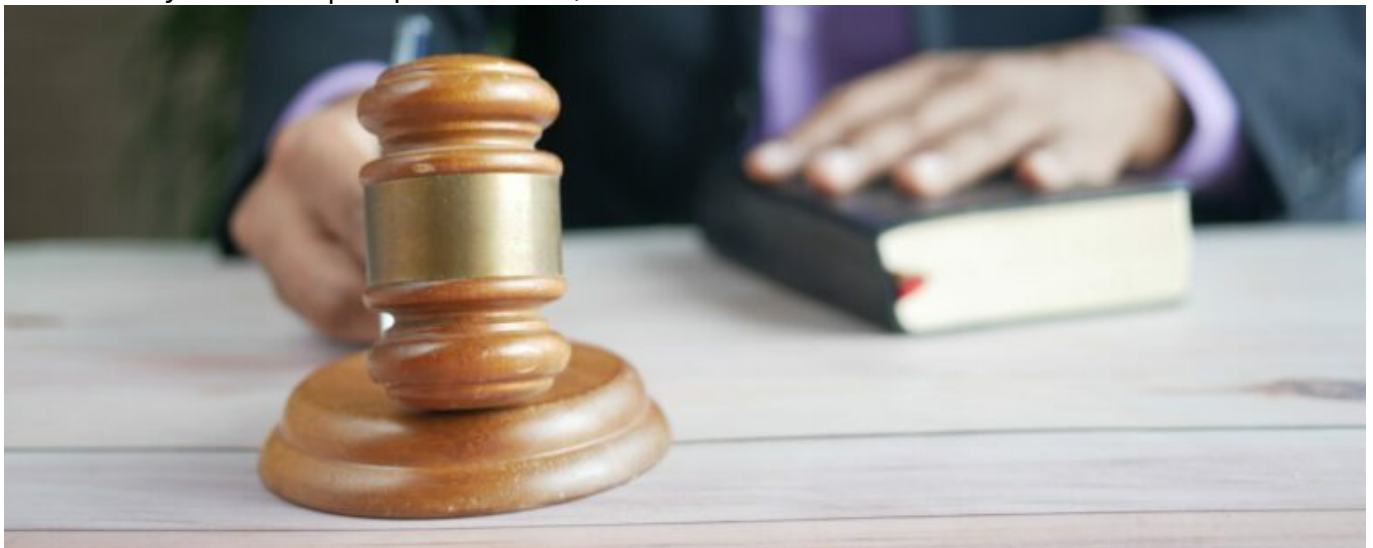


Delhi High Court: Payment Aggregators Come Under Payment And Settlements Act, 2007

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Payment Aggregators Under Payment And Settlements Act, 2007

The Delhi High Court ("DHC") has ruled, in the case of Lotus Pay Solutions Pvt Ltd & Anr vs. Union of India & Others [1], that Payment Aggregators ("PAs") fall within the definition of Payment Systems under Section 23A of the Payment and Settlements Act, 2007 ("2007 Act") and, as such, the Reserve Bank of India ("RBI") can frame guidelines to regulate them.

The Contention

The petitioner, Lotus Pay Solutions, stated that PAs who act as intermediaries do not fall within the scope and ambit of the 2007 Act. This came after the petitioners challenged the applicability of clauses 3, 4, and 8 of the Guidelines for the Regulation of Payment Aggregators and Payment Gateways ("2020 Guidelines") [2].

DHC's Rationale

The ruling by the DHC contains four vital components, which are expanded upon below:

I. Established Definition & Provisional Analysis

To answer the issue of whether PAs come under the ambit of Payment Systems, the DHC stated that under Section 2(1)(i) of the 2007 act, a payment system has been defined as a system that enables a payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them, barring stock exchange [3]. Furthermore, according to the RBI's discussion paper, a PA is defined as an intermediary in an online payment transaction who accepts payments from customers on behalf of the merchant and then transfers the money to the merchant's account [4].

A payer and a beneficiary are both involved in every digital payment transaction. The PA serves as the interface and oversees the transfer of funds to the designated nodal account. PAs are also required to maintain an escrow account with a commercial bank on a list, as per Clause 8 of the 2020 guidelines. This implies that customer funds are deposited into the escrow account and then transferred to the merchant's account after settlement. Thus, PAs provide an integrated system alongside managing the funds of the client.

This process would be classified as a function of a PA. Furthermore, a reading of the definition of "payment system" reveals that it is intended to

include any system that facilitates the transfer of funds between a payer and a beneficiary and includes clearing, payment, settlement services, or any combination of these, but excludes stock exchanges. While there is no definition of “payment service”, the updating principle [5] applies, and so, services provided by PAs to payers and beneficiaries through the use of technology fall within the purview of the payment system.

II. Mandatory RBI Authorization

Clause 3 of the 2020 guidelines requires non-banking entities that provide payment aggregation services to obtain “authorization” from the RBI to continue operations [6].

The petitioner contended that it is primarily a “payments gateway”, but since one out of its ten National Automated Clearing House (“NACH”) sponsor banks does not have an internal NACH system, it must act as a PA for that bank. In that sense, the contention is that if the Petitioner chooses to function as a PA, it should not be required to seek RBI authorization as mandated under clause 3.

Since the court deemed that PAs comes within the definition of a payment system, and the fact that RBI is the central financial authority of India, it leads to a conclusion that RBI was well within its powers to frame the 2020 guidelines. This can be corroborated via Sections 10 (2) and 18 of the 2007 act, which outline RBI’s power to determine standards and issue general directions. Furthermore, since the work function of the PAs comes within the definition of a payment system, it will be automatically necessary for them to seek authorization from the RBI for operating as PAs.

III. Requirement Of Minimum Net Worth

Clause 4 of the 2020 guidelines mandates that the Payment Aggregators – which existed on the date the 2020 Guidelines were issued – must have a net worth of INR 15 crores by March 31st 2021 and to have that amount increase to INR 25 crores, on or before March 31st 2023 [7].

The petitioner argued that requiring a minimum net worth of INR 15 crores would drive out small entrepreneurs and startups. This contention was rejected because, based on the responses received by the RBI to the discussion paper published on its website, the RBI reduced the requirement from INR 100 crores to INR 15 crores (later to be scaled up to INR 25 crores). Furthermore, because PAs will handle funds provided by customers, the RBI will require such applicants to enter the industry if they have some financial means.

IV. Escrow Account Mandate

Under clause 8, it is required that all non-bank payment aggregators ensure that the funds they collect are held in an escrow account with a designated commercial bank. It also states that for the escrow account, payment aggregator operations are deemed to be “designated payment systems” under the 2007 Act [8].

The petitioners contended that forcing PAs to switch from nodal bank accounts to escrow accounts should be prohibited because PAs currently maintain multiple nodal accounts to spread the risk of losing funds if the bank in question fails due to financial insolvency or otherwise.

In response, the DHC stated that “the RBI’s alternative is a more robust mechanism that protects the interests of all stakeholders”. Furthermore, under Section 23A of the Payment and Settlement Systems Act 2007, the RBI has the authority to require a payment system provider to deposit and then

maintain the deposited funds in a separate account or the accounts of a scheduled bank. Concerning the need to spread financial risk, the RBI had already issued a circular dated November 17th 2020, that allows PAs to maintain one additional escrow account [9]. As a result, it concluded that the public interest element infused in the guidelines' formulation trumps the petitioner's concerns.

Final Words

The RBI placed a strong emphasis on customer protection in the 2020 Guidelines as it mandated authorization, safe funds handling, and public interest. The guidelines also aid in preventing the affairs of such designated payment systems from being conducted in a manner detrimental to the customers' interests. The DHC's decision has reaffirmed the importance of customer protection, security, and fraud prevention by upholding the validity of the clauses in question.

1. W.P (C) 8215/2020, CM APPLs. 26623/2020& 34346/2021
2. RBI, Guidelines on Regulation of Payment Aggregators and Payment Gateways, 2020, <https://www.rbi.org.in/>
3. Section 2(1)(i), Payment and Settlements Act, 2007
4. Reserve Bank of India, Discussion Paper on Guidelines for Payment Gateways and Payment Aggregators, <https://www.rbi.org.in/>
5. Rama Pandey v. Union of India & Ors. 2015 (221) DLT 756
6. Clause 3, Guidelines on Regulation of Payment Aggregators and Payment Gateways, 2020, [https://www.rbi.org.in/](https://www.rbi.org.in/Clause 4, Guidelines on Regulation of Payment Aggregators and Payment Gateways, 2020, https://www.rbi.org.in/)
7. Clause 8, Guidelines on Regulation of Payment Aggregators and Payment Gateways, 2020, <https://www.rbi.org.in/>
8. RBI, Maintenance of Escrow Account with a Scheduled Commercial Bank, <https://www.rbi.org.in/>