POTENTIAL GAME CHANGERS: ROUNDUP OF LEGAL CHANGES IN THE CHINA PAYMENTS INDUSTRY

DOMESTIC BANK CARD CLEARING MARKET OPENS UP

Only a few months ago, the State Council's announcement of the *Decision on the Implementation of Market Access Administration in relation to Bank Card Clearing Institutions* (the "**Decision**") marked the opening of China's domestic bank card clearing market. This followed a high level policy statement issued by the State Council in October 2014, that *in principle* overseas enterprises would be permitted to file applications for setting up bank-card clearing institutions in China (see **here** for more on the Statement).

The Decision, which was issued on 9 April 2015 and became effective on 1 June 2015, requires all bank card clearing institutions in China to obtain a Bank Card Clearing Business Licence ("**Licence**"). Significantly, the Decision enables foreign companies, for the first time, to compete in this market, by one of two routes: (i) by setting up a foreign invested enterprise ("**FIE**"), or (ii) by acquiring a domestic bank card clearing institution (subject to a security review). The Decision is expected to bring about changes in the structure of the bank card clearing market, enhancing competition and ending the 12-year monopoly of China UnionPay in the domestic market. The attraction for foreign companies to enter this market is obvious: last year, the volume of bank card transactions in China exceeded RMB 42 trillion (around US$7 trillion).

While the Decision marks a clear step forward, and presents a significant opportunity to international credit card clearing businesses like Visa and MasterCard, we expect there will remain practical challenges for foreign players to become eligible. Moreover, even without regulatory barriers, foreign players will need to go through the process of persuading banks to issue their cards and merchants to accept them. The emergence of new entrants and enhanced competition is therefore likely to be incremental, and we are not likely to witness significant changes until the end of 2016.

Highlights of the Decision

Pre-conditions for eligibility: The Decision provides a set of pre-conditions for applicants to become eligible bank card clearing institutions. Among other things, the applicant must be incorporated under PRC Company Law with registered capital of at least RMB 1 billion with a bank card clearing system which meets national and industry standards. Other pre-conditions include requirements on shareholding structure and financial stability of the institution, qualifications of senior management personnel and prudential requirements such as appropriate internal controls and risk management.

Procedures of application: The applicant is required to submit a preliminary application to the People's Bank of China (PBOC). The PBOC, after obtaining consent from the China Banking Regulatory Commission (CBRC), will inform the applicant of its decision within 90 days of receipt of the preliminary application, and within one year of preliminary approval, the applicant must complete certain preparatory work. A second application is then submitted which, if approved, will result in issuance of a Licence.

Business operational requirements: The Decision outlines principle requirements on the operation of bank card clearing businesses. For example: the bank card clearing system should be owned by the bank card clearing institution itself; the infrastructure should be safe, efficient and stable; and the information acquired in the course of bank card clearing operations should remain confidential. The requirement for onshore processing infrastructure and PRC compliant systems (without any grace period to enable systems to be adapted) could pose a practical challenge for foreign applicants.

Special rules on foreign-funded institutions: Foreign applicants should submit their applications to PBOC through their FIEs. Note that foreign companies providing foreign currency clearing services for cross border transactions are not required to obtain a licence in principle, but should report to the PBOC and CBRC and comply with relevant business administration rules.

STRINGENT NEW CONTROLS ON INTERNET PAYMENTS INDUSTRY

While the bank card clearing market opens its doors, legal changes in other areas of the payments industry, namely online payment solutions, are expected to challenge new entrants. Anticipated new regulations could potentially slow down the online payments industry which has, until now, been one of the country's fastest developing industries. The *Administrative Measures for Internet Payment Services of Non-Banking Payment Institutions (Draft)* (the "**Draft Measures**") were published by the People's Bank of China ("**PBOC**") on 31 July 2015, and have undergone a consultation period, which ended on 28 August 2015, and we await news on when the final Measures will be published.

The Draft Measures indicate a clear shift towards a more stringent legal regime for the internet payments industry, which has until now been subject to relatively light regulation.

Highlights of the Draft Measures

The Draft Measures intend to impose strict obligations on non-banking payment institutions that operate internet payment businesses. Perhaps most notably, they will introduce:

- specific technical requirements in relation to customer identity verification;
- an annual limit and daily cap for online payments;
- restrictions on funds remitted between bank accounts; and
- a ban on the provision of certain financial services.

Requirements of identity verification: When opening a Payment Account for customers, the payment institution is required to register and verify the customers' identity through no less than 3 external channels (e.g. by way of the public security bureau, tax office and credit reporting agencies).

Setting up a "comprehensive account" and "consumption account": The Draft Measures provide two types of Payment Accounts that the payment institution may open for customers, depending on the degree of identity verification. A "comprehensive account" may be set up if either (i) the identity verification is conducted face-to-face; or (ii) the identity verification is completed through no fewer than 5 external channels. If the customer's identity is verified through 3 or 4 external channels, the payment institution is only allowed to open a "consumption account" for the customer.

Functions and annual online payment limit of the "comprehensive account" and "consumption account": The "comprehensive account" and "consumption account" differ both in terms of their functions and their annual online payment limit. The "comprehensive account" can be used for transactions, remittances and purchases of investment or financial products, while the "consumption account" can only be used for transactions and remittances. The annual online payment limit for all "comprehensive accounts" owned by a particular customer cannot exceed RMB 200,000, while the limit for all "consumption accounts" owned by a particular customer is RMB 100,000. Any sums in excess of the payment limit should be processed through the customer's bank account.

Daily cap on online payments: There are also daily caps for online transactions, depending on the security measures used to verify a customer's payment instructions. Specifically:

i. if payment instructions are verified through 2 or more means, one of which is a digital certificate or electronic signature, the daily cap can be agreed by the customer and payment institution;

ii. if payment instructions are verified through 2 or more means *not* including a digital certificate or electronic signature, the daily cap for all Payment Accounts owned by the customer is RMB 5,000; and

iii. if payment instructions are verified through fewer than 2 means, the daily cap for all Payment Accounts of the customer will be RMB 1,000, and the payment institution is fully liable for the risks and losses associated with the relevant transaction.

Note, however, that the transfer of funds from a customer's Payment Account to his/her own bank account is not restricted by the above rules.

Restrictions on remittance: The Draft Measures impose restrictions on remittances between a customer's Payment Account and bank accounts. Customers are only permitted to transfer funds from their own personal savings or current account into their own Payment Account, and vice versa.

Ban on provision of financial services: The Draft Measures make clear that payment institutions are not financial institutions, and are banned from providing financial services in any form. "Financial services" include cash deposits and withdrawals, money lending, funding, wealth management, guarantee services and currency exchange.

Payment institutions are also required to report to PBOC before providing any "innovative" internet payment products or services; there are certain requirements to protect customers' personal data, for example, payment institutions must not store customers' sensitive information (such as bank account passwords and verification codes).

While regulation of the payments industry is necessary to protect consumers and enhance confidence in innovative payments systems, the new regulations, if implemented, could close the market to potential new players due to the significant costs involved in operating multiple verification measures. The fairly low transaction caps are also likely to impact overall revenue for online payment providers.

FUTURE DEVELOPMENTS

We will continue to monitor developments in this regard and provide our clients with updates. In the meantime, if you would like any further information on payment regulations in China, our Technology team would be pleased to hear from you.

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