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**New Regulatory Movement by China's Central Bank in the
Online Payment Sector**

Background

The Chinese e-commerce industry has evolved at a remarkable pace over the last eight years. Amazon's acquisition of Joyo.com in 2004 and Alibaba's highly profitable IPO in 2007 are among many examples of how significant the market has become to both domestic and international players.

As a result of the proliferation of e-commerce transactions, numerous companies have emerged in China to provide third-party online payment solutions to Internet end-users. In a move to regulate such companies, on 16 April 2009 the People's Bank of China (PBOC) issued Announcement No. 7 [2009] (**Announcement 7**). Announcement 7 requires all non-financial institutions engaging in the business of online payment and settlement (**Online Institutions**) to register with the PBOC.

This is not the first time the PBOC has sought to regulate the online payment industry. On 10 June 2005, it issued for public comment the *Draft Measures for the Administration of Payment and Settlement Organizations*, which set forth various requirements for companies wishing to operate in this area, such as obtaining a PBOC license. However, neither those measures nor a subsequent draft released in early 2006 were actually promulgated. Currently, Online Institutions do not need to obtain special government approval to conduct their business. Rather, they must simply obtain a value-added telecommunication services operating permit from the Ministry of Industry and Information Technology (MIIT), as is required of all Internet companies operating commercial websites in China.

Key Provisions of Announcement 7

1. Timeframe for Registration

Announcement 7 states that all Online Institutions established prior to its date of issue must register with the relevant local arm of the PBOC by 31 July 2009. Online Institutions established after its issuance date must complete PBOC registration within one month after commencing payment and settlement activities.

2. Scope of Announcement 7

Announcement 7 does not provide a clear definition for "payment and settlement activities". However, it does set out a list of activities that would be construed as such by the PBOC and consequently require registration:

- processing online payments;
- issuing e-money and settling e-money transactions;
- inter-bank settlement of bank note transactions;
- inter-bank settlement of bank card transactions; and
- other payment and settlement activities approved by the PBOC.

3. Significance of Registration

Article 8 of Announcement 7 explains that registration with the PBOC is solely for filing and record-keeping purposes. As such, completing registration formalities should not be construed as obtaining a PBOC license to conduct online payment and settlement activities.

Our Analysis

A discreet "homework" and "warm-up" exercise?

There is speculation within the industry that the regulation of Online Institutions has been protracted due to the PBOC's lack of sophistication and familiarity with online payment and settlement, and that these traits could lead to inappropriate legislation. For example, in commenting on the draft measures, many industry observers and small- to medium-sized online payment companies voiced their concern that the PBOC's proposed requirements for an Online Institution operating license were excessively high. If promulgated, the measures would thus have unfairly prejudiced start-up companies and led to a monopoly for larger players in the market.

The issuance of Announcement 7 is generally viewed as an attempt by the PBOC to do its "homework" and carry out a "warm-up" exercise before enacting formal regulations. Announcement 7 applies to all sizes and types of Online Institutions, and requires extensive data to be submitted during the registration process. Thus, the PBOC can use it to gain a better sense of the current framework and level of development of the third-party payment and settlement industry.

The PBOC's position on certain key issues remains to be clarified

Announcement 7 does not address certain key issues that have concerned the industry for years, such as:

1. what the requirements are for capitalization, ownership structure and record-keeping of Online Institutions and their investors;
2. what qualification criteria and restrictions apply to foreign investors in Online

Institutions;

3. whether Online Institutions are classified as non-banking financial institutions with online payment functions or Internet companies with special approval to engage in third-party payment businesses;
4. which governmental authority (*i.e.*, the MIIT or the PBOC) is the primary supervisory and administrative authority for Online Institutions; and
5. how "e-money" is to be defined. As a category of payment and settlement under Announcement 7, "e-money" is generally understood to be a payment by a debit card or credit card issued by a financial institution. However, it remains unclear if virtual currencies (*e.g.*, the "QQ Coin" created by the Internet portal Tencent for use on its gaming platforms and to purchase value-added services linked to its popular instant messenger tool) will also come under the scope of "e-money".

Conclusion

Numerous start-ups are eager to enter the online payment market in China. Given the contrast between the substantial amount of funds that these companies process as payment intermediaries and the relatively low barriers to entry under the current regulatory environment, the PBOC is likely to introduce a licensing system for Online Institutions.

Moreover, as the sector is expanding rapidly and is relatively unregulated, potential legal and financial risks exist for China's Internet industry. The PBOC's legislative process has traditionally been influenced by attempts to reduce these risks. Indeed, such attempts could lead the PBOC to adopt a stringent approach in its eventual regulation of online payments, including raising the barriers to entry in order to limit the number of market players.

Although Announcement 7 is a significant step forward, the online payment sector is in need of clear regulations on Online Institutions from the PBOC, as well as a comprehensive, well-defined licensing system.

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