



**ASIC**

Australian Securities & Investments Commission

# **ASIC and the regulation of non-cash payment products**

**A presentation by Mark Adams, Director, Regulatory Policy,  
Australia Securities and Investments Commission (ASIC)  
to the CARDS Australia Conference, August 2004**

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Thank you for giving me the opportunity to speak with you today.

Today I propose to talk about ASIC's involvement in the regulation of some of the products offered by members of the audience and exhibitors here at CARDS Australia. It is my understanding that many of you will be unfamiliar with the regulatory role of ASIC. So I plan to cover some fairly broad ground today including, who ASIC is and what we do, how we regulate products like loyalty schemes and the effect that all of this might have for some of you.

## **About ASIC**

The Australian Securities and Investments Commission (ASIC) is an independent government body responsible for the regulation and enforcement of companies and financial services laws. These laws include (among others) the *Corporations Act (2001)* (Corporations Act) and the *Australian Securities and Investments Commission Act (2001)* (ASIC Act).

Under these laws ASIC regulates Australian companies, financial markets, financial services organisations and professionals who deal in and advise on investments, superannuation, insurance, deposit taking and credit. The focus of our regulation is on protecting consumers, investors and creditors, and promoting market integrity.

It is ASIC's regulation of the financial services industry, which will be of most interest to you.

ASIC is responsible for regulating the activities of individuals and organisations that provide financial services to consumers of financial products. In general, this will include individuals and organisations like you that provide financial services to consumers of non-cash payment products. For example, issuers of store gift vouchers or those that have loyalty scheme programs.

## History of the regulation of non-cash payments

Before I address some of the specific aspects of ASIC's regulation of non-cash payments, I would like to draw your attention to some of the background developments that lead up to this regulation.

The regulation of non-cash payment products under the Corporations Act was introduced by the *Financial Services Reform Act 2001* (FSR Act).

Before the FSR Act, the regulation of non-cash payment products was scattered among various State, Territory and Commonwealth Acts and regulatory bodies. For example, each of the following bodies might have had something to do with regulating non-cash payment systems: the Reserve Bank of Australia, the Australian Prudential Regulation Authority which regulates Australian deposit taking institutions, the Australian Competition and Consumer Commission which regulates competition in Australia as well as consumer protection, and State and Territory consumer fair trading agencies.

In 1997, a Government Report (the Financial System Inquiry Report, also known as the Wallis Report) recommended that certain non-cash payment products like traveller's cheques, stored value cards or other smart cards, electronic cash and other payment instruments should be subject to regulation to ensure the safety and integrity of the payments system.<sup>1</sup>

This recommendation was addressed in part by the Wallis legislation, which introduced amendments to the *Banking Act* and a new regime administered by the Reserve Bank (via the newly established Payment Systems Board). The new regime was *Payments System (Regulation) Act 1998*.

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<sup>1</sup> Recommendation 72, Commonwealth of Australia, AGPS, *Financial Service System Inquiry Final Report*, March 1997, (Canberra), at 404

Another result of these recommendations was the Government's reform of the financial services industry. In 2001, the FSR Act was introduced making substantial changes to the way the financial services industry had operated up until then. The FSR Act introduced a single licensing and disclosure regime for all financial services and products.

Prior to the FSR Act, each financial product had its own particular licensing, conduct and disclosure regime. For example, securities were dealt with under the Corporations Act, insurance was dealt with under the *Insurance Act*, the *Insurance Contracts Act* and the *Insurance (Agents and Brokers) Act*, superannuation was dealt with under the *Superannuation Industry and Supervision Act*; and, as I just pointed out a second ago, non-cash payment systems were regulated in a very ad hoc way, without any specific licensing, conduct or disclosure regime applying to them.

The aim of the recent financial services reforms was to implement a single licensing, conduct and disclosure framework for all financial products. The inclusion of non-cash payment products within the definition of "financial product" meant that providers of non-cash payment products and services come within the scope of financial services regulation.

The regulation of some loyalty schemes under the financial services regime as a financial product might come as a surprise to some of you. Much of the focus of the Wallis Report and other government discussion papers leading up to the implementation of the financial services reforms (eg CLERP 6) seemed to be on products like smart cards and electronic cash arrangements (such as, for example, phone cards). However, it was clear the concept of a non-cash payment facility (as defined in s763D of the Corporations Act) was intended to be broad – including to deal with arrangements not specifically mentioned in the discussion papers. This means we have to start from the assumption that arrangements like loyalty schemes were intended to be covered by the FSR regulatory framework.

I would like to address the specifics of the financial services framework and how this applies to non-cash payment products.

## **Outline of the financial services regime**

Under the Corporations Act, a person who carries on a financial services business in Australia must hold an Australian financial services licence (or AFS licence). In general, the licence must cover the financial services they want to provide (unless an exemption applies): s911A. A person provides a financial service if (among other things) they deal in a financial product or provide financial product advice: s766A, s766B and s766C.

The term "financial product" covers a broad spectrum of products. In general, it refers to three types of product. They are: financial investment products (like securities, superannuation and managed investment schemes); financial risk management products (like general insurance products, life insurance products and derivative products); and lastly, non-cash payment products.

### ***Non-cash payment products***

A non-cash payment product includes, among other things, cheque accounts, travellers cheques, stored value cards, electronic cash, direct debit services, funds transfer services and electronic bill payment services. And, depending on the circumstances, gift vouchers and loyalty schemes may also be non-cash payment facilities.

In general, ASIC considers that loyalty schemes are likely to constitute or include a non-cash payment facility and may be regulated under the Corporations Act.

For example, a loyalty scheme may include a rewards or redemption facility where points allocated to a customer under the loyalty scheme can be used to:

- make a payment, or cause a payment to be made for goods or services;

- obtain a discount on goods or services; or
- obtain points for other loyalty schemes.

This means that if you intend to carry on or are carrying on a business of dealing in or providing financial product advice on a non-cash payment facility in Australia (which can include loyalty schemes), then under s911A(1) of the Corporations Act you must hold an AFS licence authorising you to deal in or advise on non-cash payment products (unless an exemption applies to you).

### ***Australian financial services licence***

If you fall into this category then you need to apply to ASIC for a licence. Information on how this can be done is available free of charge from ASIC's website.<sup>2</sup>

A person who holds an AFS licence is required to comply with a number of general obligations. These obligations are outlined in the Corporations Act and include:

- (a) an obligation to make sure your financial services are provided efficiently, honestly and fairly;
- (b) an obligation to manage your "conflicts of interest";
- (c) an obligation to comply with the conditions of your licence. I should note at this point that ASIC has the power under the Corporations Act to impose additional conditions on your licence.<sup>3</sup> We may do this where we consider that your business exposes consumers to a particular risk. The conditions we impose will be intended to mitigate that risk;
- (d) an obligation to make sure you comply with the financial services laws as well as an obligation to make sure that people who carry out services or provide products on your behalf also comply with the financial services

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<sup>2</sup> For further information about how to apply for an AFS licence see Parts 1 and 2 of ASIC's licensing kit (Version 5, March 2004): *How to apply for an AFS licence* and *Answering the questions in your AFS licence application* available on ASIC's website [www.asic.gov.au](http://www.asic.gov.au)

<sup>3</sup> s914A of the Corporations Act.

- laws. "Financial services laws" include certain provision of the Corporations Act as well as certain provisions of the ASIC Act;
- (e) an obligation to make sure that you have adequate resources to provide your financial services;
  - (f) an obligation to make sure that you are competent to provide your financial services as well as an obligation to make sure that the people who provide services on your behalf are also adequately trained and are competent;
  - (g) an obligation to have a dispute resolution system if you provide a service or product to retail clients; and, lastly,
  - (h) an obligation to make sure that you have risk management systems in place.

To help licensees understand and comply with these various obligations, ASIC has published a number of policy statements. These documents are available free of charge from ASIC's website.<sup>4</sup>

ASIC's policy statements cover a variety of topics including the amount of financial resources you are required to have; the type of education and training you must have to provide financial services in relation non-cash payment products; and, the systems and structures you should in place so that you are in a position to comply with your licensing obligations.

### ***Conduct and disclosure***

The Corporations Act also imposes certain conduct and disclosure obligations on persons who provide financial product advice or deal in a financial product to retail client (unless an exception applies).<sup>5</sup> These include:

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<sup>4</sup> For further information about how to comply with your AFS licence conditions refer to the following ASIC policy statements: Policy Statement 146 *Licensing: Training of financial product advisers* [PS 146]; Policy Statement 164 *Licensing: Organisational capacities* [PS 164]; Policy Statement 165 *Licensing: Internal and external dispute resolution* [PS 165]; and, Policy Statement 166 *Licensing: Financial requirements* [PS 166].

- (a) the obligation to give a client a Financial Services Guide (**FSG**). An FSG is a disclosure document intended to help a retail client decide whether to obtain a financial service from you, eg advice about a financial product;
- (b) the obligation to give a client a Statement of Advice (**SoA**) when providing personal financial product advice.<sup>6</sup> An SoA is a disclosure document intended to help a retail client understand, and decide whether to act on advice that you give;
- (c) the obligation to give clients a Product Disclosure Statement (**PDS**). A PDS is a point of sale disclosure document that sets out the significant features of a financial product, including its risks, benefits and costs;
- (d) the obligation to give clients a statement confirming transactions;
- (e) the obligation to give clients specific ongoing disclosures about a financial product;
- (f) obligations relating to handling client money and property; and
- (g) the prohibition against hawking financial products.

In relation to disclosure, the Corporations Act sets out certain minimum standards that must be met. To help licensees understand and comply with these various obligations, ASIC has published a number of policy statements. These are available free of charge on ASIC's website.<sup>7</sup>

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<sup>5</sup> Under the Corporations Act, financial products are classified as retail or wholesale financial products. The test to determine whether a financial product is a retail or wholesale is set out in s761G of the Corporations Act.

<sup>6</sup> See s766B of the Corporations Act.

<sup>7</sup> For further information, refer to the following ASIC policy statements: Policy Statement 168 *Disclosure: Product Disclosure Statements (and other disclosure obligations)* [PS 168]; Policy Statement 169 *Disclosure: Discretionary powers and transition* [PS 169]; and, Policy Statement 175 *Licensing: Financial product advisers – conduct and disclosure* [PS 175].



## Exemptions

I should also note that some non-cash payments are completely excluded from the FSR regime (ie they are not treated as financial products at all). For example, the following facilities are excluded from the regime:

- (a) payment facilities where there is only one person to whom payments can be made; and
- (b) money orders and certain electronic funds transfer systems .<sup>8</sup>

Other products are regulated under the FSR regime but have been exempted from the licensing requirement. For example, POSTbill pay facilities are excluded, so too are non-cash payments that can only be used within one corporate group such as for example, a gift voucher that is limited to Coles Myer companies.<sup>9</sup> (Being exempted from the licensing regime only means that these products *do* still require a Product Disclosure Statement).

## ASIC interim relief

I note that ASIC has also provided some temporary exemptions from the licensing and disclosure requirements for certain non-cash payment products and some loyalty schemes.

For example, in relation to loyalty schemes, ASIC is willing to give an exemption from the licensing and disclosure obligations I have referred to, where:

- (a) the scheme is designed to reward customer loyalty or promote spending on the goods and services you provide;
- (b) the scheme includes a reward program whereby clients are given points if they use, or spend money on, the goods or services you provide; and
- (c) these points can be used by the client to make a payment for goods or services, or to obtain points for other loyalty schemes.

<sup>8</sup> See, regs 7.1.07F and 7.1.07G of the *Corporations Regulations 2001*.

<sup>9</sup> See regs 7.6.01(1)(l)-(lc).

To get an exemption, you need to make an application to ASIC in writing. The application should cover a number of issues set out in an ASIC information release which is available on our website (Information Release 04-06).

ASIC will also give a licensing and disclosure exemption for non-cash payment products that we consider are "low value" products conducted on a small scale or for a limited purpose.

If you get an exemption from us, you will be required to comply with certain conditions. These usually relate to disclosure issues and dispute resolution issues. For example, our relief will usually require that you clearly disclose the terms and conditions of your product to your client.

Further information about ASIC's temporary exemptions for non-cash payments products is available free of charge on ASIC's website.<sup>10</sup>

## Examples

To give a clearer picture of how the licensing and disclosure regime works, I would like to give you a couple of brief examples.

### Example 1:

Company One Ltd issues a stored value card that can be used to make purchases with various merchants. It promotes the card widely (which includes giving general advice). This means that Company One must hold an AFS licence authorising it to advise and deal in non-cash payment products. To get a licence, Company One must apply to ASIC. It must show ASIC that it meets minimum financial requirements and that its staff meet minimum organisational capacity requirements. The first time Company One meets each 'retail' client it must give them a FSG. If

<sup>10</sup> For further information refer to the following ASIC information releases: IR 04/07 *ASIC guidelines for interim for low value non-cash payment facilities* 24 February 2004; and, IR 04/606 *ASIC Guidelines for interim relief for loyalty schemes*, 24 February 2004.

Company One sells a product to that client (eg it 'issues' the stored value card to them) it must give the client a PDS. Company One will also have some ongoing disclosure obligations (such as notices of material changes and periodic statements) to these clients.

**Example 2:**

Company Two is a retailer that provides a frequent purchaser rewards program. For every \$50 worth of goods a customer buys, Company Two will give them 5 purchasing points. Once a customer collects 20 purchasing points Company Two will give the customer a shopping voucher for any store in the same shopping centre (as the retailer) to the value of \$10. Company Two realises that it is issuing a non-cash payment product and that it will need to get an AFS licence. It also realises that its customers are retail customers, which means it will need to give each customer who joins its reward program certain disclosure documents (eg a PDS and ongoing disclosures). However, Company Two thinks that it is not appropriate for the FSR regime to apply to it and is aware of ASIC's interim relief. Company Two decides to make an application to ASIC for an exemption from the FSR requirements and obtains interim relief under ASIC's current policy. The permanent relief question remains open.

## **ASIC policy development**

ASIC has provided interim relief to give us time to develop policy proposals about how we intend to regulate non-cash payment products under the Corporations Act. We are aware that there is some uncertainty in industry at the moment about the regulation of non-cash payment products under the financial services regime.

For example, we know that there is some uneasiness about whether loyalty scheme and reward programs do or should come under the definition of non-cash

payment facility. We know that there are concerns about whether it is appropriate for some non-cash payment products like gift voucher schemes to be regulated under the Corporations Act given the costs that are likely to be involved in getting a licence and complying with the conduct and disclosure requirements under the Corporations Act.

ASIC is currently in the process of developing some policy and guidance to address some of these issues. And we hope to release a policy proposal paper (PPP) for public consultation later this year. I encourage you all to look at our PPP and make any comments or suggestions you have about our policy proposals.

In general, we will raise issues (in our PPP) about:

- when, if at all, certain NCP issuers should be exempt from licensing;
- where NCP issuers are licensed, whether any of the licensing obligations need refinement in their application; and
- whether any of the product disclosure obligations need refinement in their application.

ASIC welcomes any contribution you wish to make to the development of our policy. Information about how you can make comments will be available in the PPP. We are hoping for comments from a broad cross section of industry, practitioners and consumers. This will give ASIC the opportunity to formulate our policy on a much more informed basis.

## **The relationship between credit facilities and non-cash payment facilities**

I know that some of you here today will be actively involved in credit type products. So I would briefly like to touch on ASIC's regulation of credit.

In general, credit products are not caught by the financial services regime in Chapter 7 of the Corporations Act. Credit facilities are specifically excluded from the definition of financial product in s765A. As a result those that provide credit products are generally not subject to the licensing, conduct or disclosure obligation in Chapter 7 of the Corporations Act.

Although credit is excluded from regulation under Chapter 7, it is subject to the consumer protection provisions of the ASIC Act. These provisions relate to misleading or deceptive, and unconscionable conduct offences. In the context of consumer credit, I note that these are subject to a State-based regime under the Uniform Consumer Credit Code.

Even though credit products are excluded from the Chapter 7 regime, I need to point out that in some circumstances, credit products are being sold to consumers as part of a package of products, some of which may be caught by Chapter 7 of the Corporations Act. For example, credit card facilities are being packaged together with loyalty scheme programs. Depending on the structure of these arrangements, it is likely that the loyalty scheme may be subject to the Chapter 7 financial services framework, even if the credit facility is not.

If you are unsure about the nature of your product and whether it's a credit product or a non-cash payment product then we would suggest you take a cautious approach. Your first step should be to seek legal advice about the products and services you are offering and take it from there.

## **Other legal requirements**

One thing you should keep in mind is that an exemption will only mean that you do not have to get a licence or comply with the disclosure requirements under the Corporations Act. This means that other obligations under the Corporations Act and the ASIC Act will still continue to apply to you. For example, the consumer

protection provisions in the Corporations Act and ASIC Act will continue to apply. The consumer protection laws cover things like misleading or deceptive conduct.

I would also like to touch on today some of the other regulatory tools that we think you should be aware of.

Many of you will be aware of the Electronic Funds Transfer Code of Conduct (EFT Code). The EFT Code is a self-regulatory code supervised by ASIC. Many banks, building societies and credit unions subscribe to the code, to the benefit of them and their customers.

The EFT Code sets out minimum standards on a number of issues, based on a long consultation process between industry and consumers. We believe it strikes a fair balance on a number of important issues. It deals with product disclosure, privacy, refund rights, dispute resolution and lost or stolen cards. We encourage you to subscribe to the EFT Code. In our experience consumers are more likely to take up products that include these protections.

ASIC periodically reviews and updates the EFT Code. We plan to review the code this year. You will hear more about this in the coming months, particularly from our Consumer Protection area. More information about this will be available on our website.

## **The relationship between ASIC, APRA and the RBA**

What is the relationship between ASIC, the Australia Prudential Regulation Authority (APRA), and the Reserve Bank of Australia (RBA) and their respective roles in relation to non-cash payment products?

ASIC is responsible for regulating the provision of financial services to consumers of financial products, which includes certain non-cash payment products. The focus of ASIC's regulation is on consumer protection and market integrity issues.

APRA on the other hand is a prudential regulator and is responsible for the prudential regulation of Australian Depositing-Taking Institutions (ADIs) (eg banks, credit unions and building societies), insurance companies, superannuation funds, and friendly societies.

It is APRA's work in relation to authorising ADIs (and as such setting and administering their prudential requirements) that is relevant for our purposes. In general, a person must not carry on any 'banking business' in Australia without an authority from APRA. Under the *Banking Act* and *Banking Regulations*, APRA has discretion to determine that the provision of a purchased payment facility is effectively banking business. (A purchased payment facility is defined in the *Payments System (Regulation) Act*. It is a similar concept to that of non-cash payment facility in the *Corporations Act*.) The circumstances in which APRA can exercise its discretion are set out in the *Banking Regulations*.

The RBA is also responsible for the regulation of purchased payment facilities under the *Payment Systems (Regulation) Act* (which is carried out by the Payments Systems Board under the *Payment Systems (Regulation) Act*). In general, a purchased payment facility is a facility that stores value that can be used to make payments by the holder of the facility. The amount of value that can be stored and be available for use under a purchased payment facility depends on the terms and conditions applying to the facility.

Under the *Payment Systems (Regulation) Act*, the holder of the stored value for a purchased payment facility must be either:

- an Australian Deposit Taking Institution (a body authorised by APRA to carry on any banking business); or

- an entity that holds an authority from the RBA; or
- an entity that is covered by an exemption from the RBA.

We understand that the RBA continues to do work in this area and has exempted some classes of payment products already.

## **Why does ASIC care about non-cash payment products?**

I would like to finish with some brief comments on what ASIC's main focus is in the area of non-cash payment products.

The inclusion of non-cash payment products within the financial services regime signalled a clear intention by government that ASIC should regulate these products as part of its financial services responsibilities. The fact that only a few non-cash payment products and product providers have been carved out of the regulatory framework also shows that it is the Government's intention that non-cash payment products be regulated by ASIC.

In light of this clear government intention, ASIC will approach the regulation of non-cash payments in much the same way it approaches the regulation of other financial services and products.

Much of the focus of ASIC's regulation of the financial services regime is to ensure that there is confident and informed decision-making by consumers of financial products (including non-cash payment products). In our view, the best way to achieving informed decisions by consumers is to ensure that there is clear, concise and effective disclosure to consumers.<sup>11</sup> Another major focus of ASIC's

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<sup>11</sup> For further information, see: Information Release [IR 04/062] *FSR disclosure to be clear, concise and effective*, 10 March 2004.



regulatory work is to ensure that financial services are provided in a fair and honest way.

To achieve these goals, ASIC always keeps in mind the risks to consumers and market integrity issues we think are raised by certain financial products. As such, our regulatory activities will be in direct response to a consumer risk or market integrity issue that we think is not being adequately dealt with by industry.

In the context of loyalty schemes for example, ASIC is concerned about asymmetry of information between product providers and consumers. In our view, in order for consumers to make a fully informed decision about whether to join a loyalty scheme they must be told upfront about the features of the product both good and bad;

the costs associated with joining the scheme, (including any ongoing costs); the terms and conditions of using the benefits of the scheme and whether these can be changed at any time with or without notice to the consumer; whether a consumer's points balance will expire before they are used.

This is just a few of the matters that we think need to be disclosed to consumers in order to adequately address the issue of asymmetry of information. I note that even where ASIC has given relief to loyalty schemes from the licensing and disclosure obligations we have imposed on that relief conditions that require clear and effective disclosure about these matters.

I would be happy to discuss either ASIC's interest in the area of non-cash payment products or the consumer risks involved during the following question time and panel discussion.

Thank you.