

## **Regulation of Purchased Payment Facilities:**

### **Proposed Exemptions under the *Payment Systems (Regulation) Act 1998***

The Reserve Bank is requesting public comment on proposed exemptions from regulation under the *Payment Systems (Regulation) Act 1998* for certain purchased payment facilities. The draft exemptions are attached with this background paper.

#### **Background**

In the mid 1990s, the birth of Internet commerce and the commercialisation of smart cards were widely perceived to be leading toward an electronic payments revolution. High-profile trials of products such as the “electronic purse” (a smart-card-based stored-value payment system) and Internet-based “electronic cash” caught the attention of the public and of international regulators.<sup>1</sup>

In 1997, at the height of public interest in these new systems, the Financial System Inquiry (the Wallis Inquiry) took the view that such new electronic payment facilities had the potential to become an important element of the Australian payments system. The Inquiry recommended to the Government that the financial store of value backing such general-purpose stored-value facilities be prudentially regulated. At the same time, the Inquiry concluded that participation should not be confined solely to deposit-taking institutions. As a result, the *Payment Systems (Regulation) Act 1998* (the Act) gave the Reserve Bank authority to regulate “purchased payment facilities” other than those offered by authorised deposit-taking institutions (ADIs). Specifically, Part 4 of the Act requires that the “holder of stored value”, that is, the corporation undertaking the financial obligations within such a facility or holding funds payable to users, be authorised by the Bank under the Act, exempted by the Bank from regulation or be an ADI supervised by the Australian Prudential Regulation Authority (APRA).

The Government subsequently determined that, in order to ensure consistency of regulatory treatment, those purchased payment facilities that are akin to deposits (whether or not offered by an ADI) should be regulated by APRA under a common regime. As a result, in 2000 it enacted a regulation under the *Banking Act 1959* to allow APRA to supervise certain purchased payment facilities.<sup>2</sup> The regulation defines the provision of purchased payment facilities which have deposit-like characteristics as “carrying on banking business”, thus bringing such entities under APRA’s supervision. The criteria for supervision by APRA are that:

- the product is available, on a wide basis, for purchase and use as a means of payment; and

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<sup>1</sup> See for example Bank for International Settlements, *Implications for Central Banks of the Development of Electronic Money*, 1996.

<sup>2</sup> See APRA and Reserve Bank of Australia, Joint Media Release, “Regulation of Purchased Payment Facilities”, 15 June 2000, [www.rba.gov.au](http://www.rba.gov.au).

- the stored value is redeemable by the user on demand in Australian currency.

Since the time of the Wallis Inquiry, “electronic cash”, stored-value cards, and other similar payment instruments have underperformed the expectations of the 1990s. In Australia, like most other countries, the bulk of products in operation have been card-based payment instruments. They are used in closed environments, such as universities, or for purchases of specific goods or services. Several prepaid Internet-based payment mechanisms are being tested in Australia; however usage is very low. As a result, to date, no purchased payment facilities have been authorised by APRA or by the Reserve Bank.

### **The Current Regulatory Environment**

As a result of the formal division of responsibilities between APRA and the Reserve Bank in 2000, any purchased payment facilities that ultimately come to be widely used and therefore pose potentially broader risk to the community or the financial system will fall under APRA’s supervisory authority. Nevertheless, some regulatory uncertainty remains regarding the regulatory framework for facilities not supervised by APRA. The definition of a purchased payment facility in the Act is very broad; as a result, many limited-purpose systems and products that have never been subject to regulation are potentially captured, such as prepaid transit cards and gift certificates.

The Reserve Bank has also received enquiries from organisations developing or offering purchased payment facilities in a pilot or test phase. In the Reserve Bank’s view, there would seem to be little public benefit in requiring companies to undergo a potentially lengthy and costly prudential authorisation process early in their business development process, where systemic risk does not exist and any risk to the users of the facility is negligible.

More recently, the *Financial Services Reform Act 2001* established, under the responsibility of the Australian Securities and Investments Commission (ASIC), a broad new licensing regime for all types of providers of financial services, including providers of non-cash payment instruments. Providers of purchased payment facilities are explicitly covered and required to be licensed by ASIC (unless ASIC issues an exemption). Those purchased payment facilities not supervised by APRA may therefore be required to undergo separate licensing processes with both the Reserve Bank and ASIC, with potentially overlapping requirements.

### **Proposed Exemptions**

In order to clarify the regulatory regime governing purchased payment facilities not supervised by APRA and to alleviate unnecessary regulatory burden, the Reserve Bank proposes to exempt certain classes of facilities or the associated “holder of stored value” from regulation. These payment facilities are unlikely to pose material risk to users. Any purchased payment facilities that achieved widespread usage would come under APRA supervision.

### *Limited facilities*

As noted above, because the Act is drafted quite broadly, it can be read to require authorisation by the Bank of special-purpose systems that have successfully operated outside financial regulation for decades, such as prepayment cards and closed-system payment instruments that are only used within a limited population. To remove regulatory uncertainty and potential compliance burden in these cases, the Reserve Bank is proposing to issue exemptions under the Act.

Section 9 of the Act gives the Bank some latitude to determine the scope of payment facilities to which the Act applies, in particular, facilities that are limited in usage. The proposed exemptions (Attachment 1) would declare that small-scale facilities with \$1 million or less in outstanding payment value issued, such as those in a trial phase, and those operating in a relatively closed environment, with 50 or fewer payees, are not subject to the provisions of the Act on purchased payment facilities. The exemptions would cover most of those products being tested for small-value Internet payments, as well as closed-system stored-value products, such as cards used on university campuses, transit systems, telephones, and for store gift voucher arrangements. The Reserve Bank believes that such exemptions are appropriate in light of the small and limited nature of these facilities and the limited risk to users and the payment system.

### *Guaranteed facilities*

Other payment facilities may also pose little risk to the community. These could include purchased payment facilities that are backed by an ADI, or by a Commonwealth, state or local government authority. Attachment 2 provides a proposed class exemption for purchased payment facilities where the obligations of the holder of stored value in the facility are guaranteed by an ADI or government entity. It is intended that privately operated purchased payment facilities should be able to obtain a financial guarantee (a function which financial institutions commonly provide) from an ADI to provide equivalent financial protection for users. The exemption would also allow those facilities that are already government-sponsored to avoid regulatory intervention that would have little additional public benefit. The proposed exemption does not specify a particular required form of the guarantee and the Reserve Bank invites comments from interested parties on how such guarantees might be structured.

### *Other systems not supervised by APRA*

The Bank believes that the minimum market conduct/disclosure requirements imposed by ASIC for an Australian financial services licence covering the provision of non-cash payment facilities are in most cases likely to be adequate to address the regulatory intent of the *Payment Systems (Regulation) Act 1998* for other purchased payment facilities that neither meet the criteria for supervision by APRA nor fall under the above proposed exemptions. ASIC has published these general licensing

requirements.<sup>3</sup> Going forward, the Reserve Bank anticipates considering any applications for purchased payment facility authority or exemption under the Act on a case-by-case basis, taking into account whether the applicant holds an appropriate Australian financial services licence.

### **Consultation**

The Reserve Bank is requesting public comment on the proposed exemptions from regulation under the *Payment Systems (Regulation) Act 1998* for certain purchased payment facilities. The draft exemptions are attached with this background paper. Although the Act does not impose any formal consultation requirements on the Reserve Bank in exercising its authority in this area, the Reserve Bank is nevertheless interested in obtaining the views of those parties potentially affected by the proposals before finalising the exemptions. Written comments should be sent by 24 October 2003 to:

Head of Payments Policy  
Reserve Bank of Australia  
GPO Box 3947  
Sydney NSW 2001

### Attachments

Reserve Bank of Australia  
Sydney, NSW  
15 September 2003

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<sup>3</sup> See [www.asic.gov.au](http://www.asic.gov.au) for more information on financial services licensing.

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**Exemption notice for Limited Facilities under Section 9(3)**

The Reserve Bank of Australia, under section 9(3) of the *Payment Systems (Regulation) Act 1998* (“Act”), declares that the Act does not apply to the following specified classes of facilities, having determined that it is not appropriate for this Act to apply to facilities in those classes:

- (a) limited-value facilities, being facilities where the total amount of obligations to make payments under the facility does not exceed \$1,000,000, having regard to restrictions on the number and types of people who may purchase these types of facilities; and
- (b) limited-participant facilities, being facilities where the number of people to whom payments may be made using such a facility does not exceed 50.

Unless the contrary intention appears, words used in this instrument have the same meaning as in the Act.

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**Exemption Notice for Certain Guaranteed Holders of Stored Value under Section 25**

The Reserve Bank of Australia, under section 25 of the *Payment Systems (Regulation) Act 1998* (“**Act**”), grants an exemption to the following class of corporations allowing each corporation in the class to be the holder of the stored value in respect of purchased payment facilities in the following class even though the corporation is not an authorised deposit-taking institution (within the meaning of the Banking Act 1959), and does not have an authority under section 23 of the Act that covers those facilities, where:

- (a) the class of corporations is constituted by corporations:
  - (i) whose obligations in respect of a purchased payment facility described in paragraph (b) are guaranteed by:
    - (A) an authorised deposit-taking institution (within the meaning of the Banking Act 1959); or
    - (B) a Commonwealth, State or local government authority;
  - and
  - (ii) which are not the providers of purchased payment facilities in relation to which a determination has been made by the Australian Prudential Regulation Authority (“APRA”) under regulation 3 of the Banking Regulations 1966; and
- (b) the class of facilities is constituted by facilities:
  - (i) which do not fall within the scope of the exemption issued by the Reserve Bank of Australia pursuant to section 9(3) of the Act on [insert date of limited facility exemption notice]; and
  - (ii) in relation to which a determination has not been made by APRA under regulation 3 of the Banking Regulations 1966.

Unless the contrary intention appears, words used in this instrument have the same meaning as in the Act.