2. Acquiring business – BSC will be in competition with Bank of Palestine in the card acquiring business
3. International card gateway - BSC will be in competition with Bank of Palestine

The current pricing in the Palestinian market means that if a customer withdraws cash from the ATMs or branches of his own bank using an ATM or debit card there is no charge for this cash withdrawal. ATM cash withdrawals from other bank's ATMs incur fees which are based upon a fixed cost of \$2.50 plus an ad valorem fee.

In the case of a Jordanian bank card being presented at another Jordanian Bank ATM, the transaction fee is set:

1. JD 0.500 for Cash withdrawals (JD 0.350 for Acquirer Bank-ATM Owner, And JD 0.150 to the Switch)
2. JD 0.100 for Balance Inquiry (JD 0.100 for Acquirer Bank-ATM Owner, while D 0.000 to the Switch)

4.4.1. ATM switching

4.4.1.1. Anticipated reactions from JoNet and VISAnet

Given that JoNet is situated in Jordan, and is primarily focused on servicing the Jordanian market, it is deemed unlikely that JoNet will act to defend their current market position in Palestine. The only likely impact, which JoNet will have on the BSC, is that, as a viable substitute, they set the maximum pricing on services delivered to the Jordanian banks.

The BSC will be a registered VISA processor, on behalf of the acquiring bank and therefore no competitive issues are anticipated from VISAnet.

4.4.2. Card Acquiring

4.4.2.1. Anticipated reactions from Bank of Palestine

Once the BSC launches, Palestine will have two competing card acquirers in the market; the Bank of Palestine and the BSC.

To protect their investment in the acquiring field, the Bank of Palestine has begun to deploy the following defensive strategies:

- 1) Increase their current rate of deploying terminals in the market.
- 2) Possibly reduce their merchant commissions.
- 3) Extend the PalPay suite of value added services to differentiate their service from the BSC service.

4.4.2.2. Mitigations which BSC should implement

It is strongly advised that the interests of the industry would be better served by the merging of the BSC and Bank of Palestine acquiring operations, to eliminate duplicated costs, and to allow for a more rapid rollout to the merchant base.

If this is not possible, then the following mitigation methods exist:

- 1) Conduct an aggressive terminal rollout plan into the market, leveraging the reach and capability of all partner banks.

- 2) Price merchant commissions aggressively in the market, and adopt the position of price leader for any downward movement in the merchant acquiring rates.
- 3) In the launch product suite, there is no direct competitor for the Bank of Palestine value added services. What the BSC does have, which the Bank of Palestine does not support, is cash back at point of sale. The fees paid for this service are likely to be similar in total value to those offered by the Bank of Palestine for its value added service, but, once accepted by the market at a level such as in the UK, then cash back is a more frequent use product. This is of value to the merchant, as his primary focus is to drive feet into his store through a multitude of products and services.

4.4.3. International Card Gateway

4.4.3.1. Anticipated reactions from Bank of Palestine

Selection of the Visa Access Point (VAP) is within the control of the issuing and acquiring banks, therefore the Bank of Palestine is able only to control the route into and out of Palestine for their own cards and terminals which they acquire.

4.4.3.2. Mitigations which BSC should implement

It is strongly advised that the interests of the industry would be better served by the merging of the BSC and Bank of Palestine acquiring operations, to eliminate duplicated costs, and to allow for a more rapid rollout to the merchant base.

If this is not possible, then the BSC will have to compete with the Bank of Palestine for the role of VAP to the other issuers. Since this is an undifferentiated service, and has no visible impact on the merchants or the card holders, competing in this space will most likely centre on price and systems stability.

4.5. Market research

Market research for the Banking industry consisted of a series of one-on-one meetings between the Project team and the following banks in Palestine:

- 1) Arab Bank – Jamal Hurani
- 2) Cairo Amman Bank – Josef Nesnas
- 3) Bank of Jordan – Johny Samir Zeidan
- 4) Housing Bank for Trade and Finance - Mahmoud Ahmad Al Takruri
- 5) Palestine Islamic Bank – Khitam Ali Abu-Aita
- 6) Palestine Commercial Bank - Masoud Arda
- 7) Arab Islamic Bank - Sami Saidi

During these meetings, the following topics were discussed on their institution's interest and thoughts on:

- 1) Using the switching and acquiring services of the BSC
- 2) The ownership structure of the company
- 3) The capital structure of the BSC

- 4) Becoming shareholders in the BSC
- 5) The pricing policy of the BSC
- 6) The future services of the BSC

4.5.1. Bank interest in using the switching and acquiring capability of the BSC

All banks interviewed indicated a desire to work with the BSC, in the role of client. Their reasoning hinged around the following topics:

- 1) A clear need to see the payments industry formalized, and structured.
- 2) A desire for a bank neutral service provider to support the industry.
- 3) The need to align Palestine with global trends.
- 4) The desire to share the existing, deployed, payments infrastructure in a cost effective manner, to the benefit of all Palestinian clients and banks.

4.5.2. Bank thoughts on the ownership structure of the BSC

There was clear support for the concept of a balanced board for the BSC, and structured governance procedures which would preclude any single bank controlling or directly interfering in the operations of the BSC.

There was less emphasis on the sharing of economic proceeds from the BSC, with a clear message that the structuring of the industry was more important than making direct returns from the company, although the company's ability to generate attractive investment returns was seen as essential to secure bank board backing for any investment made in the BSC.

4.5.3. Bank thoughts on the capital structure of the BSC

Many suggestions were made in this regard, with the common consensus steering towards using share capital to fund the establishment of the core switch, and to fund the initial operational cash flow of the company, while loan capital could be used to finance the deployment of terminal equipment.

Some suggested that a differentiated contribution structure be implemented, based upon capital capacity of the various banks, while others indicated that equal control would probably require equal capital exposure to the company.

It is clear that this topic will be an important one in engaging the banks at the commencement of the implementation phase but the consensus seemed to be that the BSC is necessary and the necessary funding will be found for it. Resolution of this discussion by the banks, through the ABP will be essential prior to the commencement of any implementation project.

4.5.4. Bank interest in becoming a shareholder of the BSC

All banks require board approval to make any capital investment in the BSC. Therefore, they were not in a position to make an unqualified undertaking to participate in the BSC shareholding.

Notwithstanding this governance aspect, all banks clearly understand the need to be a shareholder in the venture, and the need to work together with the other banks to build an entity to enable industry wide cooperation. Some touched on the strategic risk to their organization of 'being left behind' the industry, citing this as a clear motivation to participate.

4.5.5. Bank thoughts regarding the pricing policy of the BSC

Pricing parity with JoNet was tested against the banks, who all indicated satisfaction with this pricing level as an initial price for the services delivered to the banks.

To clarify, VJCS prices are of two types, periodic and transactional

The periodic charges are as follows:

- 1) Owners (banks who are shareholders in VJCS):

JONET Member fees (Paid Once): 20,000 JOD

JONET Annual Member fees (4600) JOD Paid Quarterly.

- 2) Non-Owners (banks who are not shareholders in VJCS):

JONET Member fees (Paid Once): 20,000 JOD

JONET Annual Member fees (15000) JOD Paid Quarterly.

4.5.6. Bank thoughts regarding the future services of the BSC

The banks were asked to indicate their thoughts regarding the next products which they would like to have the BSC deliver to them. These are:

- 1) Mobile Banking
- 2) Card Issuing
- 3) Installation of unbranded ATM's
- 4) Taking over ATM management and cashing

5. Conclusion

The Banking Service Company delivers value to its shareholders in two ways; firstly by way of providing an essential service, which is core to the operations of their businesses, and secondly by providing dividend returns to its shareholders.

The benefits within the shareholder businesses are the following:

- 1) Providing their customers with an acceptance infrastructure at which to use their cards
- 2) Facilitating moving funds between banks

- 3) Improving electronic funds usability which leads to more funds being retained in bank accounts

The financial returns in terms of dividends from the company are more fully explained under the financials section of the Business Plan.

The business is designed to:

- Offer a central switching service in Palestine:
 - Connecting the ATMs of all participating banks to each other, thus facilitating asset sharing and customer convenience
 - Connect POS devices in as many merchants as possible to the issuers
 - Manage the acquiring relationship with those merchants on behalf of the banking sector as a whole
- The Service (and equity in the business) will be offered to all banks in Palestine