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Analysing developments impacting business

DECIPHERING THE RECENTLY NOTIFIED IFSCA (PAYMENT SERVICES) REGULATIONS 2024

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Introduction

On 29 January 2024, the International Financial Services Centres Authority (IFSCA) notified the International Financial Services Centres Authority (Payment Services) Regulations, 2024 (PS Regulations) with the intention of governing and regulating payment services in International Financial Services Centres (IFSC).

We have analysed the key provisions of the PS Regulations below:

KEY REGULATIONS

Applicability

The PS Regulations are applicable to any person seeking to provide payment services in or from IFSC. The term "payment services" includes the following activities: (i) account issuance service (including e-money account issuance service); (ii) e-money issuance service; (iii) escrow service; (iv) cross border money transfer service; and (v) merchant acquisition service. Any person undertaking these activities is required to obtain a certificate of authorisation for operating as a payment service provider (PSP).

A PSP whose business volume exceeds the prescribed limit and meets the thresholds and conditions will be designated as a "Significant" PSP by the IFSCA. To differentiate between Significant PSP from other PSPs, all other PSPs are referred to as "Regular" PSPs.

Eligibility Criteria

- **Type of entity:** The applicant will have to be a company incorporated and having its registered office in the IFSC. Such a company is not mandatorily required to be set up at the time of the application.
- **Minimum net worth requirement**: The applicant will be required to comply with the minimum net worth requirement as specified in Schedule V of the PS Regulations on an ongoing basis. For instance, a regular payment service provider will have a minimum net worth requirement of USD 100,000 (or equivalent in a specified foreign currency) upon commencement; and shall achieve USD 200,000 (or equivalent in a specified foreign currency) by the end of the third financial year from commencement.
- **Fit and Proper requirement:** The applicant is required to ensure that its directors, key managerial personnel and persons exercising "control" over it satisfy the 'fit and proper requirements', as specified in Schedule II.
- **Authorisation requirement:** The IFSCA evaluates all matters it deems relevant for grant of authorisation *inter alia* confirmation on whether personnel possess adequate experience (potentially including existing authorization to provide similar services in other jurisdictions),

adequate infrastructure (i.e., office space, equipment, communication, manpower), meeting net worth requirements, financial soundness, compliance with "fit and proper" status, etc.

Authorisation Procedure

The process flow for authorisation of a PSP has been summarised below:

- **Application**: Eligible applicants can submit an application to the IFSCA in the prescribed format, accompanied by a non-refundable application fee. Given that there is no mandatory requirement for the applicant to be incorporated at the stage of the application, the application can also be submitted by the parent company wishing to set up the PSP as a subsidiary or a group company.
- **In-principle approval:** After scrutinizing the application for authorization, if the IFSCA is *prima facie* satisfied with the conditions of authorisation, it may issue an 'in-principle approval' letter to the applicant. This letter may outline additional conditions the applicant must fulfil before final authorization is granted. Having said that, an in-principle approval will not automatically entitle the applicant to be granted a final authorization.
- **Setting up a company:** Of the various conditions in the in-principle approval letter, one such condition could be for the applicant to set up the company with its registered office in IFSC (in case the parent company is applying to set up the PSP) and infuse capital to satisfy the minimum net worth requirements.
- **Grant of authorisation**: Once the IFSCA is satisfied that the applicant has met all the conditions, it will issue a certificate of authorization, subject to such conditions it may deem fit. The certificate remains valid unless revoked by the IFSCA or surrendered by the PSP. Every application for authorisation will be processed by the IFSCA as soon as possible with an endeavour to dispose it within 6 months from the date of filing of such application. At this stage, the IFSCA may require the PSP to maintain a security deposit as it may specify.
- **Nodal bank**: The PSP will be required to identify an IFSC banking unit or IFSC banking company to serve as its nodal bank. This will be the bank through which the PSP will undertake its transactions.

Commencement of Operations

The PSP is then required to commence its operations within 6 months from the date of issuance of certificate of authorisation. There is also a provision for requesting the extension of time by submitting a request at least 2 months before the commencement of operations. The IFSCA may provide an extension not exceeding 3 months.

Compliance Requirements

We have summarised the key compliance requirements to be followed by the PSP below:

- **Governance:** PSPs shall formulate comprehensive and clear governance frameworks, i.e., the framework under which its board and senior management shall function., including but not limited to, role and composition of the board and its sub-committees, senior management structure, ownership structure, reporting lines between management and the board, and internal governance policy.
- PSPs cannot undertake activities other than providing payment services without the IFSCA's consent. A financial Institution, set up as a company, may also seek for authorisation to act as a PSP, if authorised by the IFSCA under the appropriate regulatory framework.
- **Risk management of third-party service relationships:** A PSP must establish a risk-based framework to evaluate the criticality of services provided by third-party service providers. For onboarding such third-party providers, the PSP is required to conduct thorough planning and due diligence before entering into such an arrangement, ensuring the level of scrutiny aligns with the service's criticality. Further, the PSP will also be required to test strategies for exiting such third-party arrangements, report critical incidents and maintain up-to-date records of their third party relationships.

- **Protection of funds:** They are required to formulate safety protocols to protect applicable funds in terms of the specifications provided under Schedule IV. This includes the fundamental requirement to always keep applicable funds segregated from any other types of funds held by the PSP.
- **Compliance with anti-money laundering laws:** PSPs are required to comply with International Financial Services Centres Authority (Anti Money Laundering, Counter- Terrorist Financing and Know Your Customer) Guidelines, 2022.
- **Approval and notification requirements to the IFSCA:** Maintenance of open and cooperative communication with the IFSCA. This includes promptly informing the IFSCA of any significant events concerning the PSP. Any proposed major changes, such as modifications to product features, processes, or the structure and operation of payment services, must be communicated to the IFSCA with full details. Additionally, PSPs must obtain prior approval from the IFCSA before engaging in any mergers, consolidations, reorganizations, or changes in shareholding structure.
- **Redressal of grievances and dispute resolution:** Maintenance of adequate staff at their permanent place of business or IFSC registered office to handle queries, complaints, and grievances from its users within a 30-day timeframe. PSPs must offer multiple channels for users to submit queries and complaints, including options like web forms, paper forms, IVR, mobile apps, call centers, SMS, or branch offices.
- **Returns, documents, or other information etc:** The PS Regulations also prescribe robust reporting requirements to the IFSCA which is to be completed in prescribed formats as and when specified by the IFSCA. Further, the PSP is required to furnish its accounts and balance sheet to the IFSCA and maintain books of its accounts and other relevant records as deemed necessary by the IFSCA.

Comment:

The PS Regulations have paved way for setting up entities that can undertake payment services within the IFSC, especially payment system provider entities that have been/ propose to be part of the IFSCA Fintech sandbox. The PS Regulations offer a robust operational and compliance framework, including governance and risk management framework, redressal of grievances, and know your customer norms.

Given that the PS Regulations provides an opportunity for payment service providers registered with the Reserve Bank of India to set up their presence in IFSC through its subsidiary/ group company, it becomes imperative for proposed applicants to assess pertinent provisions of foreign exchange regulations during the structuring phase.

In addition, the IFSCA, since the introduction of the PS Regulations has clarified that it views the formal submission of application as the final step in the process of setting up a PSP. As such, the IFSCA prefers that prospective applicants engage with it to give an overview of its business model and plan operations prior to submitting a formal application.

While the PS Regulations mark a positive stride, we anticipate further clarifications/ guidance on pertinent aspects.

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