Third party payment licences in China – are they within the grasp of foreign investors?

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Online sales in China are booming. Gigantic figures are regularly trotted out by commentators to illustrate the size of the online market, such as the recent jaw-dropping figures for online sales for China's answer to St. Valentine's Day, Singles' Day. That market is underpinned by payment services, and the number of payment services providers, and online payment services providers in particular, has grown exponentially along with the explosion in online sales. Online payment services, however, remains an area where foreign players are struggling to gain a foothold.

Rapidly developing industry

Third party payment services is a rapidly growing industry. So rapid that regulatory authorities have been struggling to keep up with changes. In March 2014, the People's Bank of China ("PBOC"), China's central bank and the regulatory authority overseeing the third party payments industry, intended to suspend the rollout by Tencent and Alibaba (two of China's largest and best known companies in this space) of online credit cards and code (QR) scanning payments, ostensibly due to concerns about data privacy with this new system, but perhaps also partly because the authority needed time to understand their impact (and because these payment methods did not go through China UnionPay at that time, which had a de facto monopoly on credit card network services in China). A regulation issued that same month by the PBOC together with the banking industry regulator, the China Banking and Insurance Regulatory Commission ("CBIRC", the new super-regulator that took over the functions of the former China Banking Regulatory Commission and China Insurance Regulatory Commission in 2018), addressed data privacy issues, among other matters. Drafts of that regulation had proposed to set significant limits on spending via online payment services, which would have severely impacted the industry. However, the final version only requires that banks set payment limits that are appropriate to customers. The suspension order issued by the PBOC, however, has never been really implemented. Both Tencent and Alibaba continued to explore the market for code (QR) scanning payments and upgraded the relevant technologies. On 3 August 2016, the Payment & Clearance Association of China issued the Code Scanning Payment Service Specification draft for comments, which, for the first time, demonstrated PBOC's official intent to recognize the legitimacy of code (QR) scanning payments following the suspension order in 2014. It was not until 25 December 2017 that the formal Code Scanning Payment Service Specification (trial implementation) was promulgated by the PBOC, which confirmed the legal status of code (QR) scanning payments. The all-pervasive QR code has been redefining what it means to make purchases and sales in China during the past years, and it is driving a mobile payment trend that is severely impacting the growth of traditional payment infrastructure like ATMs and even POS (point of sale) terminals.

Foreign participation in the industry

Foreign investors in online payments are particularly limited by regulatory restrictions – some of which are explicit, while others seem to be a matter of unwritten policy. In this note, we briefly set out the regulatory "state of play", mainly from the standpoint of would-be foreign invested providers of online payment services.

Payment Licences

People's Bank of China's requirements

As a general statement, the PBOC regulates non-financial institutions providing payment services quite strictly, as these are seen as a sensitive area because of the potential for consumers to suffer losses and/or for payment institutions to be used as a conduit for 'hot money', money-launderers or those engaged in terrorist financing.
A provider of third party payment ("TPP") services in China (a "Payment Services Operator") must hold a payment services licence ("PSO Licence") issued by the PBOC, as well as an approved business licence on which the business scope section explicitly includes the particular service(s). Under the TPP Regulations (as defined below), TPP services that may be provided by non-financial institutions holding PSO Licences in China include online payment services, issuance and acceptance of prepaid cards and bill collection via bank cards (as well as any other payment services that the PBOC may specify). The rules that impose this requirement (the "TPP Regulations") do not expressly prohibit foreign-invested enterprises ("FIEs") from becoming Payment Services Operators, but they do state that separate provisions specifically regulating FIEs in this space will be issued.

Almost 8 years after promulgation of the TPP Regulations, the PBOC issued a public announcement on opening up the payment services market to FIEs on 19 March 2018 ("March 2018 Announcement"). The March 2018 Announcement provides that a foreign institution intending to provide electronic payment services to Chinese citizens in relation to domestic and cross-border transactions must establish a FIE in China and obtain a PSO Licence.

However, as "electronic payments" is not a defined term used in the TPP Regulations, it is not entirely clear if foreign institutions will be permitted to establish subsidiaries in China to conduct all forms of online payment services (which are defined under the TPP Regulations to broadly include payment services provided involving use of computers, mobile terminals or other electronic devices such as Internet payment, mobile payment, landline payment, digital television payment and other network-based payment services). Notwithstanding the lack of clarity, it is highly likely that foreign-invested payment service providers approved by the PBOC will be able to offer payment services through websites and mobile devices.

In addition, although the March 2018 Announcement relaxes, or more to the point clarifies, market entry criteria for foreign payment companies entering the Chinese market, it is still unclear to us how the PBOC will deal with applications from FIEs in practice or what specific criteria apply to such applicants.

**Payment licences have been issued to two FIEs**

In July 2013, the PBOC issued the PSO Licences to two FIEs: the China subsidiaries of Sodexo and Edenred (both French companies). Each was issued a licence permitting it to provide prepaid card services in China. With no specific regulations expressly authorising provision of TPP services by FIEs in place in 2013, the Sodexo and Edenred PSO Licences seemed to have been issued in something of a legal vacuum and took the market rather by surprise. The Sodexo and Edenred FIEs’ licences are the only two PSO Licences on the public record (of a total of 238 PSO Licences issued by the PBOC) issued to FIEs in China to date, and those are very limited in scope – allowing prepaid card services only, and not, for example, online payment services.

To our knowledge, no FIE is currently licensed to carry out online payment services in China. London-based currency exchange and payments solutions company World First, being the first applicant after the liberalization under the March 2018 Announcement for a PSO Licence covering "online payments services" and "mobile phone payments services", withdrew its application in January 2019 after it appeared to have been approved, without disclosing the underlying reasons, but we understand that it

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1 Measures for the Administration of Payment Services of Non-financial Institutions, effective 1 September 2010, and Detailed Implementing Rules for the Administration of Payment Services of Non-financial Institutions, effective 1 December 2010.

2 According to [the PBOC’s website at www.pbc.gov.cn] at time of writing.
was due to it being bought by Ant Financial which already has one PSO Licence and may not be permitted by the PBOC to hold two within the same group without a specific justification.

**Current Market Practice**

Based on the PBOC press conference minutes published on 12 August 2016, in principle, the PBOC suspended issuing any new PSO Licences for an unspecified period of time. It is uncertain when the PBOC will resume the issuance of PSO Licences. Based on our no-name inquiries with Shanghai PBOC, the official indicated that business operators are still allowed to submit applications for PSO Licences, but it is becoming very rare for the PBOC to issue any new PSO Licences. However we assume that the announced opening of the sector to foreign investment should not be limited by this where the applicant is the China subsidiary of a reputable and well-run overseas company. However query whether the PBOC will be willing to issue the highly symbolic first PSO License for online payments to a US-based company, given the current trade frictions.

In addition to the reluctance of the PBOC to issue new PSO Licences, the PBOC has rejected certain applications to extend the term of PSO Licences made by domestic capital payment institutions or even withdrawn certain PSO Licences, due to the non-compliant activities of the holder. Again we see this as an attempt by the PBOC to clean up the market. Even well-known companies like AliPay and Tencent (which between them hold roughly 90% of the market) have recently been fined for non-compliant activities, presumably to send a message to the market.

**Telecoms Licences**

We noted above that the PSO Licence obtained by the Sodexho and Edenred FIEs (the only FIEs to have obtained such licences to date according to public record), permit the holders to carry out prepaid card services and not online payment services.

**Internet/telecoms industry regulator's requirements**

Prepaid card services are subject to the PBOC licensing requirements discussed above. The provision of online payment services may, however, fall under both the payments and the telecommunications legal regimes in China, and therefore into the regulatory ambit of both the PBOC and the government department that oversees the Internet and telecommunications industries, the Ministry of Industry and Information Technology ("MIIT"). However, the position is not entirely clear.

China's telecommunications regime imposes licensing requirements on providers of telecommunications services. In particular, that requires providers of "online transaction processing services" must hold a Value-added Telecommunications Services Operating Permit for online transaction processing ("OTP VATS Permit"), issued by the MIIT.

The 2015 *Catalogue for Classification of Telecommunications Services* ("2015 Telecoms Catalogue") defines "online transaction processing services" as "the use of various application platforms for transaction/business processing which are linked to a public communications network or the Internet to provide subscribers with online transaction/business processing services over a public communications network or the Internet".

**Do online payments services providers need telecoms licences?**

Based on the wording underlined above, and the fact that the TPP Regulations do not require providers to obtain an OTP VATS Permits from the MIIT as a precondition to being able to provide online payments services, it is arguable whether an online payment services provider would need to apply for and obtain an OTP VATS Permit in addition to the Payment Service License. In accordance with the MIIT Circular on Removing the Restrictions on Foreign
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Equity Ratios in Online Data Processing and Transaction Processing (E-commerce) Business ("E-commerce Circular") effective 19 June 2015, the MIIT seems to have come to the position that an OTP VATS Permit is typically applicable to e-commerce service providers, which in practice means online platform providers providing "marketplaces" for third parties selling/providing their products/services on such platforms (such as Tmall). That is to say, it is the public transaction processing platform provider (i.e. Tmall) that would need the OTP VATS Permit. We asked the MIIT on a number of occasions and at several of its branches, whether a provider of online payments services must hold an OTP VATS Permit. We got mixed answers, but most of the officials we spoke to were of the view that an OTP VATS Permit is NOT required. However, we did find that some domestic capital online payment services providers have obtained OTP VATS Permits. It is not clear whether these OTP VATS Permits were obtained by such online payment services providers for the purpose of providing online payment services or they were obtained for the purpose of providing other existing or possible future online transaction processing services (such as e-commerce).

Difficult for foreign investors in non-e-commerce industry to obtain

Telecoms, and the Internet in particular, is a sensitive area in China and, under Chinese law, VATS Permits are generally available only to Sino-foreign joint venture ("JV") FIEs in which a Chinese investor (or investors) hold at least 50% of the equity interests (except for operational e-commerce services, of which the cap on foreign investment has been lifted entirely across the country in 2015 and call centre, domestic multi-party communications and store and forward services which were recently fully liberalised). Even then, the MIIT has issued relatively few VATS Permits to FIEs. As a result of MIIT's (whether real or perceived) unwillingness to issue these licences to FIEs, many foreign investors have opted to invest in China's telecoms sector through nominee or indirect structures, such as the variable interest entity ("VIE") structure. This structure has been used in a wide variety of industries (including education for example), extending beyond those sectors where foreign investment restrictions are most commonly encountered, such as the media, telecoms and the Internet, but it remains highly controversial in the eyes of many Chinese officials and is subject to a variety of regulatory and legal threats and challenges, which are beyond the scope of this note.

This means that, in order to obtain an OTP VATS Permit that permits it to provide non-e-commerce-related transaction processing services, an FIE must be a JV company (as mentioned above, operational e-commerce is now open to all FIEs including wholly foreign owned enterprises ("WFOE") and JV FIEs). In turn, that means that a foreign investor must find, and agree terms with, a Chinese partner and deal with all the relevant relationship and partnering issues before it can even begin to apply for permission to provide these services.

International Remittances

Foreign non-financial institutions can provide cross-border payment services in cooperation with Chinese banks where the latter act as international remittance agents and the former as principals.

International remittances are overseen by yet another regulator, the CBIRC.

The relevant regulation in this area requires the foreign principal to establish a representative office in China, through which it must keep the CBIRC informed of events that might impact its China business that occur in other countries where it does business.

Under this regime, the foreign party has no 'legal person' presence in China and does not require (and, indeed, cannot hold) a PSO.

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Licence – because it is the agent bank in China that makes or receives payments.

This route is currently used by some foreign payments companies, giving them access to a portion of the China payments market. It is, however, relatively speaking, addressing a very small portion of the market, as the vast majority of payments made in China are, of course, in RMB and onshore (between Chinese parties).

Comments

Our understanding then, is that it is theoretically feasible for an FIE (including a WFOE, a 100% subsidiary of a foreign company or a JV) to obtain a PSO Licence that allow it to carry out any of the services regulated by the TPP Regulations – or at the very least electronic payments under the March 2018 Announcement. However, thus far the only two PSO Licences granted to FIEs only authorise the provision of prepaid card services. Therefore there is an opportunity to be the first FIE to break into this area.

What is not entirely clear is whether, in order lawfully to provide online payment services, an OTP VATS Permit is also required. It is, on the face of the rules, possible for a JV FIE with at least 50% Chinese ownership to obtain an OTP VATS Permit to allow it to carry out non-e-commerce transaction processing services (operational e-commerce-related, which is now open to all FIEs, is outside the scope of our discussion).

It is difficult to see any technical or other reason for limiting foreign investment in China’s vast payment services market –beyond simple protectionism. Many of the world’s leading payment companies have advanced technologies and know-how derived from extensive experience in other markets, which would clearly be helpful to developing the nascent China payments industry. Given the size and growth prospects of China’s online payments services market, foreign investors will continue to seek a way into this potentially lucrative market. The March 2018 Announcement was seen as a positive development toward opening up of foreign investment in this highly promising payment service sector in China where foreign investment had been almost impossible, but here we are now over a year from then without any concrete progress to show for it. The key questions at this stage are whether the PBOC has appetite to issue PSO Licences to FIEs that permit them to provide online payments and whether (and in which circumstances) MIIT will require such FIEs to hold OTP VATS Permits. More importantly, even if PSO Licenses are issued to FIEs, will they be able to compete in an environment where Chinese people have already formed strong brand loyalties and habits, which will be difficult to shift without considerable effort and investment.
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