

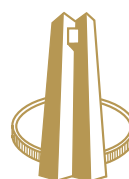
Joint consultation paper

Regulatory proposals on payroll deductions



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA



South African Reserve Bank

Stakeholders are invited to forward their comments on this joint consultation paper by 30 April 2018. Any comments may be addressed to: npsdirectives@resbank.co.za.

<http://www.resbank.co.za>



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1. Introduction

- 1.1 In recent years, the South African Reserve Bank (SARB) has become aware of an escalation in the number of entities offering payroll deduction services. These services are offered with prior agreement between employers and employees and, in certain instances, are requested or initiated by financial institutions, including financial intermediaries.
- 1.2 There is currently no single legally acceptable definition of 'payroll deduction'. Generally, a payroll deduction is understood to refer to the withholding or withdrawal of an amount by an employer from the employee's salary/earnings for the payment to a third party or to discharge an obligation to the employer. This happens before the salary or earnings are paid into the employee's bank account.
- 1.3 Essentially, the offering of payroll deduction services provides preferential treatment to certain beneficiaries as their payments are processed before the remaining funds are transferred to the employee's banking account. Only thereafter are other creditors or service providers allowed to collect on the remaining available funds credited to the bank account of the employee. Although payroll deduction systems may be beneficial to financial services providers and enhance employees access to broader financial services, significant shortcomings have been identified relating to the payroll deduction service and its negative impact on the financial system and vulnerable employees.
- 1.4 Following the concerns referred to in 1.3 above, the SARB, in collaboration with National Treasury, initiated the investigation into the payroll deduction system in early 2016. Structures were established for this purpose which included the establishment of the Payroll Deductions Steering Committee (Steering Committee) and a working group. The Steering Committee is the main driver of the process. It comprises representatives from the SARB, National Treasury (Financial Sector Policy and Office of the Accountant-General), Department of Labour (DoL), Department of Trade and Industry (the dti), National Credit Regulator (NCR), Department of Public Service and Administration (DPSA), and the Financial Services Board (FSB). The working group comprises representatives from the SARB, National Treasury, NCR, FSB and the dti.
- 1.5 The engagements within the Steering Committee and the working group highlighted the far-reaching impact of payroll deductions on the roles of the various government departments and regulatory authorities across the various sectors. This necessitated a collaborative approach between the relevant government departments and regulatory authorities for payroll deduction issues to be addressed through clear and stringent regulatory interventions.
- 1.6 The collaborative approach is in line with the current South African financial sector regulatory reforms aimed at providing a coordinated, overarching regulatory framework that can be applied consistently and uniformly across the financial services sector. The reforms also aim to provide the institutional structure necessary to implement a more comprehensive and consistent strategy to improve market conduct and the safety of the financial system, and deliver better outcomes for consumers.
- 1.7 Accordingly, the regulatory proposals explored in this document seek to achieve a safe and efficient payroll deduction system that works in the interests of employees and enhances the socio-economic conditions of employees. The proposals are also sought to be achieved through a framework that promotes the safety, efficiency and integrity of the payroll deduction system and will form part of the wider initiative taken by government to deal with the problem of household over-indebtedness.

2. Purpose and objective

- 2.1 The purpose of this paper is to consult with stakeholders involved in or affected by payroll deductions, such as trade union bodies, financial services providers, employers, consumer groups and other relevant stakeholders on identified issues associated with voluntary or discretionary payroll deductions as well as possible regulatory options to address these issues.
- 2.2 The objective of the consultation is to solicit stakeholders' input on the most appropriate regulatory option that should be adopted to address payroll deduction-related issues. The regulatory option will seek to harmonise and align the legislative requirements adopted by various government departments and relevant regulatory authorities with regard to payroll deductions. The optimal regulatory option should promote the safety, integrity and efficiency of the broader financial system (including the national payment system (NPS)), and benefit/protect employees.

3. Scope

- 3.1 This paper focuses on addressing issues relating to discretionary or voluntary payroll deductions. In this context, voluntary payroll deductions refer to payments made to third-party creditors/service providers (such as insurers or credit providers) or a payment to an employer where there is no statutory or court order obligation. Payroll deductions emanating from statutory, court order, collective agreement, and arbitration award are not impacted by the regulatory options proposed in this paper. The distinction between statutory, court order, collective agreement, and arbitration award payroll deductions, as well as voluntary or discretionary payroll deductions are set out in paragraph 4 below.
- 3.2 Further, the paper covers all employees in South Africa from both the public and private sectors.
- 3.3 Deductions from social grants are excluded from the scope of this paper as grants are not regarded as remuneration.
- 3.4 The payment of contributions to benefit funds that are regulated by section 34A of the Basic Conditions of Employment Amendment Act 11 of 2002 are also excluded. These include pension, provident, retirement, medical aid or similar funds.

4. Types of payroll deductions

- 4.1 Payroll deductions may be categorised as statutory deductions, court order deductions, collective agreements deductions, arbitration award deductions as well as discretionary or voluntary deductions. Box 1 provides a description and examples of each type of payroll deduction.

Box 1: Types of payroll deductions

Statutory, court order, collective agreement, and arbitration award deductions

- a. Statutory payroll deductions are those deductions that are authorised by legislation such as the Income Tax Act 58 of 1962 (i.e. Pay As You Earn) and Unemployment Insurance Contributions Act 4 of 2002 (i.e. Unemployment Insurance Fund contributions).
- b. Court order deductions are a judicial debt collection through the court system, including emolument attachment orders (EAOs) (commonly known as garnishee orders and administration orders).
- c. A collective agreement deduction is a deduction in terms of a written agreement concerning terms and conditions of employment or any other matter of mutual interest concluded by one or more registered trade union; or one or more employer; or one or more registered employers' organisation. 'Council' includes a bargaining council and a statutory council.
- d. An arbitration award payroll deduction is a deduction made in terms of an arbitration awarded under the Labour Relations Act 66 of 1995.
- e. Section 34(b) of the Basic Conditions of Employment Act 75 of 1997 precludes employers from making any deductions from employees' salaries unless "the deduction is required or permitted in terms of a law, collective agreement, court order or arbitration award".

Voluntary or discretionary payroll deductions

- a. A voluntary or discretionary payroll deduction is any deduction that is not authorised by a statute, court, collective agreement or arbitration award. The most common type of these deductions relates to secured loans (e.g. home loan), unsecured loans (e.g. personal loan) and other savings deductions.
- b. Section 34(a) of the Basic Conditions of Employment Act 75 of 1997 precludes employers from making any deductions from employees' salaries unless "the employee in writing agrees to the deduction in respect of a debt specified in the agreement".

5. Regulatory objectives and principles

- 5.1 In exploring the various regulatory proposals, the regulators seek to achieve a stable and effective payroll deduction system that works in the interests of employees and enhances the socio-economic conditions of employees through a framework that promotes:
 - a. the safety and efficiency of the payroll deduction system;
 - b. the fair treatment and protection of employees;
 - c. the integrity of the payroll deduction system;
 - d. the transparency of the payroll deduction system;
 - e. the prevention of financial crime (e.g. fraud in the payroll deduction system); and
 - f. financial inclusion.
- 5.2 In addition, the benefit to employees and the enhancement of the socio-economic welfare of employees should be achieved through the adoption of the following principles:
 - a. Protect employees from predatory or unfair lending and/or selling practices. This includes employers inducing employees to take up certain products that may not be beneficial to them.
 - b. Afford employees the benefit of access to finance at reasonable rates.
 - c. Promote savings and productive credit over unproductive credit and other financial products and services that may erode the enhancement of wealth building.
 - d. Minimise the potential for regulatory arbitrage and regulatory avoidance.
 - e. Minimise the potential for conflicts of interest, especially where the employer or representative persuades the employees to take up a product in which the employer has a vested interest.
 - f. Ensure that regulatory requirements are easily understood by providers and consumers.
 - g. Ensure that the provisions for the protection of employees are clear.

² <https://www.resbank.co.za/BanknotesandCoin/Upgrade1Banknotes/Documents/SA%20Reserve%20Bank%20Act%2090%20of%201989.pdf>

³ [https://www.resbank.co.za/RegulationAndSupervision/NationalPaymentSystem\(NPS\)/Legal/Documents/NPS%20Act.pdf](https://www.resbank.co.za/RegulationAndSupervision/NationalPaymentSystem(NPS)/Legal/Documents/NPS%20Act.pdf)

6. The National Payment System Legal Framework and preferential payments

- 6.1 Section 10(1)(c)(i) of the South African Reserve Bank Act 90 of 1989, as amended (SARB Act) empowers the SARB to “perform such functions, implement such rules and procedures and, in general, take such steps as may be necessary to establish, conduct, monitor, regulate and supervise the payment, clearing or settlement systems”.² Furthermore, in terms of the National Payment System Act 78 of 1998 (NPS Act), the SARB is required to provide for the management, administration, operation, regulation and supervision of payment, clearing and settlement systems in the Republic of South Africa, and to provide for connected matters.
- 6.2 The NPS encompasses the entire payment process, from payer to beneficiary, and includes settlement between banks. The process includes all the tools, systems, mechanisms, institutions, agreements, procedures, rules or laws applied or utilised to effect payment. The NPS enables the circulation of money, that is, it enables transacting parties to exchange value.
- 6.3 A payroll deduction service that enables payments to be effected to beneficiaries is regarded as a ‘payment system’. A ‘payment system’ is defined in the NPS Act as “a system that enables payments to be effected or facilitates the circulation of money and includes any instruments and procedures that relate to the system”.³ Payroll deduction services create a closed-loop payment system that limits access and constrains competition as ‘preferential treatment’ is given to the payment instructions included in payroll deductions.
- 6.4 If the payroll deduction system is allowed to expand to include more types of non-statutory deductions, it would have the potential to negatively impact the broader NPS by becoming a general purpose payment system. Preferential treatment of payment instructions is allowed in terms of the NPS Act, provided these payment instructions are prescribed by law.

7. Developments in the payroll deductions landscape

- 7.1 The 1990s saw a dramatic increase in the demand for credit, particularly in the lower-income market. Borrowers with minimal financial literacy often became over-indebted through the reckless lending practices of some lenders. With employees’ finances placed under strain, employees would often have very little or, in some cases, near zero take-home pay.

Box 2: Growth in consumer indebtedness

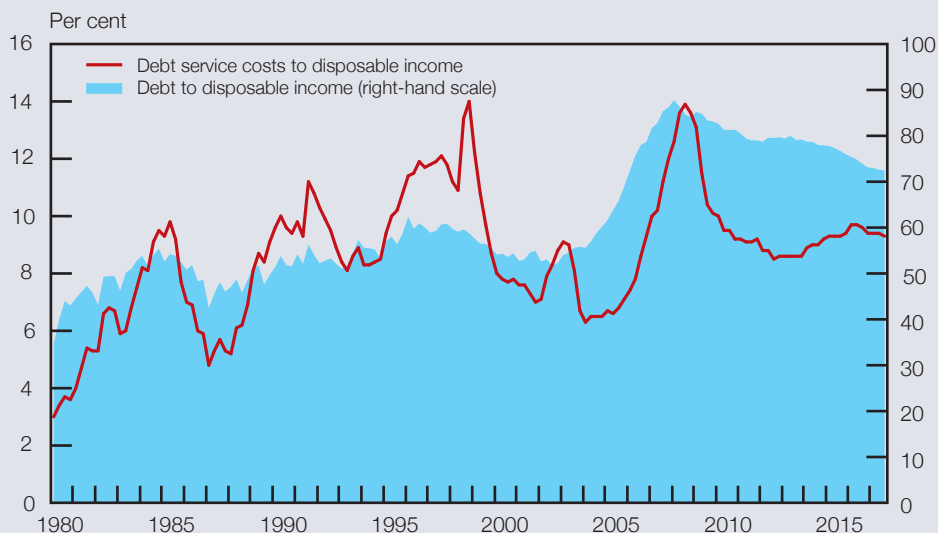
According to the National Credit Regulator (NCR), as at June 2017 credit bureaus held records for 24.78 million credit-active consumers compared to 20.21 million in June 2013, while the percentage of consumers who are three or more months in arrears increased slightly from 21.1% in June 2013 to 22% in June 2017.

Additional data from the South African Reserve Bank (SARB) indicates that household debt as a percentage of disposable income increased from around 50% in the 1980s to 73% in June 2017, peaking at 83% in March 2009.

The SARB also calculates the ratio of debt-service costs to disposable income. This ratio was 9.4% in June 2017 (see figure 1). However, this may understate the servicing costs faced by many households as it is lowered by the dominant mortgage rate, rather than being more heavily weighted towards the more expensive types of credit that are the only types available to many households.¹

¹ A study conducted by Eighty20 for National Treasury in 2013 estimated that household debt- servicing costs based on the value of the gross debtors book by credit category, together with assumptions about the total cost of credit in each category, was likely significantly higher (approximately 29–30%) than the 9% calculated by the SARB at the time.

Figure 1: Household debt to disposable income ratio



- 7.2 In 2000 the Minister of Finance published the draft Treasury regulations on government payroll deductions prohibiting discretionary deductions on the personnel salary system (PERSAL system). The publication of the draft regulations arose from the severe debt crisis that many of its employees faced due to the rampant abuse of government's payroll system by various players in the financial services industry and the ease with which civil servants could access unaffordable levels of credit and insurance cover. Specifically, government had identified that a total of about 497 000 state employees¹ had non-statutory deductions made from their salaries, and the vast majority of these were repayments on microloans. Of those employees subjected to non-statutory deductions, each had an average of 2.1 loans, illustrating the debt spiral that could escalate from taking out even one loan.
- 7.3 Moreover, government was gravely concerned at the low level of take-home pay of many employees. Nearly 7 000 employees took home less than R100 a month while a total of 68 659 employees took home less than R600 a month as a result of microloan deductions. The vast majority of these were on salary level 7 or below, which equated to a gross salary of less than R5 783.50 a month at the time.
- 7.4 After the publication of the draft regulations, the Ministry of Finance went through the process of consultation with stakeholders. This resulted in the current regulations for government payroll deductions contained in Chapter 23 of the Treasury regulations in terms of the Public Finance Management Act 1 of 1999. These regulations aim to cap discretionary deductions at 40% of the state employee's salary to ensure that, after the emolument attachment order (EAO) deductions, the employee should still have sufficient means for the maintenance of himself or herself and any other dependants.

Box 3: Review of emolument attachment orders in the public sector

In 2015 the government, under the auspices of National Treasury, appointed a service provider to investigate the extent of abuse of emolument attachment orders (EAOs) in the public service and to implement a process for the ongoing management of EAOs to ensure that all EAOs enforced against salaries of public servants were legitimate. This project, which was implemented in July 2016, dovetailed the Department of Public Service and Administration's (DPSA) Public Service Employee Debt Relief Programme aimed at addressing the over-indebtedness of public sector employees.

The legitimacy of about 121 487 EAOs, with an outstanding balance amounting to R1.9 billion, is under investigation. Results as at July 2016 indicated that the highest number of occurrences of EAOs per employee was 22, followed by 18 and 17 EAOs deducted from employees' salaries on a monthly basis. The highest outstanding debt recovered by EAOs was R1 553 813.04, followed by R1 079 937.56 and R963 396.85 as at July 2016. So far, over R190 million has been saved for employees.

1 http://www.treasury.gov.za/comm_media/press/2000/2000080201.pdf

- 7.5 These regulations were, however, restricted to the government payroll and private sector employees did not benefit from similar regulations.
- 7.6 As a result of the above-mentioned regulations, collectors turned their attention to the NPS and, in particular, the electronic funds transfer (EFT) and automated teller machine (ATM) payment streams. Banks were enticed to provide solutions to afford collection preferences to creditors and sorting-at-source arrangements. Access to preferential payment mechanisms was not available to all lenders, with the result that certain classes of beneficiaries always had access to account holder funds before others. The situation was further aggravated through unscrupulous lending without the necessary affordability tests, which lead to the over-indebtedness of consumers.
- 7.7 Unsuccessful collections and unpaid transactions also increased as some customers would withdraw cash from their bank accounts as soon as funds became available; either assuming that the debit order obligations had already been deducted or evading payment. Some lenders, in an effort to secure their repayment, resorted to illegal methods. These included using the ATM network by retaining the identity document, ATM card and personal identification number (PIN) of their clients, and waiting for salaries to go through and then withdrawing funds due to the creditor. Consumers were exposed to excessive penalty fees by banks as a result of the numerous attempts by microlenders to collect funds owed to them.
- 7.8 In 2003, as a result of the abuses perpetrated in the NPS, the SARB facilitated the establishment of a Collections Forum to examine and formulate solutions to these problems. In 2006, the Collections Forum delivered the launch of the early debit order (EDO) system. In this regard, all EDO payment instructions are randomised, which means that all EDO users who have deductions 'loaded' have an equal opportunity to collect funds owed to them. Moreover, the SARB directive specifically allowed for EDOs to be processed first, after 'bulk credits' (e.g. salaries) had been posted to the customer's account.

8. Potential benefits and challenges of payroll deduction systems

8.1 Potential benefits of discretionary or voluntary payroll deductions

- 8.1.1 The main potential benefit of entering into a payroll deduction agreement for loan repayment is that the consumer is viewed as less of a credit risk to the lender and may therefore receive a lower interest rate. Thus, payroll deductions are said to be convenient for customers as they can lower the costs of borrowing.
- 8.1.2 When credit is used for the accumulation of wealth, such as buying a house or saving to provide for the accumulation of wealth rather than for retail consumption, payroll deductions can play a positive role in improving the quality of lives of employees and fostering financial inclusion.

8.2 Concerns pertaining to discretionary or voluntary payroll deductions

a. Preferential treatment may be anti-competitive

As stated above, the payroll deduction services in effect create a closed-loop payment system that limits access and constrains competition where 'preferential treatment' is given to the payment instructions included in that payroll system.

However, preferential treatment of payment instructions is allowed in terms of the NPS Act and the SARB's Directive 1 of 2017 titled 'Directive for Conduct within the National Payment System in respect of the Collection of Payment Instructions for Authenticated Collections' (Authenticated Collections directive), if prescribed by law. Statutory deductions thus qualify as exceptions to the rule against preferential treatment, given that they are prescribed by law. Any non-statutory

deduction or the repayment of obligations that are processed alongside statutory deductions on payroll are given the same preference as statutory deductions, which results in the introduction of an undesired preferential treatment of certain beneficiaries. This is in conflict with the broader public policy objectives of promoting transparency, competition, inclusion and broader access to the NPS.

b. Real potential to compromise the debit order collection reform

In addition to preferential treatment, the collection of payments using voluntary payroll deductions instead of using the NPS collection methods, such as EFT debits or EDO systems, is a concern for the SARB. The SARB has, over the years, in collaboration with other regulatory authorities developed measures to address preferential debt collection through the EDO system. In June 2017, the SARB further issued a directive for payment stakeholders to develop an authenticated collections (AC) system that will replace the EDO system. The unintended consequences of allowing a non-statutory payroll deduction service that is closed and not interoperable is that it will negate the progress made in terms of the reform of the debit order systems and envisaged resultant benefits. This includes the authenticated early debit order (AEDO) and non-authenticated early debit order (NAEDO) systems, as well as the AC system. If the payroll deduction system is allowed to expand to include more types of non-statutory deductions, it would have the potential of negatively impacting the broader NPS by becoming a general purpose payment system.

Furthermore, since credit-linked payroll deductions provide a preferential deduction for the participating lenders and possibly reduce their credit risk, it will not be beneficial to the credit sector as a whole due to the information asymmetries it promotes. Credit-linked payroll deductions allow credit providers to secure the client's repayment directly from his or her payroll. Although this does reduce the cost and risk for the credit provider, it may also create incentives for excluded credit providers to resort to undesirable practices, such as the retention of bank cards and PIN numbers, or to jump the queue by obtaining EAOs. Payment preferences thus increase the risk in the credit market overall and exacerbate the bias against new entrants and innovation.

c. Risk of abusive intermediation

Payroll deduction results in employers intermediating employee third-party relationships and also carrying the administrative burden to provide such a payment service. The growth in appetite of third parties wishing to enter into arrangements with employers to provide beneficial services and products to employees on condition of employees paying the third parties through the payroll system is a concern. These concerns relate to the fact that some of the products offered are not necessarily beneficial for the employees but are positioned by the employer to unduly persuade the employee to accept them. Moreover, some employers may be highly incentivised to persuade the employees to accept the product(s).

d. Lack of regulation

Apart from section 34 of the Basic Conditions of Employment Act 75 of 1997 and the Treasury regulations relating to government employees, discretionary or voluntary payroll deduction systems in the private sector are not regulated. Clear protection measures are not afforded to these employees and no principles are applied to ensure the safety, efficiency and integrity of payroll deduction systems from an NPS perspective.

e. Socio-economic factors and over-indebtedness

Various financial services entities and other stakeholder communities are of the view that they have valid business cases to collect or facilitate collection through the payroll system due to socio-economic reasons to promote financial inclusion to sectors of disadvantaged and low-income segments of society, and to provide them with affordable access (i.e. low interest rates) to financial products through tailored insurance, savings and credit (including home loan) products. Most, if not all, of these stakeholders have initiated or entered into agreements with

employers through which the employer negotiates preferential rates with a financial institution to provide home loans or other types of loans or products to its employees. In some cases, financial institutions negotiate directly with the employees during the contracting phase.

However, there are no regulations or principles governing payroll deduction arrangements to ensure that the envisaged socio-economic benefits are indeed realised. In certain instances, unscrupulous financial services providers provide products without conducting the necessary suitability tests, or credit providers over-extend credit or extend credit without the necessary affordability tests, which both lead to the over-indebtedness of employees.

f. Potential employee exploitation and abuse

In the absence of an appropriate regulatory framework for discretionary or voluntary payroll deductions, employees remain vulnerable and susceptible to potential exploitation by unscrupulous employers and service providers. Some of the issues identified in this area include the following:

- i. A lack of proper understanding of the legalities, processes and advantages/ disadvantages of a payroll deduction service by some employers and employees, which may result in employee exploitation. For instance, there may be no clarity with regard to the action required by the employer where an affected employee resigns or dies (e.g. whether the employer is required to inform the third parties or pay the obligation in full).
- ii. Weak payroll deduction mandates or improperly authenticated payroll deduction mandates by the employee, which may result in unauthorised deductions from the employee's salary, as well as a lack of clarity regarding the legal protection afforded to both the third party and employee when a payroll deduction mandate is disputed by the employee.
- iii. Whether the employee will be allowed to stop the deductions and, if so, what legal protection would be afforded to the employee for stopping the deductions or the employer for stopping payments as per the employee's instruction.
- iv. Whether the employer is allowed to refuse to accept more voluntary payroll deductions from third parties, as the employer may deem the employee vulnerable to unscrupulous lenders.
- v. A lack of consumer protection platforms available for the escalation of disputes relating to payroll deduction administration, which may exacerbate vulnerability and consumer exploitation as there will be no avenue for dispute resolution.
- vi. Employees may be exposed to fraudulent activities on the part of the employer or the third party, given that the collection activities of the third party are not monitored, as compared to other NPS collection services where the sponsoring bank is responsible for the proper on-boarding of third parties and the monitoring of their activities.
- vii. Employee choices may be limited as normally the third party (or employer) will condition the contract or dictate that the collection of the payment be made through payroll, which leaves the employee with no alternative (e.g. to suggest that payment be collected through the NPS collection mechanisms).

9. Options for regulatory intervention

9.1 Payroll Deductions Notice

Discretionary or voluntary payroll deductions have recently come under the SARB's scrutiny given their potential impact on the safety and efficiency of the NPS, coupled with the concerns raised in 8.2 above. As an initial regulatory intervention, the SARB

issued a 'Notice to stakeholders in the national payment system, financial institutions and other non-bank institutions on payroll deductions in South Africa' (the Notice) in July 2016. The Notice highlighted the negative impact of payroll deductions on the NPS and advised stakeholders and participants in the NPS to refrain from entering into or executing non-statutory commercial arrangements for payroll deduction services as these could potentially contravene the NPS regulatory framework. Stakeholders were also informed of the collaboration between the SARB and National Treasury in investigating the payroll deduction system and practices, and identifying possible ways of addressing the issues associated with this system and practices.

9.2 Proposed regulatory options

To mitigate the concerns and risks identified above, regulatory intervention is required to ensure that the objectives and principles outlined in paragraph 5 are achieved. In this regard, the regulatory community proposes three options outlined in table 1 below to address the shortcomings of the payroll deduction system. These options are assessed against both the objectives and principles in paragraph 5 and additional requirements below. Proposed debt relief shows over-indebtedness to still be a huge problem in South Africa and that it should be curbed. The regulators are open to receiving submissions on other options that are not proposed in this paper. However, the suggested option/s should indicate the advantages, disadvantages/unintended consequences, proposed regulatory changes and objectives/principles justifying the option.

Table 1: Payroll deductions regulatory options

Option 1: No access to payroll voluntary deductions; only allow statutory, court order, collective agreement and arbitration award deductions	
Advantages	<ol style="list-style-type: none"> 1. Less complicated option, as no further decision-making is required from the employer's side beyond statutory, court order, collective agreement and arbitration award deductions. 2. Promotes the efficiency and effectiveness of the current NPS collection mechanisms, as collectors have to collect through the NPS. 3. The playing field is levelled as no preference is created in respect of providers or products. 4. Employees are protected as the potential for unauthorised deductions is eliminated. 5. Provides legal certainty and enhances consumer protection – customers can dispute collections directly with collectors.
Disadvantages/unintended	<ol style="list-style-type: none"> 1. Socio-economic – this may affect employee benefit programmes offered by employers, thereby decreasing employer willingness to provide the employee with financial assistance. 2. Employees may forfeit long-term benefits. 3. Increased financial exclusion – employees may lose the cost-effective benefit of paying through payroll.
Proposed regulatory changes	<ol style="list-style-type: none"> 1. No regulatory framework required. 2. Issuance of a directive/standard prohibiting voluntary payroll deductions.
Objectives/principles justifying the option	<ol style="list-style-type: none"> 1. Increases access and competition in the NPS – all collecting parties (including employers) will use the current and future regulated NPS collection systems. 2. Promotes the integrity and effectiveness of the NPS. 3. Promotes customer protection.

Option 2: Limited access to voluntary payroll deductions; enhance and adopt principles of the current regulations governing government payroll deductions

Advantages	<ol style="list-style-type: none"> 1. Allows for voluntary payroll deductions that are beneficial to the employees, especially in the long term, which focus on wealth creation (mortgage, savings, retirement annuities), thus ensuring that employees do not become a burden to the state in the future and fostering financial inclusion. 2. Provide some access to regulated service providers into the payroll system.
Disadvantages/unintended	<ol style="list-style-type: none"> 1. Employers will need to ensure that their payroll systems are modified accordingly to accommodate payroll deduction changes. 2. Some financial services providers may feel disadvantaged as their type of deductions may not be allowed. 3. Employees' choices may be restricted with regard to the type of payments allowed through payroll. 4. Employees who work for smaller firms may be disadvantaged if their employers do not have the capability or the capacity to meet the required changes. 5. A challenge may be experienced in determining the benefit incurred to the employee for granting collectors access to the payroll system.
Proposed regulatory changes	<ol style="list-style-type: none"> 1. Adopt and enhance current government payroll deduction regulations to apply and accommodate other specified sectors. 2. Similar to the Treasury regulations, only allow for specific deductions with prescribed maximum amounts against an employee's basic salary. The following voluntary deductions should be permitted to only one: (i) savings – retirement annuity; (ii) home loan; (iii) life insurance policy; and (iv) non-life insurance policy (cannot be funeral or credit policy). 3. Similar to the Treasury regulations, determine minimum take-home pay. 4. Similar to the Treasury regulations, prescribe the qualification criteria for parties allowed in the voluntary payroll deduction system. For example, a credit provider must be registered with the NCR. 5. Similar to Treasury regulations, the party that is allowed to collect through the payroll system for voluntary deductions must already be under the regulatory oversight of the FSB, SARB, NCR or National Treasury to monitor compliance with the regulations. 6. NCR to determine the maximum interest rate on loans collected through the payroll system. 7. Similar to the Treasury regulations, the contravention of regulations should attract appropriate penalties. 8. Ensure that all regulations impacted by voluntary payroll deductions are properly aligned. 9. In addition to the contravention of regulations and penalties listed under the Treasury regulations (some may be adopted for private sector regulation as applicable), employees should be permitted to reverse and stop voluntary payroll deductions and be reimbursed accordingly under specific conditions.
Objectives/principles justifying the option	<ol style="list-style-type: none"> 1. Consumer protection – rights of employees will be clearly specified. 2. Integrity and efficiency of the NPS will be maintained – once the deduction is above the maximum threshold then collectors will collect through the NPS. In addition, employee obligations will be clearly set out to avoid system abuse. 3. Improved financial inclusion and positive socio-economic impact – employees will have access to specified affordable financial services and products orientated towards wealth accumulation (e.g. home loans and savings products).

Option 3: Unrestricted access to payroll voluntary deductions

Advantages	<ol style="list-style-type: none"> 1. Level playing field will be created as all parties will have equal access to the payroll system, which will increase competition and drive down costs for employees, such as the reduction of interest rates for credit repayments. 2. Preference will be addressed as no product or service provider will be preferred over another in the payroll system. 3. Improvement in employees honouring their obligations, consequently mitigating penalties and risks associated with dishonoured, late and non-payment of obligations. For example, valuable assets (homes) will be safeguarded and lapses of insurance policies will be avoided. 4. Employees will have a choice to decide who is paid from payroll. 5. Socio-economic benefits – it is expected that employees will have access (i.e. lower interest rates) to affordable financial products and services.
Disadvantages/unintended	<ol style="list-style-type: none"> 1. Inefficient allocation of resources as multiple payroll systems would have to be modified by employers or their service providers rather than leveraging a shared NPS such as EDO, EFT and AC. 2. Increased administrative burden for employers to manage the collections from the payroll. 3. Collection preference may occur as the employer will decide the hierarchy of collections. Employers are thus unfairly advantaged as they own and have control of payroll, will always have preference and might ensure constant preference of their collection over those of other collectors. 4. Employers may be incentivised to prefer specific creditors and may not act in the best interest of employees. 5. Compromising or bypassing the regulated NPS collection mechanisms (i.e. AEDO, NAEDO, EFT debit and the future AC – this will promote the use of the payroll as an alternative guaranteed collection mechanism by collecting parties. The need for the NPS EDO collection system and AC may lessen significantly, which will negatively impact the integrity, efficiency and effectiveness of the NPS. 6. Unfavourable contractual terms – creditors or service providers may include, as part of the credit granting terms and conditions, the right to collect through the payroll; thus, the employee may not be able to change payment mechanisms. 7. Employers may be disadvantaged as employees may change jobs to avoid/escape voluntary payroll deductions – similar to consumers changing banks to avoid debit orders. 8. Given the unregulated nature of payroll deductions, it may be difficult for employees to stop or dispute payroll deductions. 9. Employees are likely to prioritise borrowing for consumption purposes rather than for productive or wealth-accumulation purposes.
Proposed regulatory changes	<ol style="list-style-type: none"> 1. Relevant regulatory authorities and government departments (e.g. FSB, NCR, DoL, National Treasury (including the Office of the Accountant-General), Department of Justice and Constitutional Development (DOJCD) and the dti to effect the necessary changes to their respective regulatory frameworks to ensure alignment with the voluntary payroll deductions regulation. 2. Imposition of a 25% maximum total deductions threshold above which no further deductions will be allowed. 3. The regulation will stipulate the priority of all payroll deductions (statutory, court order deductions and discretionary/voluntary payroll deductions). 4. Determination of the hierarchy and randomisation of voluntary deductions to ensure no constant preference of one collection over others. 5. The necessary protections should be afforded to the affected employees, including the right to consent to voluntary payroll deductions, and recourse in respect of unauthorised deductions. 6. Affordability assessments should be conducted by employers and other providers when loans are extended to ensure that employees are not disadvantaged. 7. All collectors from payroll, whether employers or service/product providers, will be required to register as credit providers with the NCR or as service/product providers with the FSB, unless exempted by either the NCR or FSB. 8. The obligations of the employees should be clearly specified to ensure the fulfilment of obligations by the employees, irrespective of whether they remain in the employment of the deducting employer or not.

Option 3: Unrestricted access to payroll voluntary deductions

Objectives/ principles justifying the option	<ol style="list-style-type: none">1. Fairness to all collecting parties insofar as they can equally access 'preferential treatment'.2. Level playing fields will be created between the NPS' preferential collection systems, EDO and AC, and payroll deductions as the consumer will have protection measures and creditors will have equal access to both collection systems. This will enhance the safety and efficiency of the NPS.3. Integrity and efficiency of the NPS will be maintained – once above the threshold then collectors will collect through the NPS. In addition, employee obligations will be clearly set out to avoid system abuse.4. May support financial inclusion and have a positive socio-economic impact if employees have access to more affordable financial services and products.
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For each option, the following additional requirements should apply:

- a. The consent to deduct from payroll must be clearly provided by the employee through an authenticated mandate. The deductions should be made in good faith without any undue influence on the part of the employee.
- b. No more than 25% of the basic salary should be committed to deductions in terms of the court order, collective agreement and arbitration award, as well as discretionary or voluntary payroll deductions.
- c. Deductions in terms of court order, collective agreement and arbitration award deductions must be prioritised over discretionary or voluntary deductions.
- d. The employee should be advised of the status of the portion available for voluntary payroll deductions.
- e. The employee should preferably pay the full monthly payment due instead of portions of the monthly debt, and avoid the consequences of being debited twice (from the payroll and from their bank accounts), which could result in an administrative and reconciliation nightmare for the creditor, employee and employer.
- f. Employers should not be obligated to provide payroll deduction services for discretionary or voluntary deductions.

10. The way forward

The planned process and timelines going forward are as follows:

- 10.1 Comments on this consultation paper should be received by 30 April 2018.
- 10.2 An industry workshop will be arranged during March 2018.
- 10.3 Comments received will be considered and the preferred regulatory option will be communicated accordingly.

11. Comments and contact details

Stakeholders are invited to forward their comments on this consultation paper by 30 April 2018. Any comments may be addressed to: npsdirectives@resbank.co.za.

Annexure A: Confronting over-indebtedness

Government recognises that access to 'good' credit is important for households to build net wealth, and can ease cash flow problems in times of unforeseen life events. This supports efforts to rebalance South Africa's inherited inequality through promoting inclusive growth. However, the unprecedented growth in the past few years in the consumer credit market (see Box 2) has seen government raise concerns around the high level of over-indebtedness and associated exploitive and poor market practices adopted by some financial institutions, including the abuse of the payments system and emolument attachment orders (EAOs). The systemic abuse of EAOs has left many workers without money to live on, and in an inescapable debt trap.

In recognition of this, in December 2013 Cabinet approved measures aimed at assisting over-indebted households. Steps taken/underway include the following:

- Preventative steps to minimise the risk of over-indebtedness. These include the following:
 - Setting clear, affordability criteria that all retail lenders have to adhere to and clearly defining a 'reckless' loan, thus enhancing reckless lending controls under the National Credit Act.
 - Ensuring the provision of credit is not only affordable but suitable. For example, it is clearly inappropriate to promote a short-term (30-day) loan as being suitable for supporting borrowing over longer periods.
 - Reviewing the pricing caps under the National Credit Act to ensure that current levels of caps are appropriate, especially for pay-day loans where rates are excessive.
 - Strengthening regulatory monitoring, supervision and enforcement to ensure the shutting down of unregistered credit providers and full compliance of registered credit providers.
 - Reviewing the regulatory framework for credit insurance policies that are sold with, or linked to, credit.
 - Setting norms and standards for access to the payment system, including for debit orders. Persistent reckless lenders should be denied access to the payments system.
 - Setting norms and standards for EAOs and garnishee orders issued for credit.
 - Extending and strengthening the debt collection law to apply to legal firms.
 - Investigating simpler and lower-cost insolvency arrangements for lower- and middle-income individual persons.
- Government commitments to assist households that are already in the debt trap. These include the following:
 - Engaging with lenders and their industry associations to provide appropriate relief to qualifying distressed borrowers by reducing their instalment burden, without additional cost to the borrower.
 - Enabling major lenders to provide voluntary debt relief measures to distressed borrowers without charge, in addition to the current debt counselling process, subject to compliance with the National Credit Act and the Financial Advisory and Intermediary Services Act.
 - Engaging with current lenders to take steps to withdraw certain categories of existing EAOs for credit, and to use such orders for future credit only as a last resort and according to a robust code of conduct.
 - Regulating debt collection firms, including legal firms, to ensure they do not indulge in unscrupulous debt collection practices.

- Encouraging employers to investigate the legitimacy of all emolument attachment or garnishee orders they may be enforcing against their employees (for purposes of credit not maintenance) and to write to credit providers to reduce or even remove all onerous orders.

The South African Reserve Bank has implemented several initiatives with respect to the setting of norms and standards for the use of debit orders. With effect from 31 October 2019 consumers will be required to authenticate debit orders before they are processed to customers' accounts. Authenticated collections are designed as a proactive measure to remove abusers, and increase trust and transparency in the NPS.

Abbreviations

AC	authenticated collections
AEDO	authenticated early debit order
ATM	automated teller machine
DoL	Department of Labour
EAO	emolument attachment order
EDO	early debit order
EFT	electronic funds transfer
FSB	Financial Services Board
NAEDO	non-authenticated early debit order
NCR	National Credit Regulator
NPS	national payment system
PIN	personal identification number
SARB	South African Reserve Bank
Steering Committee	Payroll Deductions Steering Committee
the dti	Department of Trade and Industry