

PREPAID PAYMENT INSTRUMENTS

Meal cards, loyalty cards, debit cards, and other pre-paid cards of all hues have gained much public acceptance. The ease of their use has made them an instrument of choice for the vast majority of our people. Further, the increasing acceptance of meal vouchers and prepaid cards has made them as good as currency. This system for long was unregulated. The Reserve Bank of India, in order to check possible money laundering, issued guidelines under the Payment and Settlement Systems Act 2007.¹

The RBI under this Act has issued a set of four Guidelines for the regulation of various instruments falling under the Act. **The Issuance And Operation of Pre-paid Payment Instruments in India (RBI) Directions 2009**² incorporate the regulatory framework pertaining to pre-paid payment instruments in India, except for those instruments which have been issued under FEMA and payment instruments permitting cross border transactions.

PAYMENT INSTRUMENT: A payment instrument may be defined as those instruments which permit transaction for value between a payer and beneficiary by which the beneficiary discharges the payment obligation of the beneficiary. It may be pre-paid, post paid or payment or paid upfront.. Payment system enables two-way flow of payments in exchange of goods and services. Further, development of internet and telecom facilities has enabled the masses, hitherto un-reached by banks³, to reap the benefits of these instruments.

¹ The Payment and Settlement Systems Act, 2007 was enacted empowering the Reserve Bank to regulate and supervise the payment and settlement systems, lay down policies to this effect and provide a legal basis for multilateral netting and settlement finality. Accordingly, the Reserve Bank framed and notified the 'Board for Regulation and Supervision of Payment and Settlement Systems Regulations, 2008' and 'Payment and Settlement Systems Regulations, 2008' for operationalisation of the Payment and Settlement Systems Act.

² Issued vide RBI Notification no. RBI/2008-09/ 458 dated April 27, 2009. Subsequent Amendment to the said Direction was made vide RBI Notification no. RBI/2009-10/123 dated August 14, 2009.

³ Dr. K.C.Chakrabarty, Deputy Governor, Reserve Bank of India at the *India Telecom 2009 Conference* organized by Department of Telecom, Government of India, in collaboration with FICCI on December 4, 2009 at New Delhi, spoke of the importance of pre-paid payment instruments in enabling inclusive growth. In the course of his speech, he spoke of the huge lacuna in banking services in the rural sector and the capability of mobile/telecom companies in filling this lacuna. He cited the example of Kenya, another third world country, where m-commerce has helped to bring in financial inclusiveness.

In the present paper, the author has restricted itself with domestic pre-paid payment instruments and their regulatory framework in India.

PRE-PAID PAYMENT INSTRUMENT: A Pre-paid payment instrument may be defined as those instruments which permit transactions for value stored in them. Pre-paid Payment Instruments⁴ are payment instruments where value for use is stored in advance, such as, smart cards, magnetic strip cards, internet accounts, internet wallets, mobile accounts, mobile wallets, paper vouchers, *etc.* meal vouchers, loyalty cards are also species of these instruments.

Prepaid payment instruments enhance convenience as a mode of payment *in lieu* of cash. Also, this facilitates e-payment for goods/services purchased/availed through internet/ mobile. The maximum loss on account of fraudulent use of the card is limited to balance available on the card.⁵

As said earlier, the RBI is the regulatory body responsible for issue and supervision of domestic pre-paid payment instruments in India. Under section 18 of the, RBI is empowered to lay down the policy relating to the regulation of the issue and operation of pre-paid instruments in India.

TYPES OF PRE-PAID PAYMENT INSTRUMENTS: The approach paper issued by RBI speaks of and describes four types of instruments but the subsequent Directions permit issuance of three types of pre-paid payment instruments only. Further, cross border transactions are not permissible on these instruments. However, only entities which have permissions under FEMA can issue cross border transaction enabled prepaid instruments.

The Pre-paid instruments can be:

⁴ Direction 2.3 defines a pre-paid payment instrument thus:

“2.3 Pre-paid Payment Instruments: Pre-paid payment instruments are payment instruments that facilitate purchase of goods and services against the value stored on such instruments. The value stored on such instruments represents the value paid for by the holders by cash, by debit to a bank account, or by credit card.

The pre-paid instruments can be issued as smart cards, magnetic stripe cards, internet accounts, internet wallets, mobile accounts, mobile wallets, paper vouchers and any such instrument which can be used to access the pre-paid amount (collectively called Payment Instruments hereafter).”

⁵ <http://www.rbi.org.in/scripts/AnnualReportPublications.aspx?Id=903>

1. Closed System Payment Instruments: These are payment instruments generally issued by business establishments for use at their respective establishment only. These instruments do not permit cash withdrawal or redemption;
2. Open System Payment Instruments: These are payment instruments which can be used for purchase of goods and services and also permit cash withdrawal at ATMs;
3. Semi-closed System Payment Instruments: These are payment instruments which are redeemable at a group of clearly identified merchant locations/ establishments which contract specifically with the issuer to accept the payment instrument. These instruments do not permit cash withdrawal or redemption by the holder; or
4. Semi-open System Payment Instruments: These are payment instruments which can be used for purchase of goods and services at any card accepting merchant locations (Point of sale terminals). These instruments do not permit cash withdrawal or redemption by the holder.

The RBI in its Directions has permitted the issuance of the following three types of instruments:

(i) Closed system payment instruments⁶- Examples of such instruments are gift vouchers issued by certain merchant establishments and telephone calling cards. Mobile prepaid value may also be considered as a closed-system prepaid payment instrument, though they can be used for availing of additional value-added services.

(ii) Semi-closed system payment instruments⁷- E.g. prepaid cards which are redeemable at a group of establishments associated with a particular shopping mall, tourist resorts, or at establishments and service providers listed out by the issuer; and

⁶ The RBI Directions 2009 defines it as:

“2.4 Closed System Payment Instruments: These are payment instruments issued by a person for facilitating the purchase of goods and services from him/it. These instruments do not permit cash withdrawal or redemption. As these instruments do not facilitate payments and settlement for third party services, issue and operation of such instruments are not classified as payment systems.”

⁷ The RBI Directions 2009 defines it as:

(iii) Open system payment instruments⁸ - only banks are permitted to issue this type of instruments.

Eligibility:

As per the guidelines, the eligibility criteria for the issuers are:

- Banks and Non-Bank Finance Companies (NBFC), who comply with the eligibility criteria with respect to capital requirements, are permitted to issue all categories of prepaid payment instruments.
- **Mobile based Pre-paid payment instrument:** Banks, which provide Mobile Banking Transactions, are permitted to launch mobile based prepaid payment instruments (mobile wallets & mobile accounts). RBI by its Notification dated August 14, 2009, has amended this provision to include “other persons” also as permissible issuers of mobile based semi-closed system pre-paid payment instruments. These instruments issued by other persons must also comply with the following conditions:-
 - i) The maximum value of such instruments must not exceed Rs 5000/-.
 - ii) The purchase/reloading of these instruments against the value of airtime/talk time will not be permitted.
 - iii) This facility shall be enabled only to facilitate purchase of goods and services. Person-to-person transfer of value shall not be permitted.

Further, all such other persons must seek authorization from the Department of Payment And Settlement Systems, RBI under the under the Payment and Settlement Systems Act, 2007. The application for authorization must also include the risk management process that would be adopted by the entity

“2.5 **Semi-Closed System Payment Instruments:** These are payment instruments which are redeemable at a group of clearly identified merchant locations/ establishments which contract specifically with the issuer to accept the payment instruments. These instruments do not permit cash withdrawal or redemption by the holder.”

⁸ The RBI Directions 2009 defines it as:

“2.6 **Open System Payment Instruments:** These are payment instruments which can be used for purchase of goods and services at any card accepting merchant locations (point of sale terminals) and also permit cash withdrawal at ATMs.”

- Mobile Prepaid value: Mobile Service Providers are permitted to issue mobile prepaid value. In addition to talk-value the use of such prepaid value as a payment instrument is restricted to the purchase of only such value added digital contents/services which are for use on the mobile phones. The use of mobile prepaid value for purchase of other goods and services is not permitted.

Further, the holder of the instrument can be any person or organisation.

Capital requirements:

- for banks: only those banks and NBFC's, which comply with RBI's minimum Capital Adequacy requirements prescribed from time-to-time, are permitted to issue pre-paid payment instruments.
- For other entities/persons, a minimum paid-up capital of Rs. 1 crore and positive net owned fund are a must.

Permissible Exemptions for Entities Issuing Closed System Pre-Paid Payment Instruments:

Entities issuing closed system prepaid payment instruments are exempted from the purview of the guidelines. They are also exempted from seeking authorization from Reserve Bank of India, for issuance of such payment instruments subject to the following conditions:

- **A closed system payment instrument** would have a maximum value of Rs. 5000/- only.
- These instruments cannot be used for purchase of another prepaid payment instrument.
- Amounts collected under the scheme would be exempted from the provisions regarding deployment of funds, provided the value of outstanding instruments does not exceed Rs. 50 lacs or 10% of the issuers' 'net owned funds'⁹, whichever is lower.

⁹ RBI guidelines define "net owned fund" as follows:

"2.7 Net Owned Funds: For the purpose of these guidelines "Net Owned Fund" (NOF) will consist of paid up equity capital, free reserves, balance in share premium account and capital reserves representing surplus arising out of sale proceeds of assets but not reserves created by revaluation of assets. From the aggregate of items so computed, the NOF would be arrived at after deducting the accumulated loss balance and book value of intangible assets, if any. The NOF should be computed on the basis of last audited Balance Sheet and any capital raised after the Balance Sheet date should not be accounted for while computing NOF."

- Entities issuing such instruments must inform RBI when they start operating such schemes.
- A half yearly audited statement is required to be submitted to the Reserve Bank by such entities indicating the total value of instruments issued during the period and the value outstanding as at the end of the period.

As said earlier, entities authorized under FEMA to issue foreign exchange prepaid payment instruments are exempt from the purview of these guidelines. The use of such payment instruments will be limited to permissible current account transactions and subject to the prescribed limits under the FEMA

SAFEGUARDS AGAINST MONEY LAUNDERING KYC/AML/CFT PROVISIONS (DIRECTION 6)

1. The guidelines on Know Your Customer/Anti-Money Laundering/Combating Financing of Terrorism guidelines issued by the Reserve Bank of India to banks, from time to time, will be applicable, *mutatis mutandis*, to all entities issuing prepaid payment instruments. The issuing entities will be required to put in place all necessary systems to ensure compliance with these guidelines.
2. The maximum value of any prepaid payment instrument (where specific limits have not been prescribed) will not exceed Rs. 50,000/-.
3. Exemption/relaxation from the provision of KYC requirements is available only in the following cases:-
 - i) Semi-Closed System Payment Instruments of value up to Rs. 1000/- may be issued without any KYC (but, in no case not more than once to the same person) subject to reporting of annual turnover/suspicious transactions¹⁰.
 - ii) Semi-closed Prepaid payment instruments which permit only payment of utility bills/ essential services up to a limit of Rs. 10,000/- can be issued without any KYC. The issuing entities may ensure that these instruments are made acceptable only at institutions which maintain the identity of the customers. The utility bills/ essential services will include only Electricity bills, water bills, telephone/mobile phone bills,

¹⁰ All the issuing entities are required to report of any suspicious activity to the FIU-IND. The said entity must also file Suspicious Transaction Report (STR) to Financial Intelligence Unit – India (FIU-IND). (Direction 6.5)

and insurance premium, cooking gas payments, ISP for Internet/Broadband Connections, Cable/DTH subscriptions and Citizen Services by Government or Government bodies.

- iii) Prepaid payment instruments up to Rs. 5000/- can be issued by accepting any 'Government issued Identity Cards' as proof of identity. Such instruments must not, however, permit cash withdrawal.
- iv) Entities issuing prepaid payment instruments to institutions/companies for further issuance by these institutions/companies to their employees or other beneficiaries **may** ensure that these institutions/companies maintain the full details of the employees or beneficiaries to whom such payment instruments are issued. The value of individual payment instrument shall not exceed Rs. 5000/-. Such instruments will not permit cash withdrawal.
- v) All entities issuing prepaid payment instruments must maintain a log of all the transaction undertaken using these instruments and also file Suspicious Transaction Report (STR) to Financial Intelligence Unit – India (FIU-IND).

Mobile Prepaid Instrument:

Mobile Prepaid Instruments are exempt from purview of the guidelines, subject to the following conditions:

- ii) In addition to talk time-value the use of such prepaid instrument shall be restricted to the purchase of only such value added digital contents/services which are for use on the mobile phones.
- iii) The use of mobile prepaid instruments for purchase of any other goods or services shall not be permitted.
- iv) Encashment of such prepaid instruments shall not be permitted.¹¹

DEPLOYMENT OF MONEY COLLECTED

The moneys collected through pre-paid instrument are necessarily to be deployed as per these Directions to maintain credibility and preserve public trust in these instruments.

¹¹ Source: www.iibf.org.in/.../caiib_gbm_prepaid_payment_instruments.doc

- i) **FOR BANKS:** For the schemes operated by banks, the outstanding balance shall be part of the ‘net demand and time liabilities’ for the purpose of maintenance of reserve requirements. This position will be computed on the basis of the balances appearing in the books of the bank as on the date of reporting.
- ii) **FOR NON-BANK ENTITIES:** they are to maintain their outstanding balance in an *escrow account* with any scheduled commercial bank subject to the following conditions:
- The amount so maintained shall be used only for making payments to the participating merchant establishments.
 - No interest will be payable by the bank on such balances.
 - A quarterly certificate from the auditors will be submitted certifying that the entity has been maintaining adequate balance in the account to cover the outstanding volume of payment instruments issued.
 - The entity shall also submit an annual certificate, as above, coinciding with the accounting year of the entity to the Reserve Bank of India.
 - Adequate records indicating the daily position of the value of instruments outstanding vis-à-vis balances maintained with the banks in the escrow accounts shall be made available for scrutiny to the Reserve Bank or to the bank where the account is maintained on demand.

EXCEPTION: However, as an exception to the above, the non-bank entity can also enter into an agreement with the bank where the escrow account is maintained, to transfer “core portion”¹² of the amount to a separate “interest paying” account. However, this transfer will be subject to the following conditions:

- The bank shall satisfy itself by verification of necessary documents that amount deposited represents the core portion.
- The amount so deposited, must be linked to the escrow account, to enable the bank to meet payment requirements in case of shortfall in the escrow account.
- This facility can be availed of by entities who have been in the business of pre-paid payment instruments and whose accounts have been audited for the full accounting year.

¹² Core portion can be defined as the average of the lowest fortnightly outstanding balances in the account.

- The entity, however, can not avail any loan against such deposits. The bank must also not issue any deposit receipt or mark any lien on the amount held in such deposits.

ISSUANCE AND RELOADING OF PREPAID PAYMENT INSTRUMENTS

The guidelines for as follows:

- i) All entities issuing prepaid payment instruments can issue re-loadable or non re-loadable prepaid payment instruments.
- ii) Reloading of closed system payment instruments would be permitted at the retail agents and issuers outlets against cash/debit cards/credit card.
- iii) Banks and NBFCs are permitted to issue and reload such payment instrument at their branches against payment by cash/debit to bank account/credit card.
- iv) Banks are also permitted to issue and reload of such payment instruments through their business correspondents appointed as per the guidelines in this regard issued by the Reserve Bank.
- v) Other entities can issue and reload such payment instrument through their outlets or through agents by payment by cash/debit to bank account /credit card subject to the following conditions:-
 - The issuer may carryout proper due diligence of the entities appointed as authorized agents for sale of such instruments.
 - The issuer shall be responsible for all their payment instruments issued by the appointed agents.
 - The prepaid payment instrument issuers shall be responsible as the principal for all acts of omission or commission of their agents.
 - The sale/reloading by cash at the agent locations shall be restricted to the value of Rs. 5000/-.

VALIDITY (Direction 9)

As per the guidelines, all prepaid payment instrument issued in the country must have a minimum validity period of six months from the date of activation/issuance to the holder. In the case of non-reloadable prepaid payment instruments, at the expiry of the instrument, the issuer of the instrument can permit the transfer of the outstanding amount on the payment instrument to a

new similar payment instrument of the same issuer. The outstanding balance against any payment instrument cannot not be forfeited unless the holder is cautioned at least 15 days in advance as regards the expiry of the validity of the payment instrument.

REDEMPTION

The Guidelines also provide for redemption. They say that the issuers of such instruments cannot dishonor customer instructions for payments/transfers of money, at approved locations, if there is sufficient balance outstanding against the instrument. The consumers/holders of prepaid payment systems other than open-system payment instruments can also redeem the balance outstanding within the expiry date, if for any reason, the scheme is being wound-up or directed by the Reserve Bank to be discontinued.

However, the value redeemed will not exceed the outstanding for the instrument.

FRAUD PREVENTION AND SECURITY STANDARDS

In order to prevent frauds and maintain security, the issuers must put in a central database with adequate information, security infrastructure to back and secure these up and systems for the prevention and detection of frauds.

CUSTOMER PROTECTION UNDER THE GUIDELINES

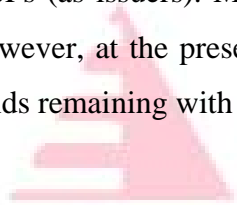
Under the guidelines, the issuers are required to disclose the terms and conditions of issue of the instruments in All Prepaid payment instruments issuers shall disclose all important terms and conditions in clear and simple language (preferably in English, Hindi and the local language).

The disclosures made therein must include:

- i) All charges and fees associated with the use of the instrument.
- ii) The expiry period and the terms and conditions pertaining to expiration of the instrument.
- iii) The customer service telephone number and website URL.

Further, the issuers must also set up an effective mechanism for redressal of customer complaints. Further, in case of pre-paid payment instruments issued by banks, customers shall have recourse to Banking Ombudsman Scheme for grievance redressal.

Financial systems the world over are evolving at a fast pace. Newer and newer instruments are launched by the players to capture larger market share. India is no different. Before, 2007, there were many cards and instruments which were issued to unsuspecting consumers. Further, with the dangers of financial terrorism lurking in the background, the RBI issued guidelines for the issue of these instruments in 2009. further, The Payment and Settlements System Act, 2007, entrusts upon RBI, the responsibility for regulation and supervision of all payment and settlement systems in the country. The policy guidelines issued in April 2009 in this regard provide wide options for issuance of such pre-paid products. The amendment to the policy guidelines issued on August 14, 2009, permits all non-bank entities including Mobile Service Providers (MSPs) to issue mobile based prepaid instruments. This relaxation was carried out based on the representation from MSPs. However, there has been very little participation of MSPs (as issuers). May be because this model that does not provide a financial float to them. However, at the present juncture MSPs cannot be permitted to enjoy the float funds. As these funds remaining with non-banks are tantamount to deposit taking which needs to be discouraged.



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