Regulation of Stored-value Facilities in Australia

Conclusions of a Review by the Council of Financial Regulators

October 2019

Council of Financial Regulators

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Contents

Executive Summary 1

Introduction 3

The Current Regulatory Framework 5

Stakeholder Consultation 10

Conclusions of the CFR Review 11

Executive Summary

The Council of Financial Regulators (CFR) has undertaken a review of the regulation of stored-value facilities (SVFs) in Australia. SVFs are payment services that enable customers to store funds in a facility for the purpose of making future payments. The 2014 Financial System Inquiry (FSI) identified the regulation of purchased payment facilities (PPFs) – a particular type of SVF defined in legislation – as having scope to be improved, and the Productivity Commission's 2018 Inquiry into Competition in the Australian Financial System recommended that the CFR review regulatory arrangements for PPFs. In conducting the review, the CFR consulted with a range of stakeholders including current and prospective providers of SVFs, banks, fintech companies and international regulators.

The recommendations in this report are aimed at modernising regulatory arrangements for SVFs, recognising the potential for such facilities to play a more prominent role in the payments system in the future as has occurred in some other jurisdictions. The CFR has sought to simplify the regulatory framework in a way that is conducive to innovation, while providing appropriate consumer protections.

The CFR also recognises that payments is a fast-moving part of the financial system and some flexibility will be required to ensure that regulation is able to adapt to innovations. An example of the type of innovation that could occur in this area is the recent attention on proposals to develop digital wallet facilities to provide payment services using 'global stablecoins'.

The CFR's key recommendations are:

Recommendation 1: Stored-value facilities (SVFs) should be introduced as a new class of regulated product, replacing 'purchased payment facilities' in the regulatory framework. Regulation of SVFs should be graduated and commensurate with risks to consumers.

Recommendation 2: Certain SVFs (and other payment products) that pose limited risk to consumers – such as small and/or limited-purpose facilities – should continue to be largely exempt from most regulatory requirements.

Recommendation 3: Issuers of payment products that hold client funds for only a short period of time for the purpose of facilitating a payment should be required to hold an Australian Financial Services (AFS) licence from the Australian Securities and Investments Commission (ASIC) and comply with the requirements of an updated ePayments code.

Recommendation 4: ASIC should be given the power to make compliance with the ePayments code mandatory, such as through a rule-making power.

Recommendation 5: The Australian Prudential Regulation Authority (APRA) and ASIC should be responsible for regulating and licensing SVF providers, consistent with their respective mandates for prudential supervision and consumer protection. The Reserve Bank of Australia (RBA) should no longer be involved in regulating individual providers of SVFs, helping to streamline regulation in this segment of the market.

Recommendation 6: APRA should be responsible for prudential supervision of large SVFs that enable consumers to hold a significant amount of funds for long periods and to withdraw their funds on

demand in Australian currency (e.g. by transferring funds to their bank account). These facilities are likely to offer similar functionality as a bank deposit and should be subject to the highest level of regulatory oversight within an updated regulatory framework for SVFs.

Recommendation 7: APRA should review its existing PPF prudential framework, with a view to introducing requirements for SVFs that are simpler, more targeted to the key risks posed by such entities and, where appropriate, better aligned with international approaches.

Recommendation 8: ASIC should be responsible for regulating SVFs that do not meet the criteria for APRA prudential supervision. In addition to holding an AFS licence, providers of these products should be subject to additional requirements administered by ASIC to ensure the safety of consumers' funds. In particular, the *Corporations Act 2001* (Corporations Act) should be amended to ensure that protections on client money loaded in to SVFs operate effectively and client funds cannot be used as the provider's working capital.

Recommendation 9: AFS licensees that are subject to the amended client money protections should be required to report to ASIC on the amount of stored value that is held and transaction flows (e.g. aggregate amount in and out during a period).

Recommendation 10: A revised regulatory framework should incorporate a mechanism to 'designate' certain facilities as being subject to APRA supervision in the public interest (e.g. on the basis of financial system risk considerations). The CFR should develop principles to guide such decisions, which could be vested in the Minister or exercised jointly by APRA and ASIC.

Recommendation 11: The CFR agencies should further consider additional measures to improve the clarity and transparency of SVF regulation for consumers and regulated entities. This could potentially include publishing a simple guide to payment regulation and providing guidance through ASIC's MoneySmart site for consumers using SVFs.

Introduction

The main elements of the framework for Australian retail payments regulation were established following the recommendations of the Wallis Inquiry in the late 1990s. The Final Report of the 2014 Financial System Inquiry (FSI) concluded that the arrangements for payments system regulation had generally served Australia well, although there was room for improvement with regard to aspects of the framework for regulating participants in the retail payments system. A particular focus of the FSI was the arrangements for regulating purchased payment facilities (PPFs) – a category of stored-value facilities – which were viewed by the FSI as complex and subject to potential regulatory overlap. The report from the Productivity Commission's Inquiry into Competition in the Australian Financial System (PC Report), which was published in August 2018, recommended that the Council of Financial Regulators (CFR) review the regulatory framework for PPFs.

In this context, the CFR has reviewed the regulatory regime for stored-value facilities (SVFs) in Australia. SVFs potentially encompass a wider range of facilities – in which stored funds are used to make payments – than PPFs, which were defined as a specific category of stored-value facilities in 1998.[1] The review had the following broad objectives:

- to identify opportunities to simplify the regulatory framework for SVFs
- to ensure that regulation does not pose an undue obstacle to innovation and competition, while maintaining appropriate levels of consumer protection and system-wide safety
- to identify any changes necessary to enable regulation to adapt to recent and prospective developments in the payments market, including those associated with advances in technology and new participants
- to identify opportunities to improve the 'competitive neutrality' of regulation
- to improve the transparency and clarity of regulation, from the perspective of regulated entities, potential new entrants, and consumers and other users.

In recent years there have been a number of developments that highlight the need to update the regulatory regime for SVFs so that it is suitable for a modern payments system. Internationally, SVFs have grown strongly in some jurisdictions, and the recent announcement by a large technology company of plans to launch a digital wallet facility to provide payment services using a 'global stablecoin' has attracted considerable attention. While details of this proposal are still emerging, and the potential international regulatory response is still being considered, it underscores the importance of having a regulatory framework that is able to adapt to the rapid pace of innovation in the payments system. Domestically, the regulatory agencies have seen increasing interest from providers of stored-value products and the CFR's recommendations are aimed at introducing a regulatory framework that

1 While the focus of the review was on the regulation of stored-value facilities, it also considered the operation of a number of other areas relevant to retail payments service providers that could be improved or clarified. Examples include some of the definitions in the Corporations Act and the broader applicability of the ePayments Code.

is easier to navigate for regulated entities, more graduated according to risks, and that provides adequate protection for consumers.

The Current Regulatory Framework

Current Regulatory Arrangements

The Wallis Inquiry established the main elements of Australia's financial regulatory framework, based on the principle of 'functional' – as opposed to 'entity-specific' – regulation. In broad terms, the Australian Prudential Regulation Authority (APRA) is responsible for prudential regulation; the Australian Securities and Investments Commission (ASIC) is responsible for market conduct and consumer protection; and the Reserve Bank of Australia (RBA) regulates the payments system and oversees the stability of the financial system as a whole. Each of these agencies has particular responsibilities in relation to participants in the payments system. Within this framework, the regulation of PPFs, in particular, has been identified as an area of complexity and potential regulatory overlap (see 'Recommendations of Recent Inquiries' section below).

PPFs are facilities that enable funds to be stored for the purpose of making future payments. This includes a range of payment products in which funds are prepaid and the facility maintains a 'float' of stored value for making payments. Prepaid products that are small and/or have a limited purpose – such as limits on the amount of value that can be held in the facility or the number of merchants at which it can be used – are typically exempted from many regulatory requirements.

At the time of the Wallis Inquiry, it was anticipated that the development of stored-value cards and 'smart' cards would begin to displace cash and 'traditional' payment cards (i.e. credit and debit cards) over the ensuing years. It was also thought that new participants outside the regulatory perimeter might offer these facilities. The focus on stored-value facilities was likely influenced by a number of initiatives which were piloted during the 1990s.[2] While these types of products did not take off as envisaged by the Wallis Inquiry, there has been increased attention in recent years on the potential for this segment of the market to grow as new types of electronic facilities emerge and the range of payment services offered expands.

In countries such as China, for example, mobile wallet services like Alipay and WeChat Pay have become very popular. These services enable users to make payments with funds loaded into the facility, as well as to access a range of other financial services (e.g. interest-bearing asset management products, crowdfunding and credit). In Australia, PayPal is currently the only APRA-regulated PPF provider.

Regulatory arrangements for PPFs have undergone a number of changes since they were introduced following the Wallis Inquiry. Initially, the RBA's Payments System Board was given responsibility for PPFs that were not offered by authorised deposit-taking institutions (ADIs), partly reflecting the view of the Inquiry that SVFs would become a more prominent part of the financial system.[3] Responsibility for 'widely available' facilities, where the funds are redeemable on demand in Australian currency, was subsequently moved to APRA in the early 2000s on the basis that the money held in these facilities was

2 Including the Mondex and Visa Cash systems.

3 The Wallis Report on the Australian Financial System (1997), 'Chapter 9: Stability and Payments', Final Report, June.

similar to a bank deposit.[4] Another regulatory change in the early 2000s was that ASIC was given explicit responsibility for the financial services licensing, conduct and disclosure regime in relation to non-cash payment (NCP) facilities, a broader class of facilities which includes PPFs.[5] Accordingly, ASIC, APRA and the RBA all now have regulatory roles in relation to PPFs, depending on the size and nature of the facility, and the risks being addressed (Figure 1).

- APRA is responsible for supervising PPF providers that have payment obligations over $10 million that are payable on demand, redeemable in Australian currency and available on a 'wide basis' (more than 50 users).[6] Providers of these facilities are deemed to be conducting 'banking business' under the *Banking Regulations 2016*, and are authorised and supervised by APRA as a special class of ADI.[7]
- The RBA has regulatory responsibility for all other (non-ADI) PPF providers – i.e. those that are not widely available or redeemable on demand in Australian currency – and is required to authorise or exempt non-ADI PPF providers from regulation. To date, the RBA has not authorised any PPF providers because the facilities that have been established have been relatively small and/or limited purpose. The RBA has granted class exemptions for certain low-value and limited purpose facilities.[8]
- ASIC's responsibilities in relation to payment products – which includes SVFs – form part of its broader responsibilities for administering the Australian financial services (AFS) licensing framework, as well as the consumer protections from the Australian Consumer Law which are replicated in the *Australian Securities and Investments Commission Act 2001.*

  ASIC takes a flexible approach to administering its obligations in relation to payment products, including granting exemptions for low-value facilities in which funds held by any one client are not more than $1,000 and total stored value held by all clients in the same facility is less than $10 million.[9] Exemptions to some aspects of ASIC's financial services regime have also been granted for gift vouchers and gift cards, prepaid mobile phone accounts, loyalty schemes and electronic road toll devices. There are also additional exemptions in the laws ASIC administers.[10]

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4 See <https://www.rba.gov.au/media-releases/2000/jmr-rba-apra.html>.

5 Non-cash payments are payments made or caused to be made, otherwise than by the physical delivery of Australian or foreign currency in the form of notes and/or coins. The *Financial Services Reform Act 2001* introduced NCP facilities as financial products under the *Corporations Act 2001* as ASIC viewed these products as clearly being intended to be regulated as part of the financial services regulatory regime.

6 *Banking Regulation 2016*, Regulation 6. See also RBA Declaration No. 2, 2006 regarding Purchased Payment Facilities <https://www.rba.gov.au/media-releases/2006/pdf/mr-06-02-purchased-payment-facilities-dec-2.pdf>.

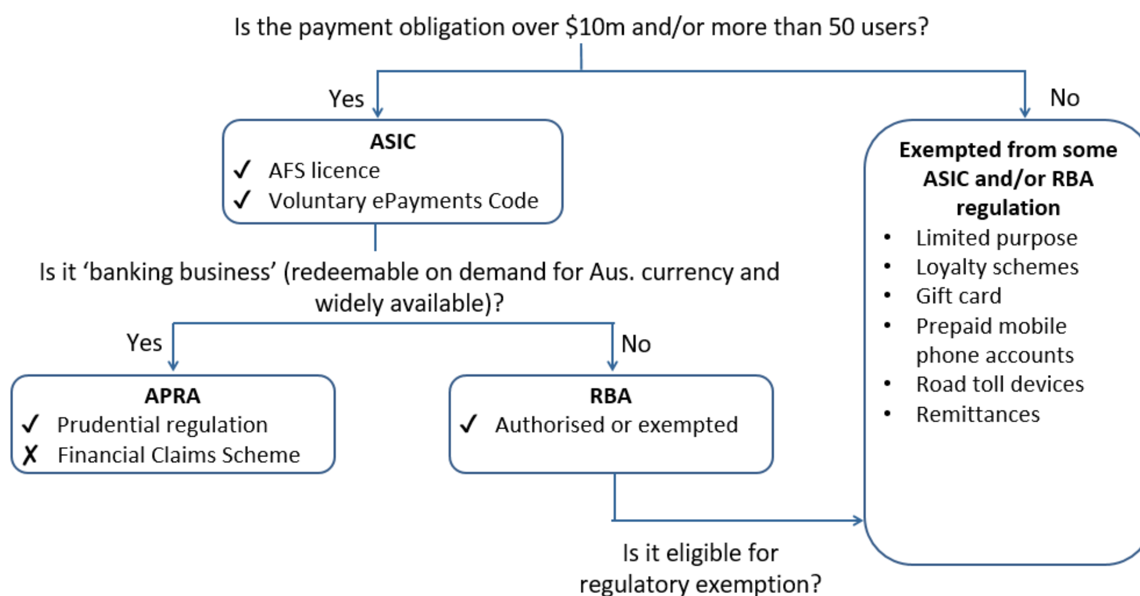
7 At this time, PayPal is the only entity licensed and supervised by APRA as a PPF provider, a special class of ADI. Unlike deposits in ADIs up to $250,000 per account holder, funds held in PPFs are not protected under the Australian Government's Financial Claims Scheme. ADIs also provide a range of these facilities, for example operating open-loop prepaid card facilities. ADIs do not require a separate authorisation to engage in this business under the *Payment Systems (Regulation) Act 1998*.

8 The RBA's regulatory responsibilities for PPFs stem from the *Payment Systems (Regulation) Act 1998*. Under section 9(3) of the Act, the RBA may declare that the Act does not apply to a specified PPF or to a class of facilities. To date, the RBA has exempted: loyalty schemes; gift card facilities; electronic road toll devices; prepaid mobile phone accounts; limited value (less than $10 million) facilities; limited participant (less than 50 payees) facilities; and the Westfield insurance card facility. The RBA may also exempt corporations from the Act, under section 25. To date, the RBA has exempted corporations that are guaranteed by an ADI or government authority.

9 Under current arrangements, a provider could potentially offer a number of different facilities and not be required to hold an AFS licence if individual facilities do not exceed the $10 million threshold.

10 Examples include reg. 7.1.07G, which is relied on by many remittance businesses.

Figure 1: Purchased Payment Facility Regulatory Framework



Recommendations of Recent Inquiries

Recent government inquiries have recommended that the regulatory arrangements for SVFs be reviewed for a number of reasons, including: the current framework is complicated and involves multiple regulators which, it has been argued, may deter potential new entrants and impose significant compliance costs; regulation may not be competitively neutral (for example, some PPF providers may be subject to certain stronger regulatory requirements than a traditional ADI when it is offering a similar service); and regulation may be 'stifling' the development of this segment of the payments system.

The 2014 FSI recommended 'enhanced graduation' of retail payments regulation, including by clarifying thresholds for regulation by APRA and ASIC (see Box A).[11] In particular, the FSI suggested that a new, APRA-administered prudential regime should apply for PPFs, which would only capture those of 'sufficient scale'. The FSI recommended using clear numeric thresholds, for example, to determine which facilities are 'large and widely used'. Within this new prudential regime for PPFs, entities would be able to choose between: (i) a tier with low compliance costs and prudential requirements, but requiring a 100 per cent liquidity ratio;[12] and (ii) a tier with a lower liquidity ratio but strengthened other prudential requirements. The FSI argued that the second tier would address concerns that APRA-regulated PPF providers currently face a higher liquidity requirement than traditional ADIs, which may be hindering competition. The FSI suggested that this could create a perverse incentive for smaller entities to limit their growth to avoid being subject to the PPF prudential regime.

A more general recommendation of the FSI regarding payment service providers was that AFS licences should be required only by entities providing access to large, widely available payment

11 Financial System Inquiry (2014), Final Report, November, available at <http://fsi.gov.au/publications/final-report/>.
12 In practice, this could mean, for example, that all customers' stored value is held in liquid assets such as bank deposits.

services/facilities. The FSI also argued that consumers would receive basic consumer protection regulation from the ePayments Code, which should become mandatory.[13]

In addition, the FSI recommended that regulators should publish a clear guide to payments regulation for the industry, particularly for new entrants, because greater transparency would help ensure that regulation is better understood by industry and encourage future innovation.

Box A: FSI Recommendation 16

Enhance graduation of retail payments regulation by clarifying thresholds for regulation by the Australian Securities and Investments Commission and the Australian Prudential Regulation Authority.

Strengthen consumer protection by mandating the ePayments Code. Introduce a separate prudential regime with two tiers for purchased payment facilities.

The Productivity Commission released the final report from its Inquiry into Competition in the Australian Financial System in August 2018 (PC Report; see Box B). The PC Report largely supported the recommendations of the FSI with regard to PPFs, arguing that PPFs face complex and 'potentially stunting' regulation (which imposes significant compliance costs) that can deter entry and expansion.[14] The Commission observed that use of SVFs such as Alipay and PayPal had grown rapidly in other jurisdictions and suggested that the regulatory framework in Australia may be limiting growth in the local market.

The commission made similar recommendations to the FSI with regard to the development of clear regulatory thresholds and the possible introduction of a tiered prudential regime for PPFs. It suggested that PPFs with stored value below $10 million should remain exempt from prudential regulation; facilities with stored value between $10 million and $50 million should be regulated by the RBA's Payments System Board or otherwise be exempted; and those with stored value above $50 million and allowing individual customers to hold above $500 should be regulated by APRA. The Commission recommended a lower threshold on individual holdings than the FSI (which suggested $1,000). As suggested by the FSI, those PPFs regulated by APRA would be able to choose between: (i) a tier with low prudential requirements but requiring a 100 per cent liquidity ratio; and (ii) a tier with a lower liquidity ratio but otherwise higher prudential requirements.

Box B: PC Report Recommendation 17.5

The Council of Financial Regulators should review the current regulation of Purchased Payment Facilities (PPFs).

The review should develop an approach to simplify the regime, develop clear thresholds for regulatory responsibility and reduce barriers to growth in this sector. The review should consult on

13 The ePayments Code is a voluntary code of practice administered by ASIC that regulates electronic payments, including ATM, eftpos and credit card transactions, online payments, internet and mobile banking and BPAY. The Code sets out requirements on: how subscribers should provide terms and conditions, receipts and statements to consumers; determining who pays for unauthorised transactions; and the recovery of mistaken internet payments. The FSI and PC Report recommended that the ePayments Code be made mandatory.

14 Productivity Commission (2018), 'Competition in the Australian Financial System', August, available at <https://www.pc.gov.au/inquiries/completed/financial-system/report/financial-system.pdf>.

and design a tiered regulatory structure for PPFs, including one tier that does not attract prudential regulation.

The review should be completed by end-2018 at the latest and provide a path forward for regulators by mid-2019.

Stakeholder Consultation

The CFR published an Issues Paper for public consultation in September 2018 inviting written submissions on a range of issues relating to the regulatory framework for SVFs. The Issues Paper sought stakeholders' views on some general issues relating to the market for SVFs, consumer demand and the impact of regulation on innovation. The aim of these questions was to better understand issues such as potential impediments to competition and innovation in this segment of the payments market, and the extent of unmet consumer demand for SVFs. The Issues Paper also invited feedback on a number of more-targeted questions regarding possible regulatory approaches to SVFs. These included the specific recommendations of the FSI and PC Report in relation to regulatory thresholds, as well as some potential alternatives to those recommendations.

The CFR received nine written submissions by the deadline, which have been published on the CFR website. Submissions were received from a range of stakeholders, including industry bodies, established payments providers, a major bank and a number of fintech firms. The CFR also convened an industry roundtable in early November 2018, with representatives from 17 organisations participating.

One of the main themes from the public consultation was that most stakeholders considered that there was potential for SVFs to become a more prominent part of the payments system in Australia. It was observed, however, that Australian consumers already have access to a range of convenient payment services. Accordingly, the general view was that SVFs had potential to grow to fill particular 'gaps' or address frictions in certain areas (e.g. cross-border payments). This would be in contrast to the situation in some other jurisdictions such as China, where stored-value products (e.g. Alipay, WeChat Pay) have become a ubiquitous means of payment.

Current regulatory arrangements in Australia were generally viewed as somewhat complicated, partly because of the involvement of multiple regulators. A particular concern for some stakeholders was that the regulatory requirements imposed by APRA on large, widely used facilities were in their view far more onerous than those imposed on smaller facilities under the ASIC-administered regime. It was argued that this could be a deterrent to growth. Another observation was that the definitions and terminology used in the Australian framework were not commonly used in other jurisdictions – for example, the term 'purchased payment facility' is not used elsewhere – and there could be benefit from being more consistent with international approaches. Additionally, it was generally acknowledged that consumer protection is important, and that rules to ensure that client funds are held safely should be a key element of an updated framework.

In terms of how to delineate the responsibilities of different regulators, a number of stakeholders argued that an approach based on the characteristics and risks of the business (i.e. an activity-based approach) was preferable to numerical thresholds of the sort proposed by the PC Report and the FSI. Basing regulation solely on thresholds relating to the total size of a facility or individual client holdings, for example, could act as a deterrent to growth in this segment of the market.

Conclusions of the CFR Review

Overview of the Proposed Approach to Regulation

The CFR's focus has been on the overall framework for regulating SVFs in Australia, taking account of the recommendations of recent inquiries and stakeholder feedback. As some elements of the regulatory regime apply to payment products that are not SVFs, issues relating to the broader regulation of payments products have also been considered where warranted. As discussed above, the aim of the review has been to develop a simpler, more transparent regulatory framework that is conducive to innovation while providing appropriate protections to consumers.

Consistent with these aims, the CFR recommends a number of changes to the current regulatory framework. These include:

- Introducing SVFs as a new class of regulated product, replacing 'purchased payment facility' in any applicable laws and regulations. Similarly, definitions should be simplified and made more intuitive – for example, SVFs could be defined along the following lines.[15]

  A stored-value facility (SVF) is a facility that can store monetary value which can be used as a means of making payments for goods and services or transferred to another person. These facilities may be either single or multi-currency. The SVF issuer makes payments on behalf of the user up to the amount of stored value that is available for use under the conditions applying to the facility.

- Reducing the number of responsible regulators in this segment of the market, with the RBA no longer having a role in relation to individual providers of SVFs (or PPFs).

  APRA and ASIC would be responsible for particular facilities, consistent with the respective mandates of those agencies (see below). In this model, the RBA would focus on its existing powers to designate and regulate payment systems on the basis of system-wide competition, efficiency or systemic risk concerns, rather than on the regulation and supervision of individual SVF providers.

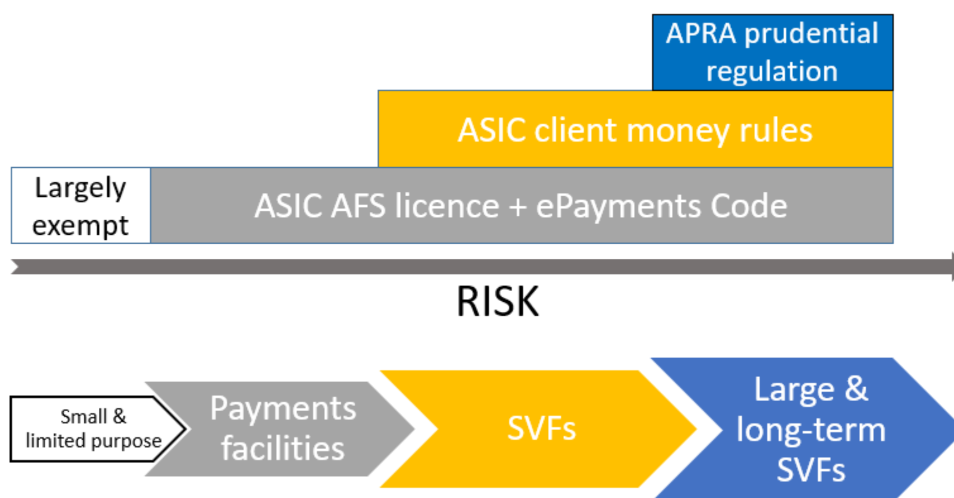
In terms of the division of responsibilities between ASIC and APRA, the CFR has sought to balance the recommendations of recent inquires that favoured numerical thresholds as a way of delineating regulatory responsibilities with stakeholder feedback that an activity-based approach would be preferable. The principle informing the recommendations on regulatory boundaries is that regulation should be commensurate with risks to consumers and the payments system. While numerical thresholds are only a rough proxy for risk, they have the benefit of simplicity and transparency.

Accordingly, an approach is being recommended in which activity-based criteria are supplemented with size-based thresholds to help determine which facilities would be subject to APRA prudential regulation. Consistent with a risk-based approach to regulation, it is proposed that providers of certain types of small and limited-purpose facilities should continue to qualify for exemptions from most

15 There is potential for this definition to be refined as part of the legislative process to implement any of the CFR's recommendations that may be accepted by the Government.

regulatory requirements on the basis that they pose relatively little risk to consumers or to the system as a whole (Figure 2).[16] Issuers of these facilities would not be required to hold an AFS licence but would be subject to the requirements of the Australian Consumer Law. It is envisaged that the current exemptions relating to small/limited purpose facilities will remain appropriate, although it is worth noting that these are due for review and ASIC may consult on specific exemptions as part of the implementation of the revised regulatory framework.[17]

Figure 2: Stylised Regulatory Framework



One way in which risk to consumers can be differentiated is according to the length of time that a facility holds client funds. Facilities that hold funds temporarily for the purpose of facilitating a payment are likely to pose less risk to consumers than those in which funds can be held for longer periods. For facilities that provide such payment services, the main risks to consumers relate to the transmission of funds, unauthorised transactions and mistaken payments. Such risks may be adequately managed by mandating (and updating) the ePayments Code and requiring providers of these facilities to continue to hold an ASIC AFS licence. This could be done without necessarily changing the terminology in the Corporations Act. Additionally, these services would need to comply with AUSTRAC's anti-money laundering/counter-terrorism financing (AML/CTF) requirements.

SVFs that do not qualify as 'small and/or limited-purpose' would be subject to additional ASIC requirements to ensure the safety of consumers' funds, and potentially also be subject to APRA supervision depending on the nature of the facility. In particular:

- APRA would prudentially supervise 'large' providers of SVFs that hold more than $50 million in total client funds, which offer customers the ability to hold a significant amount of money (over $1,000) for long periods (greater than 31 days) and enable these funds to be withdrawn on demand. The CFR is of the view that such facilities are likely to be viewed by consumers as close substitutes for ADI deposits and should therefore be subject to the highest level of regulation within a revised

16 Notwithstanding the fact that relatively low-value holdings could still be significant relative to the incomes of some consumers.

17 Currently exemptions are in place for products such as transport cards, gift cards, loyalty schemes and small facilities holding less than $10 million of client funds.

framework for SVFs. As discussed further below, APRA is however considering an approach that would impose less onerous requirements on SVFs than its current PPF framework.[18]

- Any SVF provider that did not meet the criteria for APRA regulation and which did not qualify for any other exemptions would be required to comply with provisions designed to ensure that customers' funds held in SVFs are kept safely on behalf of customers (in addition to complying with the ePayments Code and the current requirements associated with being an AFS licensee).[19]

To account for the uncertainty of future developments in the market, an additional element of an updated regulatory framework would be a mechanism to 'designate' a SVF provider as being subject to APRA's prudential regulation on the basis of financial safety or stability considerations. This would provide the flexibility to enable regulators to adapt in a timely way if a facility were to emerge that posed risks to the system but did not strictly meet the criteria for APRA supervision. While the mechanism for exercising such powers is yet to be determined, it is envisaged that it could be vested with the Minister, or exercised by APRA and ASIC jointly. The CFR intends to develop principles to guide designation decisions.

Consumer Protection

Protections for consumers will be an important aspect of the regulatory framework, and all classes of facilities will be subject to some requirements intended to address risks to consumers.

General protections

All facilities will continue to be subject to the general consumer law requirements that apply throughout the economy, such as the prohibitions against misleading and deceptive conduct and false and misleading representations. For financial services, these protections are administered by ASIC under the *Australian Securities and Investments Commission Act 2001*.

Businesses that provide payment products and services will continue to generally be required to hold an AFS licence issued by ASIC, and will be subject to the requirements of the Corporations Act. These include a range of general conduct obligations, such as requirements to operate efficiently, honestly and fairly, to maintain competence to provide financial services and to have sufficient resources to operate their regulated business. AFS licensees must also maintain internal dispute resolution procedures and be members of the Australian Financial Complaints Authority – an external dispute resolution body. The Corporations Act also requires licensees (and/or their representatives) to provide disclosure documents to their retail clients.

As noted above, ASIC will review its existing exemptions from the Corporations Act requirements to ensure they remain fit for purpose. In addition to this, some minor technical amendments may be required to the Corporations Act to give certainty about the breadth of definitions and exemptions in the legislation.

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18 As is the case with PPFs, funds held in SVFs would not be covered by the Government's Financial Claims Scheme which provides protection to deposits in banks, building societies and credit unions.

19 With the removal of the current $10 million cap, ASIC's jurisdiction may also include large businesses that offer products outside the criteria for APRA regulation.

Protections on client monies and reporting requirements

A key element of the overall reform package will be to ensure that customers' funds held in SVFs are adequately protected. ASIC has observed that there is a view within the industry that the provisions in the Corporations Act designed to protect stored value – such as requiring AFS licensees to hold client monies on trust in an account with an ADI – do not apply to money loaded into SVFs.

Accordingly, these rules are not operating as intended and changes to the Corporations Act will be required to ensure that protections on client money loaded to SVFs operate effectively and client funds cannot be used as the provider's working capital. The client money provisions in the Corporations Act are intended to ensure that client funds are held in a trust account with an ADI for the benefit of the consumer and cannot be co-mingled with the provider's own funds or working capital.

The recommended changes to the Corporations Act would be informed by other recent changes to the client money rules, and include restrictions on the circumstances where client money can be withdrawn – for example, rules that do not permit client agreement/instruction that money be used as the licensee's capital, to meet obligations incurred by the licensee other than on behalf of the client. These protections would ensure the integrity of the client money regime.

In addition, it is envisaged that SVF providers would need to report to ASIC on the amount of stored value that is held and transaction flows (e.g. aggregate amount in and out during a specified period). Currently ASIC and APRA have little information on the amount of funds held in these facilities. The reporting requirement will help to identify providers that are nearing the prudential threshold, and encourage licensees to take more timely action to consider their options for further growth.

Additional consistent protections through a mandated ePayments Code

ASIC administers the ePayments Code, which places requirements on financial institutions that make electronic payments that are aimed at protecting consumers. The Code requires subscribers to give consumers certain terms and conditions, sets out the rules about liability for unauthorised transactions, establishes a regime for recovering mistaken payments and requires internal dispute resolution. The ePayments Code is currently voluntary; while most ADIs are subscribers, many new entrants have not subscribed and their clients do not receive the protections in the Code.

The FSI recommended that the ePayments Code be made mandatory to strengthen consumer protection, as the ubiquity of electronic payments necessitates consistent consumer protections to maintain confidence and trust in the system. The Government supported this recommendation. The PC Report repeated the call for ASIC to be given the power to mandate the ePayments Code and for the Code to be updated and reviewed every three years.

ASIC has commenced work to review the ePayments Code's fitness for purpose.[20] This review is occurring in the context of significant developments in financial innovation and customer uptake of digital technologies since the Code was last reviewed. The CFR supports the Corporations Act being amended to provide ASIC with a rule making power to enable it to make the Code mandatory for organisations that issue payments products which are financial products.

20 See Consultation Paper 310 *Review of the ePayments Code: Scope of the review.*

Prudential Regulation

In order to provide additional protections to consumers, large SVFs that offer functionality similar to bank deposits will require APRA authorisation and subsequent supervision. This would constitute the highest level of regulatory oversight within an updated regulatory framework for SVFs and would be in addition to the obligations for the provider to hold an AFS licence from ASIC and comply with the ePayments Code.[21] This higher level of oversight reflects the greater risk in terms of loss of client money. At least initially, it is envisaged that relatively few facilities would meet the criteria for APRA prudential supervision, as is the case under the current regime where PayPal Australia is the only APRA-supervised PPF.

In addition to protecting client money, the framework will seek to mitigate key financial risks (insolvency, fraud) and IT risks (including cyber risk). APRA anticipates that this approach should generally be welcomed by the industry and is in line with recent recommendations of the FSI and the Productivity Commission.

Given the costs of compliance, and cognisant of barriers to entry and the limited stability risk associated with smaller providers, prudential requirements will only apply to 'large' providers of SVFs that hold $50 million or more in total customer funds (from accounts opened by persons resident in Australia). This would ensure that only those facilities of a sufficient scale would be subject to the most intensive regulatory requirements.[22] In addition to size, proposed criteria for APRA supervision relate to those SVFs that give the account holder the capacity to do all of the following:

- store value of an aggregate of more than $1,000 in the facility;[23]
- hold stored value in the facility for greater than 31 days;[24] and
- allow the account holder to demand repayment in Australia currency (e.g. in cash or by transferring funds to the client's bank account).[25]

It is envisaged that SVF providers would be subject to less onerous requirements than those that apply under the existing PPF framework (see Box C).[26] This would help address stakeholders' concerns about the current size of the step-up from ASIC's to APRA's requirements and would be consistent with the spirit of recent recommendations for a more graduated approach to regulation. As discussed below, large overseas-based SVF providers that actively seek Australian resident customers may be required to incorporate locally prior to applying to APRA for authorisation, and be subject to the same requirements as domestic entities.

As noted above, to account for the uncertainty of future developments in the market, the CFR recommends that the new framework should include a mechanism to 'designate' a SVF provider as being subject to APRA's prudential regulation on the basis of financial system safety or stability considerations (i.e. in the public interest). This type of flexibility would enable regulation to adapt in a timely way to unanticipated market developments and would be expected to be used infrequently. This

21 As is the case for other APRA-regulated businesses, some obligations imposed by ASIC may not apply.

22 Both the FSI and PC Report proposed a tiered APRA prudential regime. However, the CFR felt that this would add unnecessary complexity to the proposed tiered framework between ASIC and APRA regulation.

23 This would be consistent with the proposed threshold in the FSI Final Report and with the existing threshold for exemptions for non-cash payment facilities operating under an AFS licence.

24 Among other things, this would be consistent with the shortest commonly available bank term deposit.

25 Facilities could be either single or multi-currency.

26 While PPFs are currently regulated by APRA as a special class of ADI, consideration is being given to a regime in which SVFs would be regulated as a distinct category of APRA-regulated entity.

would mitigate against the risk of a very large facility emerging that would not otherwise meet the proposed criteria for prudential regulation.

Box C: APRA Prudential Framework

In reviewing APRA's existing PPF framework, the requirements will be simplified, more targeted to the key risks and better align the framework with international approaches. This approach would address the concerns with the existing framework that were identified by respondents to the CFR Issues Paper regarding the current size of the step-up from ASIC's to APRA's requirements and would be consistent with the spirit of recent FSI and PC recommendations for a more graduated approach to regulation.[27]

A key change in the framework would likely be the replacement of liquidity requirements with requirements for safeguarding customer funds. Among the safeguarding options that could be considered are:

- holding the stored value in a trust account; and
- holding High Quality Liquid Assets (HQLA) if:
  - the SVF provider can demonstrate it can manage its liquidity requirements; and
  - the HQLA are held in a segregated account separate to the entity's own assets.

This change would make APRA's approach more consistent with overseas approaches – for example the EU, Singapore and Hong Kong – whilst also providing greater continuity for entities moving from ASIC-only regulation.[28]

Minimum capital would likely be set initially at $3 million plus an operational risk capital charge. Further work is required to calibrate the operational risk capital charge. Internationally, there is a wide range of minimum capital requirements; the EU has an initial requirement of EUR 350,000 (~$570,000) followed by a minimum 2 per cent of customer funds held once operational, while Hong Kong requires a minimum of HKD 25 million (~$4.6 million).

For more consistency with overseas approaches, a simplified single prudential standard will likely be applied to SVF providers with a streamlined set of requirements against the key risks.

APRA and ASIC will explore introducing disclosure requirements to make it clear to customers that SVF products are not covered by the Financial Claims Scheme.[29] To further differentiate SVFs from bank deposits, payment of interest to retail clients would likely be prohibited. Whilst payment of interest is not currently prohibited for PPFs, it is a licence condition for PayPal and is prohibited in other jurisdictions, including Singapore, Hong Kong and the EU.

Further differentiation of products offered by SVF providers from ADI protected accounts could be achieved by authorising SVF providers as a class of entities separate to ADIs.[30] This would also provide an opportunity to address issues in the existing legislation, including the lack of clarity. In order to

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27 See Review of Retail Payments Regulation: Stored-value Facilities available at <https://www.cfr.gov.au/publications/consultations/review-of-retail-payments-regulation-stored-value-facilities/index.html>. A follow up round table discussion was held with respondents, which provided greater insights into concerns with the existing PPF regulatory arrangements.

28 ASIC-only regulated SVF providers will need to hold client funds in a trust account under client money protection rules.

29 The current requirement for ADIs and general insurers to include statements in Product Disclosure Statements as to whether a financial product is a protected account or protected policy for FCS purposes is imposed under the Corporations Act and administered by ASIC.

30 Treasury envisage this being done through a single Bill that would make changes to the Banking Act (and possibly the creation of a SVF-specific piece of legislation), Corporations Act and Payment Systems (Regulation) Act.

ensure resolvability, APRA's current enforcement and resolution powers in relation to ADIs should be replicated where appropriate for the business model and risks of SVFs. SVF providers could also be prohibited from conducting lending activities, for which an ADI authorisation would be required. At this stage, it is not envisaged that the Banking Executive Accountability Regime (BEAR) would be applied to APRA-regulated SVF providers, providing greater differentiation from the banking regime and alignment with the risks of the regulated activity.

Approach to Foreign Providers of Stored-value Facilities

With SVFs having become more prominent in some other jurisdictions, there is a possibility that foreign SVF providers may seek to enter the Australian market.

In this regard, the CFR recommends that there is flexibility where appropriate to require large overseas-based SVF providers that actively seek Australian resident customers to incorporate locally prior to applying to APRA for authorisation, and be subject to the same requirements as equivalent domestic entities.[31] It should be made clear under the new legislation that jurisdiction is to be asserted in cases where SVF providers overseas target Australian residents to use their SVF, e.g. via online portals. The offence-creating provision in the new legislation (the provision that makes it an offence for any person to carry on a business of providing SVFs in Australia without the requisite licence) would need to make it clear that a person carrying out an act from outside Australia that has effects within Australia is captured within its scope.

The CFR recognises that it will be important for regulation to be able to adapt appropriately to emerging products and services. In this regard, it is worth noting that the proposed new framework would include a mechanism to designate certain facilities that do not strictly meet the criteria for APRA supervision as being subject to APRA's oversight in the public interest (e.g. on the basis of system-wide risk). As discussed above, this aspect of the new framework is designed to provide regulators with the flexibility to take account of developments such as the emergence of new products. In particular, it would enable the authorities to require prudential regulation of new products and services if it is in the public interest. This mechanism could potentially be relevant in the context of recent proposals around digital wallet facilities using global stablecoins, as discussed above.

Clarity and Transparency

A key objective of the CFR's recommendations is to improve the transparency and clarity of regulation, from the perspective of regulated entities, potential new entrants and consumers. The main elements of the potential framework discussed above have been designed with this goal in mind. For example, some stakeholders have observed that the current arrangements in which ASIC, APRA and the RBA all have regulatory roles adds to the complexity and cost for new entrants in gaining an understanding of the Australian regulatory system. In this regard, the number of regulators would be reduced from three to two, with the RBA no longer having a role in regulating individual SVF providers.[32]

Another important goal of the reforms is to modernise and clarify the definition of SVFs. Stakeholders have observed that the term 'purchased payment facilities' is not used in other jurisdictions and is not intuitive. While the definition of SVFs above has the potential to be refined, the intention is to replace

31 ASIC's financial services regulatory regime generally applies to overseas-based businesses that solicit business in Australia. The CFR is not proposing a change from this general position for ASIC-regulated facilities.

32 The RBA would retain its existing powers to designate and regulate payment systems on the basis of system-wide competition, efficiency or systemic risk concerns.

‘PPF’ with the broader concept of a ‘SVF’ and to better align terminology with other jurisdictions (as appropriate for Australia). This change, in addition to removing the RBA’s regulatory role, should make it easier for potential new entrants to engage with the regulatory system.

Once the main elements of the new system have been settled, attention will turn to ways in which regulatory arrangements and implications are communicated to industry and consumers. For example, the CFR agencies could jointly publish a guide to payments regulation in Australia in conjunction with the new framework. Other initiatives could potentially include updates to ASIC’s MoneySmart site to provide guidance for consumers using SVFs, and updates to other publications on the ways in which new entrants can efficiently engage with the regulatory framework in Australia.