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Electronic Payment Schemes in Brazil: A Legal Perspective

Introduction

Electronic payment schemes are system platforms which enable the electronic settlement of payments through electronic channels (i.e., credit cards), and are booming in Brazilian financial markets after being regulated by Federal Law No. 12.865, dated October 9, 2013.

The settlement of electronic payment schemes is not a prerogative of financial institutions. Any corporation can settle such schemes, provided they comply with regulations issued by Central Bank of Brazil (BACEN).



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Electronic payment schemes cannot collect funding from the general public as regular financial institutions are allowed to. In addition, electronic payment schemes have limited permission to use the clients' funding. They are only allowed to invest such funding in federal bonds and coordinate the custody of the funds.

Electronic payments activity should not be confused with cryptocurrencies such as Bitcoin. Unlike cryptocurrencies, electronic currency is backed up in Brazilian official currency Real (R\$).

Federal Law No. 12.865/2013, was further regulated by BACEN, which issued specific regulations on the matter: (i) Circular No. 3.680/2013 (e-wallets); (ii) 3.681/2013 (risk assessment criteria); (iii) 3.682/2013 (payment's arrangement); and (iv) 3.885/2013 (payment institution).

BACEN's regulations segregate the players in this market in: (i) payment arrangements settlor; and (ii) payment institution.

Payment Arrangements

A payment arrangement is a system which operates a commercial transaction payment clearing platform. Payment arrangements dictate electronic purchaser-to-merchant payments, debiting the payer's account with immediate transfer to the receiver.

On a traditional electronic payment model transaction, the payment arrangements are known by brand (i.e., Visa and Mastercard). The brands' systems operate payment and as part of the business model, guarantee the payments to the sellers.

BACEN regulations have provided for two different payment schemes: (i) closed (three points), when the arrangement

settlor acts as a third-party intermediary between the cardholder and the merchant; and (ii) open (five points), when the arrangement settlor hires a third player (payment institution) as intermediary between payers and receivers.

The number of participants in an open payment arrangement, generally, is five, which are: merchants (receivers), acquirers, brands, issuers and the cardholders. In addition to the main five members of the payment arrangement, two more players can be included in the flow. In the relationship between issuer and the cardholder, it is possible to have a retailer or any other company with a high capillarity structure to act as a payment's card issuer. The relationship between acquirer and merchants can be incremented with the inclusion of a subacquirer with a higher capillarity or a better technology to offer, such as the Payment Service Provider (PSP), Independent Sale Organization (ISO) and Value Added Reseller (VAR).

Payment arrangements can operate payments domestically or cross-border, depending the territory of the transaction or card (local or international).

The payment arrangement can be purchase oriented if the payment scheme liquidates purchase transactions (i.e., Mastercard and Visa), or it can also be settled to operate cash transfers (i.e., PayPal).

The payment arrangement can be (i) without a specific purpose, when the payment is allowed in different merchants with no corporate or brand connection (i.e., Visa and Mastercard); or (ii) with a specific purpose, when the payment is allowed only

in a specific company/service and those with the same visual identity (i.e., store's gift card, franchising and public services).

Payment arrangement can establish a: (i) pre-paid payment's account (i.e., pre-paid cards); (ii) postpaid payment's account (i.e., credit cards); (iii) prompt deposit account (i.e., debit card); or (iv) episodic relationship, situation in which a payment flows through one system on behalf of another market player.

BACEN regulates the activities of the payment arrangements operating in Brazilian territory, and the following arrangements are exempted from BACEN previous authorization to operate: (i) with a limited purpose; and (ii) those in which the players, jointly, reach a total payment flow less than R\$ 500 million or a number up to 25 million transactions, both accumulated in the last 12 months.

Payment Institution

Payment institution is the player integrating one or more payment arrangements, which has as its main or secondary activity, alternative or cumulatively: a) services of allocation and withdrawal of the funds maintained in a payment's account; b) execution or providing tolls to increase the payment service more efficiently, including the transfer of funds from or to a payment's account; c) management of payment's account; d) payment's instrument issues; e) registration of payment instrument's acceptance; f) fund remittances; g) exchange of physical currency into an electronic coin, and vice-versa, registration and management of the electronic coin transaction; h) other activities allowed by BACEN.

BACEN classifies the payment institutions in three models: (i) electronic coin issuer or pre-paid issuer, whose activity is to manage the receiver user's account and then exchange the funds into electronic coin, used to make pre-paid payments. (ii) postpaid payment's instrument issuer, whose activity is to manage the receiver's account and to offer the possibility of postpaid payments to the payer; and (iii) acquirer, whose activity is not user's account management, but registration of merchants to accept a specific payment method and also liquidate the payments as a creditor against the card issuer.

Payment institutions are regulated by BACEN, but BACEN's previous authorization to operate is needed when the total payment flow exceeds R\$ 500 million within 12 months, or the amount of R\$ 50 million in escrow funds into the pre-paid payment's accounts. It mitigates the systemic risk and encourages new players to enter into this commercial market, boosting competition and diversification.

Some payment institutions act as e-wallet managers. Their activity is basically the coordination of the custody of their clients' funds and provision of the electronically efficient transfers. Transactions are processed electronically by accessing a website or mobile app.

A very important aspect of the acceptance of e-wallets in Brazil is that the clients' funds be segregated from assets and liabilities of the payment institutions' assets and therefore not subject to the credit risk of the payment institution, including bankruptcy and corporate reorganization.

The Future of Electronic Payment Methods

Electronic payment methods have dramatically improved in Brazil after Federal Law No. 12.865/2013 and the regulation issued by BACEN. Such legal and regulatory framework has increased the safety of transactions and enhanced competition in the Brazilian financial market.

Brazil has developed a state-of-the-art regulation, updated from time to time, combining legal safety to players and users, without prejudice to innovation of new services and the inclusion of new players in the market.

Recently, BACEN has regulated the incorporation and activities of Direct Credit Companies, allowing smaller structured companies such as Fintechs to act in the credit market, including the financing of final users' assets of the payment institutions. In addition, crowd funding companies were also allowed to operate through electronic platforms, subject to BACEN's overview.

BACEN's objective is to open the electronic market to as many players as possible. According to the regulator, the development of this market in Brazil will cause the inclusion of a significant part of the population and will increase the competition in the financial market, which is highly concentrated.

From our point of view, these governmental initiatives will cause the growth of this market in a dynamic and safe environment. **P**