



SOUTH AFRICAN RESERVE BANK

National Payment System Department

Consultation Paper

Sort-at-source in the national payment system

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Table of contents

1. Introduction and background	1
2. The purpose and scope of this Consultation Paper	2
3. What is sort-at-source?	3
4. How does sort-at-source operate?	3
5. The impact of sort-at-source on the national payment system.....	5
6. The challenges of sort-at-source	8
7. The drivers of sort-at-source	10
8. Recommendations	13
9. Comments and contact details	17
Abbreviations	18

1. Introduction and background

- 1.1 In terms of section 10(1)(c)(i) of the South African Reserve Bank Act 90 of 1989, as amended (SARB Act), the South African Reserve Bank (SARB) is required 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 payment, clearing or settlement systems. Furthermore, the National Payment System Act 78 of 1998 (NPS Act) provides 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. The functions provided for in the SARB Act and the NPS Act are performed by the National Payment System Department (NPSD) within the SARB.
- 1.2 The national payment system (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. Further, the NPS contributes to the economy and financial stability in South Africa.
- 1.3 In 1998, the SARB recognised the Payments Association of South Africa (PASA) as a payment system management body (PSMB) in terms of section 3 of the NPS Act to organise, manage and regulate the participation of its members (i.e. banks and designated clearing system participants) in the payment system. Since this recognition, the SARB has been exercising oversight responsibilities over PASA, as provided for in section 3 of the NPS Act.
- 1.4 In support of the objective of a safe, sound and efficient payment system, PASA issued the PASA Policy on Sort-at-Source in 2009 (Policy no. 01/2009) (PASA Policy) to its members, prohibiting the sort-at-source practice.

- 1.5 On 31 March 2017, the SARB issued a Notice to all stakeholders in the NPS on sort-at-source¹ (Notice), advising stakeholders to refrain from the practice of sort-at-source, which is specifically aimed at bypassing the clearing system, as it negatively impacts on the achievement of the public policy objectives and principles set out in the Notice. Further, the Notice stated that the SARB was in the process of reviewing and developing a policy position regarding sort-at-source, which would provide a clear scope and certainty.
- 1.6 In 2019, the SARB was notified of the continuing practice of sort-at-source, necessitating the SARB's intervention. As a result, through the issuance of this Consultation Paper, the SARB is seeking to gain better insights on the sort-at-source practice. This should enable the SARB to provide legal certainty as well as a policy position that includes all the necessary interventions to address sort-at-source in the NPS. This is aimed at enhancing the efficiency, integrity and safety of the NPS as well as achieving the interoperability goal outlined in the *National Payment System Framework and Strategy – Vision 2025* document (*Vision 2025*).

2. The purpose and scope of this Consultation Paper

- 2.1 The purpose of this Consultation Paper is to solicit stakeholders' insight on the practice of sort-at-source. In particular, stakeholders are requested to provide the SARB with information on how sort-at-source operates (i.e. use cases, challenges and drivers of sort-at-source), and to comment on the proposed recommendations and/or to propose effective measures to address sort-at-source.
- 2.2 The outcome of the consultation process should enable the SARB, as the primary regulator of the NPS, to provide legal certainty as well as a policy position that includes all the necessary interventions to address the practice of sort-at-source. This should ultimately enhance the efficiency, integrity and safety of the NPS as well as achieve the interoperability goal outlined in *Vision 2025*.

¹ <https://www.resbank.co.za/content/dam/sarb/what-we-do/payments-and-settlements/regulation-oversight/Sort-at-Source%20Notice%20Ref%202018-2-1-10-C.pdf>

2.3 Stakeholders are encouraged to comment openly, and are assured that their personal and organisations' details and views will be treated in a confidential manner and will not be shared with other parties. It is further confirmed that the SARB will share only consolidated/aggregated information with relevant parties (e.g. National Treasury) as part of the process of developing an appropriate policy position.

3. What is sort-at-source?

3.1 Sort-at-source refers to the practice of sorting payment instructions based on multiple holders of destination accounts, and submitting such payment instructions directly to the holders of the destination accounts or requesting clients to pay directly into specific accounts (e.g. third-party payment providers' (TPPPs) or beneficiaries' accounts), resulting in the bypassing of the clearing system, which is undertaken through regulated acquiring or sponsoring relationships.² However, sort-at-source does not include payment transactions wherein the payer and beneficiary are clients of the same participants holding the destination accounts or stores of value (i.e. on-us³ transactions).

4. How does sort-at-source operate?

4.1 *Sort-at-source payment instruction:* For example, in the case of in-store payments, in order for the merchant's accounts to be credited immediately, a merchant will sort and submit card payment instructions (payment from consumers) directly to a clearing system participant holding the destination account or store of value of a paying consumer. (A clearing system participant may be either a bank or a clearing system participant designated in terms of the NPS Act.) Also, in the case of online payment, the merchant will provide its bank account details and request that consumers with bank accounts at the same clearing system participant as the merchant pay into the merchant's bank account in order for the merchant's accounts to be credited immediately (see Figure 1). As a result, the merchant in this example

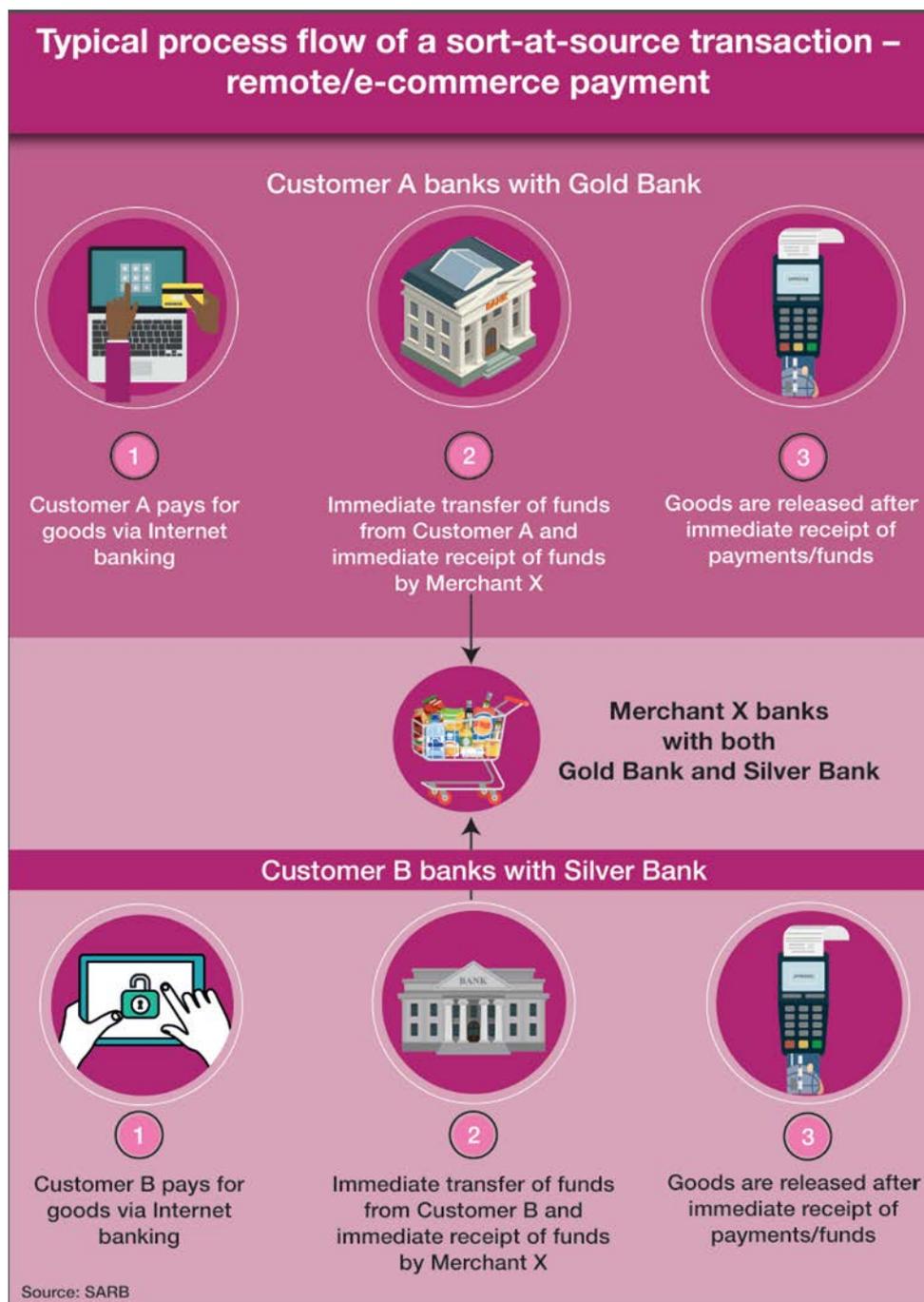
² This is the amended definition from the PASA sort-at-source policy.

³ An 'on-us' transaction means '[a] payment transaction where the payee and payer in the transaction have their respective accounts at the same institution'. See the *Banking Enquiry Glossary of Terms*, available at http://www.compcom.co.za/wp-content/uploads/2017/11/11-Glossary_non-confidential1.pdf.

will open multiple accounts with all the possible participants holding accounts or stores of value.

4.2 The sort-at-source activity bypasses the centralised clearing system operated by a payment clearing house operator (i.e. BankservAfrica, MasterCard or Visa) and results in the processing of transactions as on-us.

Figure 1: Typical process flow of a sort-at-source transaction: remote/e-commerce payment



5. The impact of sort-at-source on the national payment system

5.1 Interoperability

5.1.1 Interoperability is one of the objectives of the NPS that is aligned with the mandate of the SARB to enhance efficiency in the NPS. The *National Payment System Framework and Strategy – Vision 2010* document defines interoperability as the ease of interlinking different systems on a business and a technology level. The Position Paper on Interoperability⁴, published in 2011, further defines interoperability on a technology level as the ability of different types of computers, networks, operating systems, applications and other infrastructure of different banks and relevant stakeholders to interlink and work in partnership effectively, without interruption, explicit communication or translation prior to each event, in order to enhance the efficiency of the payment system.

5.1.2 Over the years, the SARB and industry participants have endeavoured to achieve and promote interoperability, and this has been outlined in all the *National Payment System Framework and Strategy* documents:

- a) The *Blue Book* (1995–2005) included enhancing and maintaining the interoperability and operational effectiveness of the payment system as one of the strategic objectives.
- b) *Vision 2010* states that a major objective of implementing standards is to enhance security and enable interoperability within the payment system. These standards focus on preventing fraud, increasing trust, and promoting integrity and confidence in the payment system.
- c) *Vision 2015* states that infrastructure integration could provide many benefits, including network externalities, interoperability, reduced capital investment by the

⁴ https://www.resbank.co.za/content/dam/sarb/what-we-do/payments-and-settlements/regulation-oversight/PP2011_01.pdf

region, and standardised payment system risk-reduction measures. Common standards would enhance security and interoperability in the regional payment systems.

- d) *Vision 2025* mentions interoperability as one of the nine key goals that industry stakeholders and the SARB are required to achieve by 2025. It further states that improved communication and interoperability between payment systems would help in preventing fragmentation and lead to a more harmonised and competitive payments ecosystem. Interoperability prevents fragmentation: multiple, disparate payment systems providing similar payment offerings, where such offerings are available only to a select set of customers. Achieving interoperability requires collaboration between payment system participants and contributions from all levels of the value chain: regulators, system operators (SOs), banks, non-bank payment providers and end users.

- 5.1.3 Sort-at-source undermines interoperability as it facilitates the processing of payments to occur via different systems and processes instead of using centralised infrastructure, including the payment clearing system, where all parties adhere to the same rules and standards. This negates the necessary collaboration for the greater good of the payment system to benefit all the parties involved in the processing of payments, including (but not limited to) retailers, users, SOs, TPPPs, participants and payment clearing house SOs. Ultimately, the achievement of the *Vision 2025* goal of interoperable payment system infrastructures is negatively impacted.

5.2 Efficiency

- 5.2.1 Sort-at-source fails to support the SARB's objective of enhancing the efficiency of the NPS as it requires an entity (e.g. a retailer or user) to open the same type of account with multiple participants, as mentioned in heading 4 above. It also erodes the benefits of centralised clearing, where a single connection is sufficient to access multiple participants instead of establishing multiple connections. In this regard, multiple connections increase costs and operational complexity. Processing payments through a centralised clearing system ensures that common standards as

well as access and security rules are applied to all the parties involved in the processing of such payments.

5.3 Safety

5.3.1 Sort-at-source inhibits the SARB from effectively executing its oversight responsibilities to mitigate risk in the NPS. The growth of sort-at-source may diminish interbank volumes and work against the benefit of economies of scale. This would negatively impact on the efforts and achievements of the SARB and the payment industry in respect of maintaining and enhancing the safety, efficiency and resilience of the NPS.

5.4 Modernisation of the payment system

5.4.1 Sort-at-source may impact on the shared goal of the SARB and the industry to modernise the payment system, as articulated in *Vision 2025*, including the establishment of middle-mile infrastructures to support initiatives such as real-time payments or faster payments. The benefits of these initiatives include that the immediacy of payments in the interoperable environment would achieve broader societal objectives, as articulated in *Vision 2025*. In this instance, technology developments such as real-time payments could enable industry stakeholders to expand the scope of their offerings to include services targeting the unbanked and underbanked South Africans, particularly in rural areas. This would stimulate industry stakeholders to respond to the social, economic and other challenges by bringing to the fore overlay services that leverage the established central infrastructure.

5.4.2 Sort-at-source may lead to the creation silos, which eventually does not translate into the common standards and messages required for interoperability. Through modernising the payment system, the industry may build effective clearing mechanisms and rules that enable participants to compete from interoperable platforms using better products, offerings and services. Also, silos indirectly lead to lower volumes, reduced access to retailers/users, increased cost of payments and reduced consumer experience – having to use multiple platforms depending on where a counterpart participant/bank holds its account or store of value.

5.5 Interchange

5.5.1 Sort-at-source works against the optimisation of interchange fees⁵ and further disincentivises participants who invest and provide interoperable infrastructures. Interchange fees become unfavourably skewed, and participants that balance the two-sided market may decrease their investment in interoperable infrastructures and rather provide proprietary infrastructures exclusively for their own consumers. This may result in participants who have deep pockets to provide infrastructures dominating the market and thus reducing competition, and an increase in the invariably costs to consumers. This can foster competition based on infrastructure rather than on service and product offerings, and further have a negative impact on the financial inclusion, cost-effectiveness and interoperability goals of *Vision 2025*.

6. The challenges of sort-at-source

6.1 Screen-scraping

6.1.1 Sort-at-source may sometimes lead to undesirable practices such as instant electronic fund transfers (EFTs), also known as 'screen-scraping'. The cautionary note issued jointly by the SARB, the Financial Sector Conduct Authority and PASA, titled *Consumer Alert: Instant EFT online payments (Consumer Alert)*, defines⁶ an instant EFT as a payment method offered by a third party, in partnership with e-commerce merchants, which automates the initiation of payments from consumers to e-commerce merchants and also provides immediate confirmation of payment to the e-commerce merchants to enable them to dispatch the goods or services purchased. Instant EFT payments use the 'screen-scraping' method, which makes it possible for third parties to access bank account data and automate actions on behalf of a consumer using that consumer's online banking access credentials, often without

⁵ The *Banking Enquiry Report* defines 'interchange fee' as a balancing payment from one side to another in a two-sided market. Interchange in South Africa is a transfer made by an interbank arrangement, whereby, in the context of a payment made by the customer of one bank to the customer of another bank, one of the two banks contributes a part of its revenue to the other bank.

⁶ https://www.resbank.co.za/content/dam/sarb/what-we-do/payments-and-settlements/regulation-oversight/Consumer%20alert%20on%20instant%20EFT%20online%20payments_Published%20version_.pdf

the consumer's clear understanding, knowledge or approval to facilitate the payment. The *Consumer Alert* thus outlines the following risks posed by screen-scraping to consumers:

- a) *Data privacy risk:* The method of using screen-scraping to effect payments puts consumers' access credentials at risk of being compromised. Consumers have no control over how their credentials, and any other data or personal information, are accessed and used by the third party (e.g. account numbers and account statements can be stored and utilised without the consumer's knowledge or consent).
 - b) *Fraud risk:* Rogue entities might pose as third parties offering instant EFT services on fake e-commerce sites to capture consumers' access credentials for their banks' Internet banking websites. From there, such entities might impersonate the consumer and conduct any activity that the consumer would have access to on their online banking platform (e.g. making real-time payments to themselves, applying for a personal loan, increasing transaction limits, and ultimately initiating payments to mule accounts). Rogue entities might also access relevant data and personal information such as account information and monthly statements from which fraudulent collections through debit orders might occur.
 - c) *Breach of contractual agreements:* By providing their Internet banking login credentials to a third party, consumers that use instant EFT products might be in breach of their banks' terms and conditions which regulate Internet banking. As a result, knowingly or unknowingly, consumers might be giving up their rights of recourse and any legal protection in the event of suffering fraud and/or subsequent loss.
- 6.1.2 *Risk of financial loss and the goods purchased being lost:* EFT credit payments are final and irrevocable in nature, and consumers are unable to lodge disputes to reverse a transaction in the event of the online store not honouring their agreement (e.g. not delivering the goods or delivering counterfeit goods). Consumers might also be held liable for the interest payable on such amounts when payment was made from their credit card account or overdraft facilities.

6.1.3 This payment method is generally used to conclude e-commerce transactions instantly as the entity is able to receive the payment notification immediately and funds are sometimes transferred immediately when sort-at-source is used. This enables the process to release goods without delay.

6.2 Market dominance

6.2.1 As stated before, sort-at-source requires that an entity open multiple bank accounts instead of opening a single account with the acquirer⁷. In some instances, the entity may opt to open multiple accounts with participants who have a larger market share, thus excluding smaller participants. This may disadvantage smaller participants in the market as their clients may not be provided with services similar to larger participants' clients. This negatively affects the promotion of the competition and innovation goals of *Vision 2025*.

Note:

i) Stakeholders are requested to provide information on any additional challenges of sort-at-source that are not addressed in this section.

7. The drivers of sort-at-source

7.1 Lower merchant service fees

7.1.1 Sort-at-source may be cheaper for entities as they do not have to pay typical merchant service fees in respect of normal acquiring relationships. Typical merchant service fees include the following⁸:

⁷ The *PASA Interbank Rules Card Debit Payment Instructions and Card Credit Payment Instructions South Africa* defines 'acquirer' as a participant who collects, routes and receives transactions.

⁸ <https://ikajo.com/glossary/merchant-service-charge-msc>

- a) *Interchange fee:* This fee is determined through facilitation by the SARB. It is paid by the acquirer to the issuer for cardholder purchases. In addition, the SARB facilitates the determination of cash-back at point-of-sale (POS) and automated teller machine (ATM) interchange fees.
 - b) *Assessment and network fee:* This is a fee that is due to the card scheme (e.g. MasterCard or Visa) and is paid by the acquirer.
 - c) *Acquiring fee or margin fee:* This is a fee that is paid to the acquirer. It may include rent for POS terminals (where the POS terminal belongs to the merchant – this typically occurs for small- and medium-sized merchants) and/or a connectivity fee (where the POS terminal does not belong to the acquirer – this typically occurs with large retailers that have their own POS terminals). The fee includes processing costs. The merchant fees are dependent on the sector and size of the merchant.
- 7.2 *Mitigation of concentration risk:* Depending on the type of business, the entity/corporate client may decide to use sort-at-source to mitigate concentration of risk by spreading deposits across participants or manage complex banking needs which require multiple accounts with different participants.
- 7.3 *Immediacy and cost-effectiveness of payments:* Sort-at-source enables cost-effective immediacy of payments to occur without using the faster payment services that are available in South Africa, such as real-time clearing (RTC), which is perceived to be costly. This further enables the discharge of the obligation to occur quicker, and enables the provision of goods and services that require immediate clearing⁹ of funds.
- 7.4 *Being unrestricted by threshold limits:* Unlike RTC where limits may apply depending on the time of day (i.e. cut-off times), sort-at-source is not constrained by such item (or value) limitations.

⁹ 'Clearing' is defined by the NPS Act as the exchange of payment instructions.

- 7.5 *Business continuity planning:* Sort-at-source avoids the potential single point of failure and the consequences of using an acquirer or a central clearing system. A single point of failure can occur if the acquirer or the central clearing system is down or hacked, thus delaying the processing of payments, which will lead to a delay in the delivery of goods/services and/or conclusion of transactions. The SARB has, however, made arrangements in the regulatory regime for a backup acquirer, if necessary or so desired by a merchant.
- 7.6 *No reliance on a third party:* The desirability for full control or the ability of an entity to have control with regards to processing, reliable uptime and reconciliation of its processed transactions without reliance on a third-party ‘middleman’ may also contribute to the use of sort-at-source.
- 7.7 *Absence of compliance costs:* Sort-at-source allows entities to operate without adhering to the compliance requirements that apply to entities/merchants that have contracted with acquirers, such as compliance with the Payment Card Industry Data Security Standard (PCI DSS) in relation to protecting consumer card data.
- 7.8 *Less probability of payment reversal:* Unlike other payment methods processed through centralised infrastructure and the clearing system, such as debit orders and card payments where the transactions are exposed to the risk of being reversed by a consumer via the bank that holds their account, sort-at-source payments experience a lower probability of payment reversal from the consumer as there is a low risk that the consumer will reverse the transaction in relation to an EFT credit transaction. The reversal process in this case is more demanding compared to the debit order or card payment reversal processes.

Note:

i) Stakeholders are requested to provide information on any additional drivers of sort-at-source that are not addressed in this section.

8. Recommendations

The following recommendations are proposed to address sort-at-source in the NPS:

- 8.1 *Faster payments:* An efficient, cost-effective and reliable faster payment service should be implemented and adopted by participants to address the need for immediacy of payments to better serve entities and consumers. All participants initiating or receiving low-value credit-push payments should avail faster payment services to their customers/clients. Consultations are underway with the payment industry on the facilitation/establishment of an appropriate faster payment service interoperable infrastructure for South Africa.
- 8.2 *Open banking:* The realisation of this initiative will enable TPPPs to securely gain access to customer banking or transactional accounts and leverage innovative technologies to improve the customer experience when they transact. The payment industry is exploring the adoption of open application programming interfaces (APIs) to provide innovative services and improve customer experience. This will enable such entities/third parties to initiate/make secure payments on behalf of the consumers. The SARB is considering an appropriate regulatory position on open banking for South Africa.

Note:

i) Stakeholders are requested to express their views on whether a faster payment system and open banking could potentially disincentivise or discourage sort-at-source.

ii) Stakeholders are also requested to propose/advise of other initiatives/alternative measures to counter sort-at-source.

8.3 However, if the measures outlined in paragraphs 8.1 and 8.2 are implemented but do not adequately address sort-at-source, then the SARB will issue a Directive providing for the following measures:

Note:

i) Stakeholders are requested to express their views on the proposed sequencing of implementation of measures to address sort-at-source, i.e. should the SARB proceed with the issuance of the Directive, or should it await the implementation of a faster payment system and open banking?

8.3.1 Entity (retailer or user)

Permitted use

- a) Sort-at-source should, subject to (b) below, only be permitted for business continuity planning (BCP) purposes. The entity must submit its BCP plan to the PSMB and clearly indicate the circumstances in which sort-at-source could be invoked.
- b) The PSMB may, with the concurrence of the SARB, only under exceptional circumstances and for a limited period of time, and on application by any person, allow that person to sort-at-source, provided that the sort-at-source will further the achievement of the safety and efficiency objectives and/or will be in the public interest.

Note:

i) Stakeholders are requested to advise of the various sort-at-source use cases.

ii) From the list of sort-at-source use cases, stakeholders are requested to recommend which of the use cases should be permissible in their view, and why.

iii) Stakeholders are requested to advise of the benefits and risks of the sort-at-source practice.

Reporting

- a) In cases where the entity is multi-banked and/or multi-acquired, such an entity should advise the SARB and the PSMB accordingly, and should declare to the SARB and the PSMB that it is not bypassing the central clearing system.
- b) After effecting sort-at-source as a BCP measure, the entity should be required to report the incident to the SARB and the PSMB, providing details of when, how and why sort-at-source was the most effective BCP measure to implement as well as measures to mitigate future occurrence of the incident in order to minimise the use of sort-at-source as a BCP measure.
- c) The entity(-ies) allowed to conduct sort-at-source should also be required to report the activity to the SARB and the PSMB, including the volumes, values, names of multiple banks/acquirers etc.

Note:

i) Stakeholders are requested to express their views on the proposed reporting measures/mechanism, and to propose other/alternative reporting mechanisms that may be implemented.

Processing

- a) In instances where an entity/person uses a third party such as a TPPP or SO to process or facilitate its payments, the entity/person should be required to ensure that such a TPPP or SO does not use sort-at-source to process or facilitate its transactions.
- b) Except for BCP purposes and/or as exempted by the SARB, all transactions should be processed through a centralised processing and clearing system through an acquirer.

8.3.2 Participants (holding destination accounts) and acquirers

Participants and acquirers should be required to comply with the following requirements:

Customer declarations

- c) Request a declaration, and confirm with new entities/customers that they are not involved, nor intend to be involved, in the practice of sort-at-source, except for BCP purposes and/or as exempted by the SARB.
- d) Request existing customers to declare annually whether they are multi-banked or multi-acquired, and that they are not involved, nor intend to be involved, in the practice of sort-at-source, except for BCP purposes and/or as exempted by the SARB.

Note:

i) Stakeholders are requested to propose additional or alternative declarations that will enhance transparency/disclosure in respect of sort-at-source activity.

Processing

- a) Except for BCP purposes and/or as exempted by the SARB, reject requests to process sort-at-source payment instructions, whether they be batch or single transactions.
- b) Do not differentiate pricing for processing on-us and off-us transactions.
- c) If there is suspicion that sort-at-source is being perpetuated, investigate the matter before processing the transactions.
- d) Report suspected and/or actual sort-at-source practices to the SARB and the PSMB.
- e) Implement measures to monitor, identify and prevent sort-at-source.

Note:

i) Stakeholders are requested to express their views on the proposed processing of transactions suspected to be, or linked to, sort-at-source.

ii) Stakeholders are requested to propose other processing measures to curb the sort-at-source practice.

9. Comments and contact details

- 9.1 Stakeholders are invited to submit their comments on this Consultation Paper by **15 October 2021**. Comments should be addressed to npsdirectives@resbank.co.za.

Abbreviations

API	application programming interface
ATM	automated teller machine
BCP	business continuity planning
<i>Consumer Alert</i>	<i>Consumer Alert: Instant EFT online payments</i>
EFT	electronic fund transfer
<i>Notice</i>	<i>Notice to all stakeholders in the NPS on sort-at-source</i>
NPS	national payment system
NPS Act	National Payment System Act 78 of 1998
NPSD	National Payment System Department [of the South African Reserve Bank]
PASA	Payments Association of South Africa
PASA Policy	PASA Policy on Sort at Source (Policy no. 01/2009)
PCI DSS	Payment Card Industry Data Security Standard
POS	point-of-sale
PSMB	payment system management body
RTC	real-time clearing
SARB	South African Reserve Bank
SARB Act	South African Reserve Bank Act 90 of 1998, as amended
SO	system operator
TPPP	third party payment provider
<i>Vision 2025</i>	<i>National Payment System Framework and Strategy – Vision 2025</i>