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A GIFT DESERVED: 5 THINGS TO KNOW ABOUT THE PAYMENTS INDUSTRY IN ASIA

The digital payments landscape

Digital payments[1] in Southeast Asia alone are forecast to exceed US$1 trillion by 2025, accounting for nearly one in every two dollars spent in the region[2]. China is already a world leader in digital payments.

The rapid growth of digital payments in Asia can be attributed to: (i) the expansion of both Western and local e-commerce players across the region; (ii) an increase in digital payment offerings, such as e-wallets and QR code-based payments, from both established banks 'going digital' and fintechs seeking to capitalise on the widespread use of smartphones; and (iii) a need for businesses to meet the demands of their (increasingly) digital native customers, who expect seamless everyday transactions, whether in the form of 'bricks or clicks' both locally and internationally.

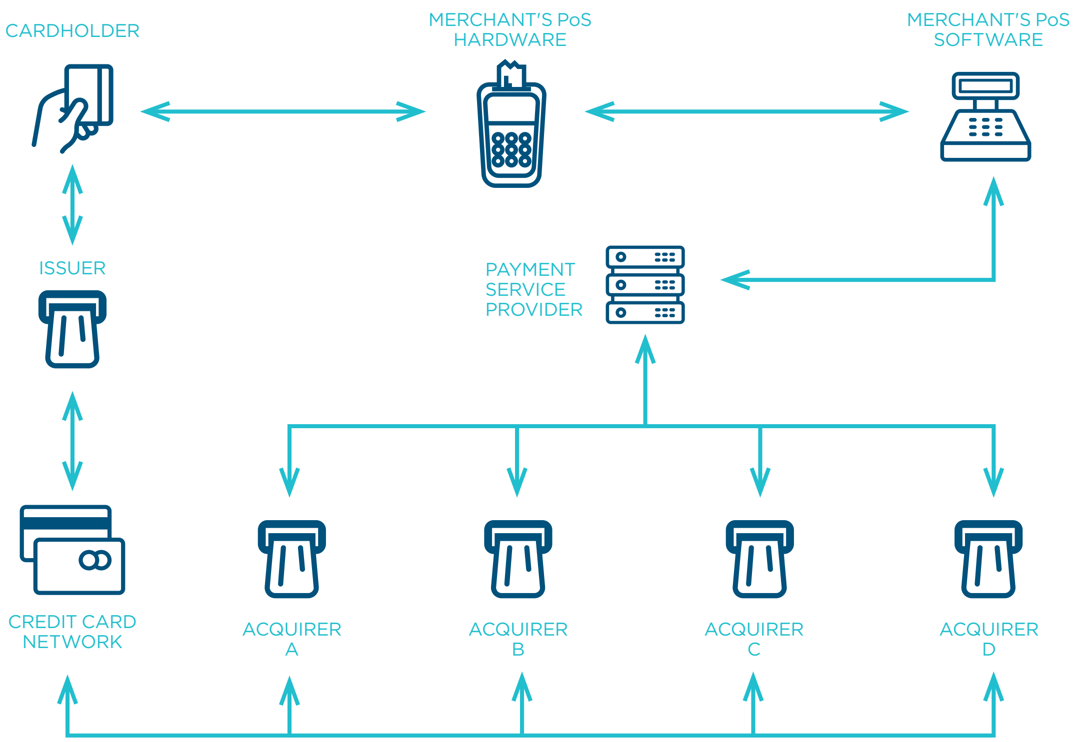
Worker or migrant remittances are also a powerful driving force behind the growth in digital payments in nations across Asia. According to the World Bank, remittance flows have outstripped both foreign aid and foreign direct investment as the largest type of inbound capital for developing nations[3].

The role of Payment Service Providers

A payment service provider ("**PSP**") plays a vital role in the digital payments ecosystem by acting as an intermediary between customers (or 'payors'), merchants (or 'payees'), acquiring banks, card payment schemes (such as Visa and Mastercard) and the issuing banks of payors.

In short, PSPs provide a range of technologies and services to ensure that money transferred through the digital payments network arrives safely at the intended destination.

The meteoric increase in digital payments in Asia in recent years has led to a proliferation of new regulations as national regulators seek to keep pace with new digital payment technologies. In turn, PSPs are coming under pressure to ensure that their technologies and business models comply with an increasingly complex regulatory landscape.



FOOTNOTES:

1. Digital payments are cashless transactions executed through digital means, for example, card transactions, account-to-account transfers and e-wallet payments.
2. www.blog.google/documents/47/SEA_Internet_Economy_Report_2019.pdf
3. http://documents.worldbank.org/curated/en/805161524552566695/pdf/125632-WP-PUBLIC-MigrationandDevelopmentBrief.pdf

The challenge in Asia

There is no 'one size fits all' guide to expanding or operating in Asia. Different jurisdictions have taken diverging approaches to the regulation of PSPs and, more broadly, the digital payments ecosystem. For example, some jurisdictions have sought to protect local players by imposing stringent local ownership and licensing requirements. Other jurisdictions have sought to focus on the rights and security of local consumers by imposing data localisation and on-shoring requirements, thereby making it difficult for foreign PSPs to enter local markets without investing heavily in local infrastructure. In contrast, there are jurisdictions which are trying to attract foreign PSPs through more flexible regulatory arrangements.

The upshot is that foreign PSPs looking to expand or operate in Asia must conduct thorough regulatory due diligence in respect of each relevant jurisdiction in order to ensure compliance with local regulatory requirements and, ultimately, their success.

Notwithstanding the lack of a 'one size fits all' guide, this article provides an overview of five key issues that foreign PSPs should consider when planning to expand or operate in Asia, and highlights how these issues may be treated differently between jurisdictions.

1. Legal structuring requirements

Early in the due diligence process, a PSP should ascertain: (i) whether a local legal entity is required in-country in order to be able to carry out payment services in that country; and (ii) what restrictions apply (if any) to the proposed structure of the legal entity in the relevant jurisdiction (see also foreign ownership restrictions below).

For example, the People's Bank of China ("**PBOC**") mandates that payment service institutions establish a local branch to service local merchants in China. While there are options for a local presence in China, certain legal structures are prohibited from carrying out particular business activities. Similarly, in Japan, foreign entities must have a registered branch in the country. The branch must be established using a legal entity but there are no restrictions on the type of entity structure.

With this issue in mind, a PSP will need to make strategic choices about the business model it adopts to establish a presence in each jurisdiction.

2. Foreign ownership restrictions

In addition to legal structuring requirements, foreign PSPs in particular need to assess whether foreign ownership restrictions apply in the relevant jurisdiction. For example, in Indonesia, e-wallet, funds transfer and payment gateway activities are open for foreign investment, but e-money and back-end payment processing tend to be more restricted.

Registration and business licence requirements are also commonly imposed on foreign-owned entities in Asia. For example, in Thailand, certain foreign-owned entities require a Foreign Business Licence issued by the Thai Ministry of Commerce. The licence is discretionary and the Ministry may impose certain conditions on the licence (for example, a requirement to develop software locally) which could impact the planned business activities of the PSP in that jurisdiction.

In addition, some countries wholly reserve certain business types for nationals or mandate that a certain number of directors are citizens or permanent residents of the relevant jurisdiction. In Japan, for example, a foreign company that establishes a registered branch in-country must have at least one representative who resides in Japan.

3. Licensing and regulatory regimes

As part of the process of ascertaining how a foreign PSP will establish its presence or operate in a jurisdiction, due consideration must also be given to the regulatory regime(s) that will apply to the PSP's business activities.

Coming to grips with Asia's fragmented regulatory landscape is one of the major hurdles faced by PSPs in this part of the world. In particular, a PSP will need to ascertain: (i) what the applicable licensing and/or registration requirements are; (ii) whether a foreign PSP is entitled to apply for the necessary licences and registrations; (iii) whether special conditions may be imposed; (iv) the processing time and costs; and (v) the ongoing regulatory obligations that licensees must comply with.

Not only do regulatory regimes differ from country to country across Asia, the applicable licensing and regulatory regime will also vary depending on the PSP's chosen business model and business activities. This is because different models contemplate varying degrees of involvement and responsibility as between a PSP and the other players in the digital payments ecosystem, most notably, the acquiring bank. For example, in Vietnam, if the business activities of a PSP qualify as 'intermediary payment services' under Vietnamese law, the PSP must obtain an operating licence from the State Bank of Vietnam. Similarly, in China, a PSP's business activities will determine the type of permit that the PSP will need to apply for. A PSP providing cross border payment services in China must also register with the foreign exchange authority (SAFE). In Japan, if a PSP's business model means that it will make definitive decisions regarding the execution of agreements with merchants, it will need to be registered with the relevant ministry.

A PSP will need to familiarise itself with the nuances of the regulatory regime in each relevant jurisdiction. A thorough diligence process should also identify how the business model and business activities of a PSP will impact the licensing and regulatory regime that will apply to it in each relevant jurisdiction.

4. Privacy and data transfer considerations

The data protection landscape across Asia is diverse and far from consistent. While some jurisdictions such as Hong Kong, Singapore and Japan have well established data protection regimes, other countries such as India and Indonesia (at the time of writing) do not have comprehensive data protection laws (although general data protection bills have been introduced in parliament in both jurisdictions).

Given the inconsistent regimes across the region, a PSP will need to carefully consider the rules that will govern its data collection, processing and transfer activities on a country-by-country basis. Again, the applicable rules and restrictions will vary depending on the PSP's business model and, amongst other things: (i) whether all or any part of the data processed by the PSP qualifies as personal data under the laws of the relevant jurisdiction; (ii) whether the PSP will be collecting the data itself or merely processing data collected by a third party; and (iii) whether the PSP will transfer data (personal or otherwise) across national borders.

Additional restrictions may apply where a PSP intends to capture transaction data (including personal data) and transfer it off-shore (for processing or storage, for example). Data localisation laws (as they are known) in countries such as Indonesia, China, Vietnam and Malaysia are intended to control cross-border data flows and can have a significant impact on a PSP's ability to operate if they are not adequately understood. In China, the PBOC requires that even licensed payment service institutions must process personal information and financial information within China, except for cross-border transactions. This means that if a PSP is planning on transmitting transaction data for domestic transactions to an overseas server for processing, it would be in breach of these data localisation requirements.

For a PSP looking to expand or operate in Asia, the importance of thorough privacy and data transfer due diligence in each relevant jurisdiction cannot be overstated. At best, a failure to carry out proper due diligence in this regard can result in costs and delays for the PSP and, at worst, may make the PSP's business model subject to risk or unviable.

5. Offshoring and outsourcing restrictions

Finally, a PSP will need to consider whether any other offshoring restrictions apply in the relevant jurisdiction in respect of its proposed business activities. This is important if, for example, the PSP's business model relies on using infrastructure (such as a data centre) based outside the relevant jurisdiction or the PSP intends to carry out certain business activities (such as data processing) offshore. For example, in Vietnam, IT infrastructure requirements are imposed on PSPs (including requirements to have in-country disaster recovery infrastructure and data back-up and storage facilities).

Even if offshoring restrictions do not directly apply to a PSP, it may be the case that such restrictions affect a PSP's customers thereby impacting how, in practice, the PSP can deliver its service to those customers. In Indonesia, for example, banks and certain other financial institutions must obtain approval from the financial services regulator (OJK) in order to store data of any kind offshore or to process data for authorising bank transactions offshore. Such restrictions, although not directly imposed on a PSP, are likely to materially affect a PSP's ability to deliver its services in the new territory.

In addition to offshoring restrictions, in our experience, a number of jurisdictions in Asia also prohibit or restrict financial institutions from outsourcing particular business activities, which may include the business activities of a PSP. For example, in China 'core' parts of an acquiring service (including transaction processing) cannot be outsourced as transaction information must flow directly from merchants to the acquiring bank's system. Similarly, in Indonesia, a local acquiring bank may only outsource 'supporting services' (a defined category) for its core and non-core activities to Indonesian service providers, but not to foreign service providers.

Various countries in Asia restrict the offshoring and outsourcing of certain business activities, which may directly (or indirectly) affect a PSP's prospects of expanding into or operating in new territories. In order to successfully navigate such restrictions, a PSP may need to rethink its end-to-end service design and delivery (including rethinking the IT infrastructure that underpins its services, particularly where cloud or SaaS solutions are involved).

Conclusion

As the digital payments landscape continues to expand and evolve throughout Asia, regulators need to strike a balance between the need for fast and convenient digital payment systems (and the commercial interests of payors, payees, PSPs and acquiring banks) and the need to guard against the inherent risks associated with digital payments, such as security, fraud, money laundering, terrorist financing, bribery and corruption.

In addition, governments need to keep national interests such as ownership and control of the money transfer market in mind.

As a result, it is unlikely that Asia will see homogenous digital payments regulation in the near future, and PSPs will need to continue to carefully assess their business models and the regulatory landscape in each relevant jurisdiction in Asia.

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