

# Dispute Resolution Hotline

August 25, 2023

## FINTECHS TO BE COVERED UNDER ANTI-MONEY LAUNDERING LAWS: INDIAN COURT DIRECTS A CROSS BORDER ONLINE PAYMENT GATEWAY TO REGISTER AS A REPORTING ENTITY!

- A system that enables or facilitates the transfer of funds from a payer to a payee/beneficiary, which may involve either clearing, payment or settlement services, could qualify as a payment system operator under the Prevention of Money Laundering Act, 2002 ("PMLA")<sup>1</sup>.
- The existence of similar definitions in two or more statutes will not be a decisive factor in interpreting the said definitions. Instead, it would be the preamble, object and purpose of the legislation, especially while interpreting special statutes such as PMLA.
- Handling of actual funds by an intermediary or an entity/system is not a decisive factor to conclude whether such entity is a payment system operator under the PMLA.
- Payment intermediaries who facilitate cross-border payments are more likely to be reporting entities under the PMLA, unlike businesses such as UPI based third party applications.
- Domestic payment intermediaries are less likely to be impacted under the PMLA since onboarding of parties is instead undertaken by and access to information is already with banks and other regulated entities. Assessment to be done on a case-by-case basis.

The Delhi High Court ("DHC") has ruled recently in a judgment pronounced on July 24, 2023<sup>2</sup> ("Judgment") that a certain Cross Border Online Payment Gateways Service Provider ("Petitioner") is a "Payment System Operator" ("PSO") under the PMLA despite not falling within the ambit of the definition of PSO (system provider) under the Payments and Settlements System Act, 2007 ("PSS Act").<sup>3</sup> Further, as a consequence of qualifying as PSO under the PMLA, the Petitioner will also be required to meet the obligations of a "Reporting Entity" ("RE") including under Prevention of Money Laundering (Maintenance of Records) Rules, 2005 ("PMLA Maintenance Rules").<sup>4</sup> Pertinently, while reaching this conclusion, the DHC examined the specific function and role of an Online Payment Gateway Service Provider ("OPGSP") and specifically of the Petitioner and how it "enabled" payments to qualify as a PSO. This Judgment of the DHC has been appealed by the Petitioner before a division bench of the same court.

In this piece, we examine the Judgment in light of the business model of the Petitioner. We will also look at the implications of the Judgment on other OPGSPs and intermediaries in the payment eco-system being regarded as reporting entities under the PMLA.

### PETITIONER'S CASE IN POINT:

Petitioner operates as a cross border OPGSP, and is regulated by the notification of the Reserve Bank of India ("RBI") dated September 24, 2015 on Processing and settlement of import and export related payments facilitated by Online Payment Gateway Service Providers ("OPGSP guidelines")<sup>5</sup> by entering into standing arrangements with Authorised Dealer Category-I Schedule Commercial Banks ("AD Banks") such as Citibank and State Bank of India. Relevant to the current case, the Petitioner facilitated Indian exporters / sellers to receive cross-border payments from foreign remitters / buyers. These remittances from foreign remitters are pooled into an offshore account and then remitted to an AD bank e.g., Citibank's NOSTRO collection account where the funds are held in USD. Thereafter, the funds are converted into INR into Citibank's export collection account in India and further disbursed to accounts of Indian exporters. While the Petitioner had represented that the offshore account where foreign remitters' payments were pooled and transferred to the NOSTRO collection account was that of a "Global acquirer / aggregator", the Respondent, Financial Intelligence Unit India ("FIU-Ind"), disputed such representation and contended as per information received from Citibank, the Global acquirer / aggregator is an "offshore account" of the Petitioner. The DHC did not reach a conclusive finding on this fact.

The Petitioner had filed the present petition before DHC challenging the order of the FIU-Ind dated 17 December 2020 holding it to be a RE under the PMLA and imposing monetary penalty of about INR 96,00,000 (USD 115,419 approximately) under section 13(2)(d) of the PMLA for the following alleged violations:

1. Section 12 of the PMLA for avoiding obligations of maintaining and reporting transaction records by not registering as RE under the PMLA;
2. Rule 7 of the PMLA Maintenance Rules for failure to register and communicate the name address of its principal officer;
3. Rule 7 of the PMLA Maintenance Rules for failure to register and communicate the name address of its

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Before the DHC, the Petitioner argued that it was not a PSO under the PMLA and hence it will not qualify as RE as it provides a mere technological interface for export transactions and does not 'enable' transfer of funds between an Indian payee/exporter and an overseas payer/buyer. It stated that it is not involved in onboarding/enrolling of the overseas remitter/payer in this export transaction and only onboards the Indian payee/exporter which provides the payment link to this foreign entity. The onboarding of foreign remitter and transfer of funds is essentially done/handled and routed by the AD Banks at the end of each transaction. Therefore, it argued that, it is the AD Banks and not the Petitioner which is involved in handling of funds, clearing, receiving payments and performing settlement activities. The Petitioner relied upon the (i) identical definition of 'payment system' under the PSS (save for the exclusion of a stock exchange) wherein payment gateways such as OPGSPs are not treated as PSOs; and (ii) an affidavit by the RBI in another case stating that OPGSPs such as the Petitioner are not a PSO under the PSS Act.<sup>6</sup>

#### ARGUMENTS ADVANCED BY THE FIU-IND AND RBI:

The Respondent, FIU-Ind, disputed the stance of the Petitioner and argued that the interpretation of the definition of 'payment system operator' under PMLA ought not to be equated to that under the PSS and has to be interpreted more expansively in light of the objectives of the PMLA legislation. On facts, the Respondent argued that the Petitioner has certain information about the foreign remitter which the AD Banks are not privy to. They argued that, this leads to FIU-Ind having 'impaired visibility' on such information thereby limiting/hindering its function to effectively carry on anti-money laundering activities as against any suspicious transactions.

#### OPINION OF THE COMMITTEE FORMED BY MINISTRY OF FINANCE:

As per directions passed by DHC on January 12, 2021, the Secretary, Ministry of Finance ("MOF") constituted a committee, with a nominee of the RBI and the MOF, to clarify their position on whether entities involved in facilitating monetary transactions ought to be categorised as PSOs and thus, REs under the PMLA. The Committee reached the conclusion in the affirmative categorising Cross-Border OPGSPs as PSOs and thus, REs under the PMLA.

#### ANALYSIS OF THE DHC:

##### ■ **Pari Materia definition of payment system under the PSS Act and PMLA:**

The DHC concluded that payment aggregators and OPGSPs are treated differently under the PSS Act. OPGSPs being technology providers does not appear to be regulated by (i.e., licensed under) the PSS Act even if they are involved in some capacity in the payment chain.

The similarity of definitions between the PSS Act and the PMLA should not have a bearing since the objectives and the underlying legislative policy of how a payment system should be treated under the PMLA is different from that of the PSS Act.

Under the PMLA, "payment system operator" should be interpreted to ensure effective implementation of its provisions and to avoid the spectre of the offender sneaking out of the "meshes of the law".

##### ■ **Petitioner as a "payment system operator" under the PMLA:**

The DHC observed that the use of the word "enabling" in the definition of a "payment system operator" would capture any system which assists, makes possible or advances the objective of a payment between a payer and a beneficiary. Further, the word "involving" in the definition of a "payment system" would also mean any facet or feature comprised or comprehended in the course of a payment transaction. Hence, these interpretations would also apply to any participant in the payment chain who is not handling actual funds but nonetheless performs an important function.

The DHC also notes that the objective of the PMLA is to prevent money laundering activities which would involve analysis of all the data points generated in a transaction. Since it was found that the actual remitter details were not initially made available to the AD Bank by the Petitioner (payments to the AD Bank were made from an "offshore" account purportedly of the Petitioner), the Petitioner was understood to be acting as a gatekeeper for such details which only the Petitioner had because of its onboarding relationship at the remitters' end.

Hence, due to the above dual factors, the Petitioner was held to be a "payment system operator" under the PMLA. Interestingly, this finding was based on the PMLA alone and the court did not consider Petitioner's conduct/operations in other jurisdictions. (where the Petitioner was offering more than a technology interface for payments).

##### ■ **Petitioner's business model distinguished from UPI Third-Party Application Providers:**

The DHC laid down a fundamental distinction between the role of the Petitioner and a Unified Payment Interface ("UPI") Third-Party Application Providers ("TPAPs") such as Google Pay or Amazon Pay. It observed that unlike the UPI TPAPs, the Petitioner plays an active role in onboarding of foreign parties under the OPGSP framework. In the process of onboarding, the Petitioner maintains a nodal/collection account with a Bank through which OPGSP funds are routed. The credits/debits in this nodal/collection account are made by the AD Banks on the instructions of the Petitioner. In the case of TPAPs however, the end-to-end transactions are undertaken from bank accounts of the transacting parties themselves and their details are already captured with AD Banks.

##### ■ **Discharge of the Penalty against the Petitioner:**

In the order dated 17 December 2020, the FIU-Ind had imposed significant penalty on the Petitioner for a period of 32 months commencing from 16 March 2018 i.e., from the time when it had received notice for alleged violation of RE obligations under the PMLA. The DHC discharged the penalty obligations imposed by FIU-Ind on the basis that (i) the Petitioner had bonafide belief that it was not a PSO and as such did not deliberately act in violation of a statutory obligation. The stand taken by Petitioner would not amount to wilful disobedience as the position of law on the aspect was unsettled. This was buttressed by the different stance taken by RBI and FIU-Ind; and (ii) the Petitioner had cooperated with the FIU-Ind at all stages even while disputing its status as an RE including suggesting different mechanisms to share information vide a letter to the FIU-Ind.

## TAKEAWAYS:

### ■ Implication on payment “technology” intermediaries under the PMLA:

The Judgment is a defining interpretation and will likely result in additional obligations and compliance requirement for other entities performing similar functions as that of the Petitioners. Considering the decision, the following key points arise in the assessment of any technology service providers as PSOs under the PMLA:

- The technology provider does not necessarily have to be involved in handling of funds; and
- The role of the technology provider in onboarding the parties to the transactions as well as having access to details of the parties and transactions.

Considering the varied functions that are performed by intermediaries such as the payment gateways, the role, function and actual involvement will have to be examined on a case-to-case basis. However, cross-border payment intermediaries may be more likely to be caught under this definition of PSOs under the PMLA, especially in cases where certain transaction details are only available with the payment intermediary and not available with AD Bank.

### ■ Applicability to Domestic Payment Gateways:

Domestic payment gateways, which are not licensed PSOs under the PSS Act, are less likely to be deemed as PSOs under the PMLA. This is because the transaction details in all likelihood will already be with the AD Bank or payment aggregators (who are licensed under the PSS Act to consummate online transactions). Thus, from the perspective of object and purposive interpretation, the intent of the PMLA stands fulfilled.

### ■ Qualifiers to be a PSO under the PMLA:

Who then can be interpreted as a PSO following the interpretation of the PMLA laid down in this Judgment? As observed by the DHC, should the determination of a PSO be:

- definition based – i.e., applies to any participant in the payment chain who is not handling actual funds but nonetheless performs an important function by enabling payments between a payer and a beneficiary? or
- function based – i.e., applies to participants in the payment chain because they have access to details of the parties and transactions to the exclusion of AD Banks?

If the definition-based approach is taken, it may lead to all payment intermediaries (including domestic payment gateways) involved in any capacity to be determined as a PSO under the PMLA so as to not frustrate the objects of the PMLA. This may be viewed by many as an extreme interpretation, and may also hamper technological innovation by many tech service providers in this space. On the other hand, the function-based approach prods one to go beyond the applicability of the definition to assess nature of access to details that a payment intermediary has. These considerations should be done on a case-by-case basis.

### ■ Role of OPGSPs under the PSS Act:

The role of OPGSPs under the PSS Act is more straightforward and the Judgment has reiterated the position that an entity which does not handle actual funds is unlikely to be controlled under the PSS Act by the RBI. Hence, OPGSPs are not subject to licensing requirements under the PSS Act.

### ■ Understanding the FIU-Ind's role of enforcement under the PMLA:

It is clear from the FIU-Ind's arguments as well as the DHC's observations that the FIU-Ind's intention is for an RE to undertake monitoring and reporting obligations regarding all available and relevant data points in a payment transaction. In situations where the AD Banks have limited data points, non-licensed entities (such as the Petitioner in the current case) could be equally held responsible for data sharing/reporting. Information is supreme under the PMLA. Similarly, a question also arises at the end of AD Banks as to what extent they can/should require non-licensed entities to share transaction data points and avoid penalties for non-compliance as REs themselves.

### ■ Levy of penalties by the FIU-Ind:

Interestingly, even though the DHC ruled that the Petitioner was in fact a PSO under PMLA, it did not uphold the penalty imposed by FIU-Ind on the Petitioner. This is attributable to the strategy adopted by the Petitioner on its position under the PMLA, bona fide efforts to cooperate and no wilful intention to disobey the law.

### ■ Other future implications:

The implications of the Judgment would also have to be looked through the lens of payment policy developments in this space in India. In 2022, the RBI published draft guidelines for Processing and settlement of small value Export and Import related payments facilitated by Online Export-Import Facilitators (OIEF)<sup>7</sup> (“OIEF Guidelines”) which is intended to replace the OPGSP guidelines. The OIEF Guidelines propose revisions to the parameters of payment transactions allowed, modes of collection, and what can be debited and credited in the collection accounts. Based on the interpretation of a PSO as per the Judgment, Online Export-Import Facilitators may also be subject to the PMLA. However, this would need to be evaluated on a case-by-case basis.

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<sup>7</sup>Section 2(1)(rc) of the PMLA defines a “payment system operator” as “a person who operates a payment system and such person includes his overseas principal.

Explanation.-For the purposes of this clause, “overseas principal” means,— (A) in the case of a person, being an individual, such individual residing outside India, who owns or controls or manages, directly or indirectly, the activities or functions of payment system in India; (B) in the case of a Hindu undivided family, Karta of such Hindu undivided family residing outside India who owns or controls or manages, directly or indirectly, the activities or functions of payment system in India; (C) in the case of a company, a firm, an association of persons, a body of

individuals, an artificial juridical person, whether incorporated or not, such company, firm, association of persons, body of individuals, artificial juridical person incorporated or registered outside India or existing as such and which owns or controls or manages, directly or indirectly, the activities or functions of payment system in India.”

Section 2(1)(rb) of the PMLA defines a “payment system” as “a system that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them.

Explanation - For the purposes of this clause, “payment system” includes the systems enabling credit card operations, debit card operations, smart card operations, money transfer operations or similar operations.”

<sup>2</sup>W.P. (C) 138 of 2021.

<sup>3</sup>Section 2(1)(q) of the PSS Act defines a “system provider” as “a person who operates an authorized payment system.”

Section 2(1)(i) of the PSS Act defines a “payment system” as “a system that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them, but does not include a stock exchange;

Explanation.— For the purposes of this clause, “payment system” includes the systems enabling credit card operations, debit card operations, smart card operations, money transfer operations or similar operations.”

<sup>4</sup>Section 2(1)(wa) of the PMLA defines a reporting entity as “a banking company, financial institution, intermediary or a person carrying on a designated business or profession.”

Section 2(1)(l) of the PMLA includes a “payment system operator” in its definition of a “financial institution.”

<sup>5</sup>Available at <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10037&Mode=0> (last accessed August 8, 2023).

<sup>6</sup>Abhijit Mishra v. Reserve Bank of India (W.P. (C) No. 7007 of 2019).

<sup>7</sup>Available at [https://www.rbi.org.in/scripts/bs\\_view\\_content.aspx?Id=4118](https://www.rbi.org.in/scripts/bs_view_content.aspx?Id=4118) (last accessed August 8, 2023).

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