

# Client Alert.

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## China Elects to Regulate the Administration of Commercial Prepaid Cards

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It is common practice for enterprises in the retail industry such as hypermarkets, department stores, and supermarkets, as well as general retail stores, hairdressing stores, and electronic products suppliers to utilize commercial prepaid cards and coupon sales in China as an effective sales channel to attract customers and increase sales revenues. The general public is generally unaware that prepaid cards could be subject to severe legal challenges under the relevant PRC laws such as the Law on the People's Bank of China (中华人民共和国中国人民银行法) (the "**People's Bank Law**") and the Regulations on the Administration of RMB (中华人民共和国人民币管理条例), which strictly prohibit use of currency substitutes.

According to the People's Bank Law, the People's Bank of China has the authority to shut down any printing or selling of currency substitutes for circulation in the market and, in addition, may impose a fine of no more than RMB200,000 on any legal entity that prints or sells currency substitutes for circulation in the market. On January 19, 2001, the State Economic and Trade Commission and Office of Correcting Industrial Improper Practice of the State Council jointly promulgated the Emergency Notice on Prohibition of Issuing and Using Coupons (Cards) (关于严禁发放使用各种代币券(卡)的紧急通知), which further prohibited the printing and issuance of coupon cards as currency substitutes for circulation in the PRC market.

Although it remains uncertain whether prepaid cards issued by commercial enterprises in connection with the sales of their own products will be deemed as currency substitutes in China, due to such legal uncertainty, PRC retailers who intend to list their shares on The Stock Exchange of Hong Kong ("**HKEx**") are routinely questioned by the HKEx and The Securities and Futures Commission of Hong Kong ("**SFC**") regarding their prepaid card activities and are also required to obtain legal opinions from PRC legal counsel in this regard and to disclose such practice as a risk factor in their prospectuses. However, there has been a shift in the position of the applicable PRC authorities following the promulgation in May 2011 of the Opinion on Regulating the Administration of Commercial Prepaid Cards (关于规范商业预付卡管理的意见) (the "**Administration Opinion**") which reflects that such authorities acknowledge the positive effect of prepaid cards and moreover do not prohibit commercial enterprises from issuing prepaid commercial cards themselves. On May 23, 2011, the General Office of the State Council circulated the Administration Opinion released by the People's Bank of China, Ministry of Supervision, Ministry of Finance, Ministry of Commerce ("**MOFCOM**"), State Administration of Taxation, State Administration for Industry and Commerce, and Bureau of Corruption Prevention, with the primary purpose of the Administration Opinion being to standardize the administration of commercial prepaid cards, as well as to prevent money laundering, illegal cash withdrawals, tax evasion, bribery, and corruption. The following is a summary of certain key points of the Administration Opinion including the latest updates of the legislation in this regard.

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## THE MEANING OF COMMERCIAL PREPAID CARDS ACCORDING TO THE ADMINISTRATION OPINION

The Administration Opinion divides commercial prepaid cards into two categories according to card issuers as follows: (i) the multi-function prepaid cards issued by specialized card issuers, which can be used across different regions, industries or entities, and (ii) the single-function prepaid cards issued by commercial enterprises, which can only be used to purchase commodities or services from that particular issuing enterprise or within chain stores with the same brand name as such issuing enterprise. The multi-function prepaid cards are subject to approval and supervision by the People's Bank of China pursuant to the Implementation of the Administrative Measures for the Payment Services Provided by Non-financial Institutions (非金融机构支付服务管理办法) ("**Administrative Measures**"). In accordance with such Administrative Measures, the relevant card issuers shall first obtain a payment services license before issuing any multi-function prepaid cards. With respect to the single-function prepaid cards, the Administration Opinion provides that the commercial authorities shall strengthen supervision, promptly establish industry standards and introduce administrative measures to properly regulate activities relating to such single-function prepaid cards. Financial institutions are prohibited from issuing prepaid cards without obtaining the necessary government approval.

## REQUIREMENTS PLACED ON CARD ISSUERS

While acknowledging the positive role played by commercial prepaid cards in general, the Administration Opinion also recognizes that certain obligations must be imposed on retailers in order to effectively regulate the issuance and purchase of commercial prepaid cards. These obligations include requiring that: (i) the issuer register the identity of each of the purchasers of registered commercial prepaid cards or each of the purchasers of non-registered commercial prepaid cards with an amount of RMB10,000 or more at one time; (ii) payment be settled through bank account transfers when an entity purchases prepaid cards with an amount of RMB5,000 or more at one time or when an individual purchases such cards with an amount of RMB50,000 or more at one time, and for such purchases settled through bank transfers, that the issuer be required to register the account name, numbers, and amount of the paying account and receiving account; (iii) the issuer implement a quota ceiling for prepaid cards, such that the face value of non-registered prepaid cards shall not exceed RMB1,000 and the face value of registered prepaid cards shall not exceed RMB5,000; (iv) the issuer of the prepaid cards provide invoices for the sale of prepaid cards according to the relevant laws and regulations, in particular, the relevant requirements of the Measures on Administration of Invoices (中华人民共和国发票管理办法); and (v) a multi-function card issuer must set up a special reserve deposit account at a commercial bank in order to deposit the prepaid monies it receives from cardholders, and sign a depository agreement with such commercial bank; provided, further, that such account shall be subject to the bank's supervision regarding the use of such reserve deposit.

## RESTRICTIONS ON EXPIRATION DATES

The Administration Opinion provides that a registered commercial prepaid card is not subject to any time limit with respect to its validity, while the validity period for a non-registered commercial prepaid card shall not be less than three years commencing from the date of its issuance. A card issuer is also required to re-activate or replace the non-registered commercial prepaid cards issued by it if such cards still contain balances after their expiration dates.

## SUPERVISION OF COMMERCIAL PREPAID CARDS

The Administration Opinion also stipulates that the People's Bank and MOFOM shall, before the end of 2011, collaborate with the other relevant governmental authorities and launch a special market check of commercial prepaid cards. In August 2011, the General Office of MOFCOM issued a Circular entitled "Conducting Special Inspections of Single-function Prepaid Cards" (商务部办公厅关于开展单用途预付卡专项检查的通知) ("**Inspection Circular**"), in order to

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implement the principles laid down in the Administration Opinion and to further strengthen the administration and regulation of the single-function prepaid cards. The Inspection Circular provides that the nationwide special inspection will be carried out of single-function commercial prepaid cards during the period commencing August 2011 to October 2011, and shall also require the following: (i) that a self-inspection be conducted from September 11, 2011 to September 30, 2011 by single-function card issuers, specifically enterprises in service sectors, such as large-sized department stores, supermarkets, barber shops, restaurants, beauty salons, etc. and chain enterprises operated under the same brand name (collectively, the **"Key Card Issuers"**); (ii) that local commercial departments conduct inspections on the relevant card issuers from October 1, 2011 to October 30, 2011; (iii) that commercial departments at various levels establish a directory of Key Card Issuers and conduct complete inspections of these card issuers; for those enterprises that are not categorized as the Key Card Issuers, random inspections shall be conducted. Further, on October 28, 2011, the People's Bank of China published a consultation paper with respect to the draft Administrative Measures for Prepaid Cards Business of Payment Institutions (支付机构预付卡业务管理办法(征求意见稿)), with a view to further regulating the multi-function prepaid cards-related activities. In addition, MOFCOM published a consultation paper on November 23, 2011 with respect to the draft Administrative Measures for Single-function Commercial Prepaid Cards (单用途商业预付卡管理办法(征求意见稿)) (the **"Draft Measures"**), which reiterate certain requirements and restrictions set forth in the Administration Opinion and further provide, among other things, that (i) the Draft Measures universally apply to commercial enterprises engaged in the business operations of single-function commercial prepaid cards, including enterprises of legal persons engaged in the business of wholesale, retail, lodging, restaurant, residential services, and other business services; (ii) the card issuer must file a registration with the relevant local MOFCOM within 30 days of the commencement of the issuance and sale of single-function commercial prepaid cards; (iii) a large-scale card issuer must complete an online filing process application within 5 days of the above-mentioned registration, and shall promptly file a registration of change on occurrence of any change in the relevant registration matters; (iv) a large-scale card issuer must set up a special reserve deposit account at a commercial bank in order to deposit the prepaid monies it receives from the cardholders in such account subject to the bank's supervision regarding the use of such reserve deposit; and (v) a fine of up to RMB30,000 would be imposed in the event a prepaid card issuer fails to comply with the Draft Measures.

Based on our experience, subsequent to the Administration Opinion, the HKEx and SFC have required, *inter alia*, that (i) a listing applicant who has engaged in prepaid card activities must fully disclose its prepaid card activities prior to the issuance of the Administration Opinion; (ii) such applicant obtain a legal opinion as to whether such prior activities were in breach of the applicable PRC laws and to what extent the applicant is subject to legal sanctions under the PRC laws; and (iii) internal control measures be put in place to ensure current and future prepaid card activities are in compliance with the applicable laws.

### CONCLUSION

The Administration Opinion including the recent updates to the related legislation represents a watershed for retailers issuing prepaid cards in China. The Administration Opinion appears, for the first time, to expressly acknowledge the issuance and use of the single-function prepaid cards and provide guidance as to how a commercial enterprise can lawfully issue single-function prepaid cards. Although the Administration Opinion acknowledges the legality of the issuance of prepaid cards, issuers of single-function prepaid cards should conduct a review of their programs and internal control procedures in order to ensure compliance with the applicable regulations. It is also expected that MOFCOM will review and consider comments received in connection with the Draft Measures and accordingly issue the formal

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administrative measures on single-function prepaid cards during 2012, which we expect to provide further clarification and guidance regarding the issuance and purchase of single-function prepaid cards in China.

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