

# On line Payment Systems

**Catherine Parr and Lewis Grimm explore some of the key issues relating to on line payment systems.**

**W**e are continuing to see the development of new on line payment systems or methods of facilitating payments on line. The developers of these systems in Australia will need carefully to consider the regulatory environment.

Payment systems and purchased payment or stored value facilities are regulated by the *Payment Systems (Regulation) Act 1998 (Cth)* ("PSRA"). That Act requires the operator of a purchased payment facility to be authorised or exempted by the Reserve Bank. However, where the provider is an authorised deposit taking institution ("ADI") it will be regulated by the Australian Prudential Regulation Authority ("APRA") and subject to capital and liquidity requirements.

There has been, therefore, the scope for some regulatory arbitrage between the prudential and regulatory regime imposed by APRA on ADIs and the prudential requirements imposed by the Reserve Bank.

In an attempt to eliminate this potential for arbitrage a new regulation was introduced on 15 June 2000. This article examines the legislation and the impact of this new regulation. It also highlights some other legal issues the providers of on line payment facilities will need to consider.

## **PAYMENT SYSTEMS REGULATION ACT**

The PSRA was enacted to protect consumers and promote public confidence in *payment systems and purchased payment facilities* as these terms are defined under the PSRA (see below).

The PSRA proceeds on the basis that a system or facility cannot be both – it will be one or the other and will be regulated differently depending on which category it falls into.

### **Purchased Payment Facility**

A *purchased payment facility* is defined as a facility (other than cash) in relation to which the following conditions are satisfied:

- (a) *the facility is purchased by a person from another person; and*
- (b) *the facility is able to be used as a means of making payments up to the amount that, from time to time, is available for use under the conditions applying to the facility; and*
- (c) *those payments are to be made by the provider of the facility or by a person acting under an arrangement with the provider (rather than by the user of the facility).*

In order for a facility to fall into this category, it is essential that the facility be "purchased". The requirement for a purchase fits neatly with stored value cards and digital cash. Such categorisation may be more difficult where the facility offered is more in the nature of a conduit for transactions and a user is merely required to register for the service to be eligible. The term "purchase" also connotes some payment or consideration from the purchaser for the service supplied.

The explanatory memorandum which relates to the PSRA says that purchased payment facilities embody the unique characteristic that consumers pay for the facility using conventional means (the example given is cash, but credit cards would be equally applicable) and rely on the holder of the stored value backing that facility to subsequently redeem the value.

A provider of a purchased payment facility will need to be:

- an ADI;
- authorised under the PSRA;

- granted an exemption under the PSRA; or
- providing a facility declared for the purpose of the PSRA to be a facility to which the PSRA does not apply.

### **Payment System**

A *payment system* is defined in the PSRA as

*"a funds transfer system that facilitates the circulation of money, and includes any instruments and procedures that relate to the system".*

If the correct characterisation is as a payment system then the relevant part of the PSRA will be Part 3. That part permits the Reserve Bank to designate a payment system to undertake direct regulation of it.

Once a payment system is designated, the PSRA provides that it can be subject to the imposition of rules of access, the determination of standards, the arbitration of disputes and the giving of enforceable directions. A system which has not been designated is not required to be licensed or authorised in any way.

The explanatory memorandum for the PSRA says that "it is expected that a sizeable proportion of payment systems will not be designated" and that designation generally will occur "only after substantial consultation with participants and after consideration of alternative regulatory approaches and voluntary arrangements have been exhausted".

## **THE NEW REGULATION**

On 7 June 2000, the Commonwealth Government passed the *Banking Amendment Regulation 2000 (No. 1)* ("Regulation"), which regulates certain types of purchased payment facilities.

The Regulation says that the holder of stored value in relation to a purchased payment facility will be deemed to be carrying on a banking business (and

therefore brought under APRA's supervision) where:

- the facility is available for purchase and use on a wide basis; and
- all or part of the facility's unused value is repayable on demand in Australian currency.

This regulation acknowledges that holding stored value is similar to a deposit at a bank.

Store of value is a broad concept, and extends beyond smart cards.

APRA has yet to determine the meaning of "available, on a wide basis".

APRA has indicated<sup>1</sup> that rather than determining "wideness" by reference to a set number of users or purchasers of the facility, it is likely it will be determined by reference to the circumstances and a combination of a number of different factors. For example a facility would be widely available if accepted at a number of geographically dispersed outlets (for example, supermarkets, newsagents or post offices). Another measure could be the size of the relevant float. A float of \$100,000 probably would not qualify, whereas \$100,000,000 probably would. In addition, APRA is likely to look at the size of individual transactions or float amounts.

It is likely that some transitional arrangements will be introduced for new businesses. Until a new facility is established and being used on a wide basis the Reserve Bank, if it grants an exemption from the PSRA, is likely to impose conditions on that exemption which will require reporting and contemplate a switch to ADI status at some point.

Once it has been determined that a purchased payment facility is a banking

business, the holder of the stored value would be subject to the same authorisation criteria as for an ADI, although the capital adequacy requirements may not be the same, with \$1,000,000 capital possibly being "a reasonable starting point" for a new business.<sup>2</sup> The holder of stored value would also be subject to risk management controls based on the recommendations of the Basle Committee on Banking Supervision's "Risk Management for Electronic Banking and Electronic Money Activities" (March 1998).

Because the PSRA is new legislation which does not appear to have been the subject of any judicial interpretation, and because it is obviously critical to remain on the right side of the regulators, the provider of a payment facility will need to reach an agreed position with the Reserve Bank on which part of the PSRA its system falls under and then, if the facility is a purchased payment facility, discuss with APRA whether the holder of the stored value is to be deemed to be carrying on a banking business.

---

## OTHER ISSUES

---

There are a number of other issues to be considered in relation to a payment system which is to be offered to consumers including the following:

### Financial Transaction Reports Act

Some of the speed and convenience of a facility intended to be provided entirely on line will be removed if the customer has to physically identify themselves and do a 100 point check. The structure needs careful consideration to see if this requirement can be avoided.

### Financial Institutions Duty

With a Customer to Customer (C2C) or Customer to Business (C2B) system

intended to be used for low value transactions an obligation to pay (and therefore a need to recover) financial institutions duty ("FID") will be a significant impediment. Although FID will disappear on 1 July 2001, careful consideration needs to be given in the meantime to the FID legislation and the situs of any relevant on line accounts.

### EFT Code of Conduct

This is being expanded to cover all forms of consumer electronic funds transfer. It will almost certainly catch, in one way or another, any C2C or C2B online payment facility.

Perhaps the most problematic area of the new Code is the proposed regime for apportioning liability for unauthorised transactions.

### CLERP 6

Changes to the Corporations Law will regulate the provision of facilities through which a person makes non-cash payments. The consequences of regulation will include the need to hold an Australian Financial Services Licence, obligations to give financial services guides and product disclosure statements and a number of other obligations. Some of the requirements are onerous and arguably totally unsuitable for a financial product which facilitates non-cash payments.

There is a lot to think about and the regulatory environment is continuing to evolve and change.

<sup>1</sup> Greg Brunner "Update: Regulation of Smart Cards in Australia"

<sup>2</sup> Greg Brunner "Update: Regulation of Smart Cards in Australia"

*Catherine Parr is a partner and Lewis Grimm is a lawyer at the Sydney office of Allen Allen & Hemsley.*