

Regulation Impact Statement

Payment Systems (Regulation) Act 1998

Exemptions for Limited Facilities and Certain Guaranteed Holders of Stored Value

1. Introduction

In 1998, Parliament enacted the *Payment Systems (Regulation) Act*, which granted the Reserve Bank a range of powers and responsibilities. These included the power to regulate “purchased payment facilities” other than those offered by authorised deposit-taking institutions (ADIs). Section 22 of the *Payment Systems (Regulation) Act*, (‘the Act’) requires that the “holder of stored value”, that is, the person undertaking the financial obligations within such a facility or holding funds payable to users, be authorised by the Reserve Bank, exempted by the Bank from regulation or be an ADI supervised by the Australian Prudential Regulation Authority.

This Regulation Impact Statement sets out the issues involved in establishing exemptions from regulation for purchased payment facilities, the options considered by the Reserve Bank in carrying out its responsibilities under the Act, and the analysis and consultation undertaken.

2. Background

In 1997 the Financial System Inquiry (the Wallis Inquiry) took the view that new electronic payment facilities, such as “smart” cards with stored value and internet-based “electronic cash”, 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). 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.¹ 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
- the stored value is redeemable by the user on demand in Australian currency.

¹ See APRA and Reserve Bank of Australia, Joint Media Release, “Regulation of Purchased Payment Facilities”, 15 June 2000, www.rba.gov.au.

3. Issues

Some uncertainty nevertheless 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. Furthermore, the Reserve Bank has received enquiries from organisations developing or offering purchased payment facilities in a pilot or test phase. The Act provides for the Reserve Bank to exempt small scale and closed facilities from the need to be authorised.

More recently, the *Financial Services Reform Act 2001* established a broad new licensing regime for all types of providers of financial services, including providers of non-cash payment instruments, which is administered by the Australian Securities and Investments Commission (ASIC). 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.

4. Objective

The objective of the regulatory regime for purchased payment facilities is to promote competition while at the same time ensuring public confidence in these systems. The regime should however not impose unnecessary regulatory burden on those purchased payment facilities which are unlikely to pose material risk to users.

5. Options

Three options are available to the Reserve Bank:

Option I: No regulatory action

The Reserve Bank could apply the full scope of the regulatory regime for purchased payment facilities and require facilities which met the definition of a purchased payment facility under the Act to apply for authorisation on a case-by-case basis under section 23 of the Act.

Option II: Provide case-by-case exemptions from the Act

The Reserve Bank could provide case-by-case exemptions to purchased payment facilities, under section 25 of the Act, from the need to be authorised under section 23.

Option III: Provide exemptions on a class-basis from the Act, applying to:

Option IIIA: Small or limited-purpose facilities;

The Reserve Bank may issue an exemption from the provisions of the Act to a facility or class of facilities under section 9(3) of the Act. The Bank must have regard to restrictions limiting the number or types of people who may purchase the facility, or to restrictions limiting the number or types of people to which payments may be made. The Bank may also have regard to other matters it considers relevant.

Option IIIB: Certain guaranteed holders of stored value.

The Reserve Bank may issue an exemption from the need to be authorised under the Act to corporations which act as holders of stored value if the Bank is satisfied that the corporation will be able to satisfy its obligations as the holder of stored value.

6. Impact analysis

The effect of the options considered by the Reserve Bank would fall on the following parties:

- purchased payment facilities and the holders of stored value backing such facilities;
- users of purchased payment facilities; and
- the Reserve Bank.

Option I: No regulatory action

The current regulatory regime is causing uncertainty in the market. As noted above, the breadth of the Act captures many limited purpose facilities and products that have never been subject to regulation. The Bank has received many enquiries from such small facilities and from organisations developing such facilities. Such facilities are too small to meet APRA's criteria and are therefore technically required to be authorised by the Reserve Bank under section 23 of the Act (or exempted under section 25: see Option II). There would also seem to be little benefit in requiring start-up facilities to undergo a 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. This option would have the potential to stifle innovation and the development of new facilities.

Meeting a prudential framework would impose compliance costs on purchased payment facilities. These costs would have the potential to be significant in the case of start-up facilities. Users of small and large facilities alike would face a higher cost of using such facilities. Potential users would also face the cost of reduced innovation and competition in the market for such facilities. There will also be the costs to the Reserve Bank of reviewing all applicants for authorisation on a case-by-case basis.

On the other hand, users may receive some benefit from the fact that all facilities have been examined by the Reserve Bank. However, this benefit would seem to be marginal for the small schemes and more than outweighed by the regulatory compliance costs.

Option II: Provide case-by-case exemptions from the Act

The Reserve Bank could issue exemptions from the need to be authorised under section 23 to purchased payment facilities, on a case-by-case basis, under section 25 of the Act. This could have the effect of reducing the ongoing compliance costs faced by facilities which would otherwise be authorised under section 23.

However, the Bank may only exempt facilities under this section if it is satisfied that the obligations of the purchased payment facility to its users will be met. This requirement is analogous to the requirement set out for authorisation under section 23. As such, exemption on a case-by-case basis is unlikely to reduce the initial hurdle faced by small and developing facilities. Moreover, it would impose initial costs that were commensurate with those imposed under Option I. The costs faced by

facilities, users and the Reserve Bank under Option II would therefore appear to be similar to those faced in Option I.

Option III: Provide exemptions on a class-basis from the Act, applying to:

Option IIIA: Small or limited-purpose facilities;

Option IIIB: Certain guaranteed holders of stored value.

The Reserve Bank could issue an exemption from the provisions of the Act for small or limited-purpose facilities. This would allow purchased payment facilities to develop their business without the burden of a potentially intrusive prudential regime until they were of sufficient size to no longer meet the exemption. This option would reduce regulatory uncertainty for start-up facilities, which would only have to comply with ASIC's licensing regime while they remained small enough to benefit from the exemption.

However, holders of stored value, such as government authorities, which present very little risk to users or to the community, and the users of the associated facilities, would still face the costs of ongoing prudential supervision. Similarly, authorised deposit-taking institutions (ADIs) are already subject to extensive regulatory controls and prudential supervision. There would be little additional public benefit in supervising Commonwealth, state or local government authorities which act as holders of stored value, or holders of stored value which obtain a legally robust guarantee from an ADI.

Option III will reduce compliance costs on start-up facilities and facilities which present very little risk to users or to the community. It will in turn reduce the costs of such facilities faced by users, and should benefit the community through innovation, increased choice and competition. It will also reduce the costs to the Reserve Bank of regulating such facilities. Any such facilities which do not meet the draft exemptions and which are too small for APRA supervision will, however, be required to apply to the Reserve Bank for authorisation on a case-by-case basis.

7. Consultation

The Reserve Bank released the draft exemptions for public comment on 15 September 2003. Interested parties were requested to provide comments on the draft exemptions by 24 October 2003.

The Reserve Bank received submissions from four parties. On the exemptions for small-scale and limited purpose facilities, two submissions were made to broaden the exemptions to apply to a wider range of facilities. The Bank is aware, however, that the power to exempt under section 9(3) of the Act is primarily aimed at small and limited-purpose facilities.² The Bank is, therefore, wary of drafting any exemption which may potentially exceed the scope of the Bank's statutory power. Furthermore, the Bank's ability to exempt facilities on a case-by-case basis under section 25 of the Act is applicable to facilities regardless of size. On this basis, the Bank believes it appropriate to gazette the exemption as currently drafted, while dealing with larger facilities on an individual basis.

It was also submitted that the exemption for guaranteed facilities be broadened to apply to a wider range of facilities. In order to do so, the Bank may only exempt a corporation under section 25

² See paragraph 5.44 of the Explanatory Memorandum to the *Payment Systems (Regulation) Act 1998*.

where it is satisfied that the holder of stored value will be able to satisfy its obligations with respect to the purchased payment facility. It is the Bank's view that facilities guaranteed by authorised deposit-taking institutions, and by government authorities, will meet this test. It is not clear that there is another class of facilities that will be able to meet this test in all cases. Again, the Bank proposes to gazette the exemption as drafted, and to deal with other facilities on a case-by-case basis.

The submissions also contained some minor comments on drafting and definitional issues. The Bank raised these with external counsel, who found no reason to change the drafting as it currently stands.

8. Conclusion and Option Chosen

As outlined above, the Bank believes that there is a need to clarify and streamline the regulatory regime for purchased payment facilities, in a manner consistent with the promotion of competition and public confidence in such facilities. The costs of imposing prudential regulation on small and limited-purpose facilities, some of which may be operating on a trial basis, are high and are likely to result in little public benefit. In addition, there would appear to be little public benefit in regulating facilities whose obligations are guaranteed by an authorised deposit-taking institution (themselves prudentially regulated) or by government. For these reasons, the Bank has chosen to adopt Option III as outlined above.

9. Implementation and Review

The implementation of the draft exemptions may result in their being some facilities which do not meet the criteria for exemption from the Act, but which are also too small for regulation by APRA. Thus the Bank will be required to assess applications from any such facilities on a case-by-case basis for authorisation under section 23 of the Act. The Reserve Bank will therefore be able to directly assess the effectiveness of the exemptions through frequent contact with the industry. The Bank has also been in discussion with ASIC on the potential for information-sharing with regard to licensed non-cash payment facilities which also meet the definition of purchased payment facilities. Further discussions will be held once the exemptions have been finalised.

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SYDNEY
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