What is a deposit (and why does it matter)?

By Rhys Bollen*

Introduction

Deposit-taking is an ancient business, dating back to early goldsmiths and money-lenders. But far from being a term of art, "deposit" and "deposit-taking" has not always been defined. Recent developments, both in the financial services legislation and banking industry practice, mean that the concept of a *deposit* needs to be reviewed.

This article looks at the history of deposit-taking and the concept of a deposit. It then considers the legal definitions of deposit-taking and banking business, under the common law and financial services legislation. The middle section of the paper examines the legal concept of a deposit, its character and implications. The paper then concludes with a discussion of the regulation of deposit-taking, and the practical implications of modernising the concept of deposit for those regimes.

Why is the definition of deposit and deposit-taking important? Deposit-taking is subject to a specialist and interventionist regulatory regime[1] in most countries, including in Australia.[2] Whether a product is a deposit (and whether the issuer is therefore taking deposits) has significant implications for customers (such as whether depositor protection regimes apply) and for issuers (such as what types of regulatory requirements, for example capital adequacy, apply). For these reasons, the definitions of deposit and deposit-taking have real-world implications. This article seeks to

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[1] Usually as an aspect of the supervision of the banking sector

[2] Nicholas Ecomides and R Glenn Hubbard, "The political economy of branching restrictions and deposit insurance: a model of monopolistic competition among small and large banks" (1996) 39 *Journal of Law and Economics* 667 at 668

examine the current legal position and then suggest some future refinements to modernise the law on deposit-taking.

History and background

In ancient times, merchants and the public found using gold and other precious metals was a viable payment system. It was more convenient and cost-effective than barter.[3] Over time, goldsmith's and banker's receipts became more convenient and cost-effective to use than gold itself. Money deposited with goldsmiths was the 17th century precursor to the modern banking system.[4]

The goldsmith held gold (or other precious metals) on behalf of numerous customers. The goldsmith issued a receipt to each customer, stating how much had been deposited by whom. With the goldsmith's agreement, a customer could transfer one of those receipts (or write a payment note) to a third party to whom the customer wished to pay some money. Assuming the third party was willing to accept the receipt or payment note (and its associated right to collect a specified amount of gold) as payment, an effective payment was made.[5] The third party (the payee in this example) could then either claim the gold to which she was now entitled, or use the receipt to make a payment to another party (again, assuming both the goldsmith and new party agree).

Over time, goldsmiths realised that their customers were likely to withdraw only a small portion of the gold deposited at any time. Thus the goldsmith was able to issue receipts in excess of the gold held, effectively lending money to customers against future repayment (in kind or cash). The goldsmith had evolved to a banker of sorts – the receipt evolved from a record of bailment to a record of debt.[6]

[3] Rhys Bollen "A review of the development and legal nature of payment facilities" (2005) 16 *Journal of Banking and Finance Law and Practice* 130 at 131
[4] Tyree Dr A, *Banking Law in Australia* (4th ed, Butterworths, 2002) at [5.2]; Geva B, *Bank Collections and Payment Transactions – Comparative Study of Legal Aspects* (Oxford University Press, 2001)
[5] Kreltszheim D "The Legal Nature of 'Electronic Money': Part 1" (2003) 14 JBFLP 161 at 183
[6] Tyree, *Banking Business in Australia* at [5.2]; Kreltszheim, "The Legal Nature of 'Electronic Money': Part 1" at 176

Using bankers' receipts also allowed the payer to leave money with a banker earning interest until it was needed to make a payment. This was attractive vis-à-vis gold and cash; which earned its holder no return. It also enabled bankers to attract a greater amount of money to be deposited with them. We have here two of the continuing commercial incentives behind the operation of payment and deposit-taking services.

Bankers taking money on deposit and providing interest as a return is a concept dating back at least to biblical times. In the parable of the tenants, the master when returning from a long period of travel chastised the "lazy" servant for failing at least to place the money left with him "on deposit with the bankers, so that when I returned I would have received it back with interest".[7]

Banking in England effectively dates from the emergence of the goldsmith-bankers in the early 17th century. It was the goldsmiths who for the first time concentrated under one roof the essential banking functions of deposit and lending, and then added a third function of issuing notes. The goldsmiths' roles as bankers developed naturally from their normal business activities. They had strongrooms where merchants and other wealthy individuals could deposit surplus cash and valuables for safekeeping. They kept the money deposited with them at call as 'running cash' (similar to the modern transaction or current account) and paid interest on it. This money could be used productively by lending it out at interest to other merchants. The depositor obtained a receipt or note that represented a promise to pay her back the amount of her deposit. Before long these notes began to pass from hand to hand as a substitute for ready cash. In this way, the 'goldsmith's note' was the forerunner of the modern bank note.[8]

Deposit-taking is what deposit-takers do; banking is what bankers do

Deposit-taking is a functional concept. An entity logically need not be a bank to be carrying on the function of taking deposits. The concept or label of 'deposit' appears to have developed as a kind of convenient shorthand for describing what is the standard legal arrangement between a bank and customer. This

[7] Matthew 25:27 (NIV)

legal arrangement, where the customer places funds with the bank to be used later (by being withdrawn or paid to others), is primarily contractual. Funds are placed with the bank directly or by having third-party payments directed to and collected by the bank on behalf of the customer (eg direct credits, cheques). It is generally accepted that the basic bank-customer contract is a loan arrangement.[9]

A deposit-taking institution is by definition, therefore, an institution that carries on the business of taking deposits. In most countries, this is a highly regulated industry, as will be discussed below. And in most countries, only entities with a particular licence or authorisation (eg a licensed bank) are allowed to carry on the business of deposit-taking. However, this is a regulatory answer rather than a legal one. For in a functional sense deposit-taking institutions are simply those that take deposits on a regular basis. This of course leads us to the next logical question – what is a deposit?

What is a deposit?

Traditional concept

The customer's primary relationship with their banker is that of credit and the banker's indebtedness to the customer is equal to the amount of money standing on deposit with the banker from time to time.[10] This has been accepted as a primary incident of the modern banker-customer relationship in many cases, including *United Dominions Trust Ltd v Kirkwood*[11] and *Foley v Hill.*[12] While the banking service evolved essentially from bailment service of the goldsmith,[13] by 1848 at least it was clear that the primary relationship

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[8] Bank of England Museum display, observed February 2005
[9] *United Dominions Trust Ltd v Kirkwood* [1966] 2 QB 431 per Lord Denning at 446, see also judgement of Diplock LJ; *Foley v Hill* (1848) 2 HL Cas 28, 9 ER 1002; approved in *Croton v R* (1976) 117 CLR 326; R Bollen, "What a payment is (and how it continues to confuse lawyers)" (2005) *MqJBL* 189 at 191
[10] [1966] 2 QB 431 per Lord Denning (at 446); Blay and Clark, *Australian Law of Financial Institutions* at [9.01]; R Bollen, "What a payment is (and how it continues to confuse lawyers)" (2005) *MqJBL* 189 at 191
[11] See also judgment of Diplock LJ.
[12] (1848) 2 HL Cas 28, 9 ER 1002; Approved in *Croton v R* (1976) 117 CLR 326.
[13] Tyree, *Banking Business in Australia* at [6.1].

between banker and customer was that of debtor-creditor.[14] The money the customer places with the bank is lent to the bank and the bank undertakes to repay it as directed. The right to repayment the customer holds in relation to money deposited is a chose in action.[15]

The arrangements under which money is placed with a banker are generally known as deposit arrangements. This form of language probably arose from the era of depositing (or physically placing) gold and precious metal with the goldsmith or merchant for safekeeping and credit. It seems to have carried over into monetary times, whereas the *deposit* customers generally now place with a bank is negotiable money, in the form of currency or a payment instrument (eg a cheque or electronic funds transfer).

In modern day banking parlance, the concept or label of deposit appears to be convenient shorthand for describing the standard legal arrangement between a bank and customer.[16] Again, this is a contractual debt-based arrangement where the customer places funds with the bank to be withdrawn or paid to others later.

As a general notion, a deposit occurs where a person makes a payment to another expecting that other person to repay (or on-pay) the same monetary value, but not necessarily the same actual currency, when required.[17] This generally involves a standing relationship between the intermediary and customer, as debtor and creditor.[18] A deposit is a chose in action,[19] recorded by the intermediary and redeemable by the customer, either at call or by another arrangement.[20]

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[14] R Bollen, "The Regulation of Internet Banking" (2001) 12 *JBFLP* 5 at 7; Dr A Tyree, "The Legal Nature of Electronic Money" (1999) 10 *JBLFP* 273 at 277.

[15] *Perrin v Morgan* [1943] AC 399 per Viscount Simon LC at 406.

[16] This is not to say that all banking products are deposits, but the basic standardised banking product (ie a savings or transaction account) clearly is.

[17] see Jowitt's Dictionary of English Law; Christopher Curtis "The status of foreign deposits under the federal depositor-preference law" (2000) 21 *University of Pennsylvania Juornal of International Economic Law* 237 at 241-2

[18] Andrea Beatty *et al* "E-payments and Australian regulation" (1998) 21 *UNSWLJ* 489 at 509

[19] David Fox "Property rights and electronic funds transfers" at 458

[20] see for example *Akbar Khan v Attar Singh* [1936] 2 All ER 545; *Commissioners of the State Savings Bank of Victoria v Permewan Wright and Company Limited* [above]; *Re Alberta Legislation* [1938] 2 DLR 81; *Foley v Hill* (1848) 2 HLC 28

Some writers have questioned whether non-traditional banking products and other payment facilities are deposits. For example, do stored value cards and stores of digital cash, particularly if held by an Authorised Deposit-taking Institution **(ADI)** on behalf of a customer[21], constitute a deposit?[22] In this author's view, they probably do. Logically, the answer should be the same even if the entity holding the funds is not an ADI.

According to Albea, under some aspects of US law a "deposit account is essentially any account maintained with an organisation that accepts money (or deposits) from an entity with an understanding that such deposits will be returned upon demand by the depositor".[23] As this is drawn from the property security part of the Uniform Commercial Code, it does not necessarily reflect the full US understanding under regular banking law.

The narrow view

The narrower view is that a deposit is by definition an unsecured advance of money to a bank for use by the bank in the ordinary course of its banking business. It is 'a specific sum of money taken and held on account by a financial institution (eg a bank) as a service provided for its clients'.[24] On this view, the identity of the holder of the money is fundamental to the characterisation of the facility as a deposit. Only money held by a bank or similar organisation is a deposit under this view.

In many jurisdictions, this is a largely circular and academic issue, as the only entities legally able to accept deposits are banks. However, in jurisdictions like Australia, whether an entity needs to be authorised as a bank depends on whether it takes deposits, so it seems unsatisfactorily circular to suggest that whether it is taking what in law are deposits depends on whether it is a bank in

[21]IE where the customer has removed value from their conventional account and converted it to digital cash.
[22]Mark Sneddon "Cyberbanking and Payment Products: Legal and Regulatory Issues" a paper presented at the 14th Annual Banking Law and Practice Conference, Sydney, 22 May 1998, at 12
[23] Stuart Albea "Security interests in deposit accounts and the banking industry's use of setoff" (2002) 54 *Alabama Law Review* 147 at 148
[24] See for example the Wikipedia online 'open-source' reference service, <http://en.wikipedia.org/wiki/Deposit>

the first place! For this reason, in this author's view it is more appropriate[25] to define deposit by reference to the nature and character of the product rather than the regulatory status of the issuer.

Broader concepts

These views may be contrasted with the broader concept of deposit, being money paid in advance to secure a contract (eg a deposit paid in a conveyancing transaction). This is not a deposit in a banking sense, in that it is not a debt arrangement established for the purpose of future withdrawals or on-payment. Rather it is a form of pre-payment or surety – the funds are paid to secure a property right and/or to pre-pay part of a purchase price.

A number of financial products act as effective substitutes for conventional deposits. For example, cash management trusts operate much like savings accounts for many consumers, and are often treated as such by consumers.[26] This is combined with the offering of deposit and deposit-like services by a wide range of businesses, many not those traditionally considered to be financial services organisations (eg supermarkets). This suggests that "the historic separation of banking and other types of business activities may be rapidly disappearing".[27]

Proposed definition

Geva and Kianieff argue that money paid into payment products such as 'e-money' that are widely accepted as means of payment

> "ought to be regarded as deposited in an account with the issuer. It is only in connection with the single purpose e-money products and to a point, restricted or limited-use such products, that e-money is to be regarded as an advance payment, or prepayment, for relevant goods or services".[28]

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[25] more helpful, useful and meaningful, and less circular
[26] Edward Symons "The 'business of banking' in historical perspective" (1983) 51 *George Washington Law Review* 676 at 677
[27] Edward Symons "The 'business of banking' in historical perspective" at 677
[28] Benjamin Geva and Muharen Kianieff, "Reimaging E-Money: its Conceptual Unity with other Retail Payment Systems" (2002) at 14 (<http://www.imf.org/external/np/leg/sem/2002/cdmfl/eng/bg_mk.pdf>, accessed 15 June 2006).

They also note that the description of a deposit fits e-money payment products "in the same way that it fits the traditional situation of monetary value deposited to a bank account, except for value recorded on [stored value product] is 'decentralised' or 'distributed'".[29]

This also raises the appropriate characterisation of non-traditional payment products, particularly those where the balance is recorded on a device in the possession of the customer (eg a plastic card, passbook or the customer's PC). The author and others have considered this in detail elsewhere.[30]

In summary, a deposit can be defined as 'the contractual loan arrangement between a financial institution and client where the client places funds with the institution for later withdrawal or use in making payments'. A facility is a deposit if it has these characteristics – placing funds, by way of loan/debt, with an institution for later withdrawal or on-payment – regardless of whether the institution is conventionally known as a 'bank'. This suggested modernised definition of deposit will be used in the remainder of the article.

What is banking business?

There appears to be little if any judicial consideration of whether a particular facility or product is a deposit-taking facility. However, a number of cases have considered whether a person is in the business of banking, which generally involves taking deposits in some way. While a number of US cases have considered whether a particular product is a 'demand deposit', they did not examine in detail the meaning of deposit (but rather whether a particular deposit was a demand deposit or not).[31]

The leading Australian case, *Commissioners of the State Savings Bank of Victoria v Permewan, Wright and Co Ltd*, held that banking business involved

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[29] at 14

[30] R Bollen, "A Review of the development and legal nature of payment facilities' (2005) 16 *JBFLP* 130; D Krelszheim, "The legal nature of electronic money: Part 1" (2003) 14 *JBFLP* 161; D Krelszheim, "The legal nature of electronic money: Part 2" (2003) 14 *JBFLP* 261; A Tyree, "The legal nature of electronic money" (2000) (<http://austlii.edu.au/~alan/svc-legal.html>, accessed 1 June 2006); A Tyree "Smartcards and unclaimed money" (2005) (<http://austlii.edu.au/~alan/unclaimed-money.html>, accessed 1 June 2006)

[31] Joseph Savage (1987) 38 *Hastings Law Journal* 377 at 390 and 399

taking money on deposit and on-lending it.[32] The case held that accepting money on deposit was a key feature of banking, without specifically defining what taking money *on deposit* means.

The High Court was asked to consider whether the operation of the Commissioners of the State Savings Bank of Victoria involved banking business. This was important on the facts, as it affected whether the defences for receiving payment of cheques "without negligence" were available to the Commissioners under the *Instruments Act 1890* and the *Bills of Exchange Act 1909.*

Issacs J, with whom Gavan Duffy, Rich and Powers JJ agreed, held that a bank is an institution that accepts deposits from customers and who is able to return their funds to them when required. Banks generally also operate so-called 'current accounts' for their customers. He said:

> "…The essential characteristics of the business of banking are, however, all that are necessary to bring the appellants within the scope of the enactments; and these may be described as the collection of money by receiving deposits upon loan, repayable when and as expressly or impliedly agreed upon, and the utilization of the money so collected by lending it again in such sums as are required. These are the essential functions of a bank as an instrument of society. It is, in effect, a financial reservoir receiving streams of currency in every direction, and from which there issue outflowing streams where and as required to sustain and fructify or assist commercial, industrial or other enterprises or adventures.
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> If that be the real and substantial business of a body of persons, and not merely an ancillary or incidental branch of another business, they do carry on the business of banking. The methods by which the functions of a bank are effected—as by current account, deposit account at call, fixed deposit account, orders, cheques, secured loans, discounting bills, note issue, letters of credit, telegraphic transfers, and any other modes that may be developed by the necessities of business—are merely accidental and auxiliary circumstances, any of which may or may not exist in any particular case."[33]

Issacs J went on to say:

[32] (1914) 19 CLR 457
[33] Issacs J at 471

> "Bankers are not bound by law to open current accounts. They may confine themselves, if they wish, to what are known as deposit accounts, and make those deposits repayable at call or at stipulated times, and withdrawable as a whole or in part as may be agreed on. The method of withdrawal may be conditioned to be by personal application, or by written order. It is all a matter of contract."[34]

While expressed differently, Powers J came to a similar view.

> "As to the first question, the definition of a banker in the Acts referred to is a person (or body corporate) who carries on the business of banking. The State Savings Bank does certainly carry on important and essential parts of the business of banking. It collects money by receiving current deposits, as a bank, and deposits upon loan repayable on demand, or at dates agreed upon; it uses the money deposited with it as a bank by lending it again at interest; it receives deposits of cash and cheques; it collects cheques deposited by customers; it pays on demand cheques drawn on it in the ordinary course by friendly societies; it pays ordinary depositors on cheques, or orders presented with passbooks; it is used by customers for business accounts as well for ordinary deposits; it has thousands of operating business accounts; it receives not only cash and cheques, but bills, drafts and notes for collection for customers, and makes charges for same; it charges exchange; it remits money to any part of the world by bank drafts; it receives remittances from Great Britain, New Zealand and all Australian States for credit in its books; it receives drafts for collections drawn in any part of the world. The deposits amount to £21,000,000."[35]

The leading UK case is that of *United Dominion Trust v Kirkwood*.[36] In *Kirkwood* the plaintiff sought to establish that they were "bona fide carrying on the business of banking" so that they were not to be considered as unregistered moneylenders under the *Moneylenders Act 1900* (England). Although English statutes defined a banker as a person who carried on the business of banking, there was no statutory definition of banking. It therefore became necessary for the court to find out the usual characteristics that went to make up the business of banking. To do so, Lord Denning MR undertook a historical analysis, going back to the eighteenth century before cheques came into common use until modern times and then concluded:

> "There are, therefore, two characteristics usually found in bankers today: (i) They accept money from, and collect cheques for, their customers and place them to their credit; (ii) They honour cheques or orders drawn on

[34] Issacs J at 471
[35] Powers J at 486
[36] [1966] 2 QB 431; [1966] 1 All ER 968

> them by their customers when presented for payment and debit their customers accordingly. These two characteristics carry with them also a third, namely: (iii) They keep current accounts, or something of that nature, in their books in which the credits and debits are entered.
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> Those three characteristics are much the same as those stated in Paget's Law of Banking …: 'No-one and nobody, corporate or otherwise, can be a "banker" who does not – (i) take current accounts; (ii) pay cheques drawn on himself; (iii) collect cheques for his customers."[37]

Lord Denning MR considered the application of the decision in the *State Savings Bank of Victoria case* and argued that if it were followed all building societies would be banks. (If the case was heard today, he may well have pondered whether payment facility providers would be banks as well.) The court held that while in previous days it was the characteristic that a banker should receive money for deposit it is now the characteristic that bankers should receive cheques on behalf of a customer. Bankers, to be properly called bankers, need to provide cheque account facilities also, so customer can draw cheques on the bank. Therefore in Lord Denning MR's view there are three characteristics of a 'bank'. They operate current accounts, pay cheques drawn by and collect cheques for customers.

This is a different functional definition of banking. Rather than focussing on taking funds on deposit and on-lending them, the *Kirkwood* formula focuses on accepting payments on behalf of customers and making further payments on behalf of those customers. This emphasises the role of the bank as payment intermediary over their role as borrower and lender. The Kirkwood formula has been cited with approval in more recent English cases, such as *Roe's Legal Challenge.*[38] Later cases have held that accepting payments on behalf of a customer and crediting those funds to a customer account is as much deposit-taking as accepting direct deposits from the customer. The UK legislative definition of banking reflects this.

[37] [1966] 1 All ER 968 at 975
[38] [1982] 2 Lloyds Rep 370

What does it mean in practice?

For historical reasons, in Australia only those institutions that both take deposits and make loans were required to be licensed as banks. US courts have also taken a similar approach.[39] The US approach focuses regulatory attention on "the potential abuses associated control over commercial credit when combined with the bank's role as a depository of funds".[40] The rationale is that "the safety of customer deposits" is less at risk where the deposit-taker is not also in the business of commercial credit.[41] Further, for many years it provided that banks could only undertake banking and related business – but could not for example engage in securities activities.[42]

The *Banking Act 1959* (Australia) defines banking business as taking deposits and making loans, which reflects the earlier case law. For many years, credit unions and building societies avoided characterisation as banking business because they lent only to their members, rather than the public at large. This was addressed in Australia in 1998 under the Wallis Report reforms.[43]

Many institutions take *deposits* without holding an ADI licence. For example, some payment service providers and debenture issuers accept funds, recorded in a customer account, in the expectation of future withdrawal or on-payment. In recent years, the banking business concept has been expanded to include debit and credit card acquiring, and operating purchased payment facilities.[44] This recognises that such activity is essentially banking business, although not necessarily a combination of both taking deposits and on-lending the funds. There are ongoing characterisation issues for a number of products that are deposit-like to a greater or lesser degree.[45]

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[39] Carol Conjura, "Comment: Independent Bankers Association v Conover: nonbank banks are not in the business of banking" (1986) 35 *American University Law Review* 429 at 430; Edward Symons "The 'business of banking' in historical perspective" at 678
[40] Conjura, "Comment: Independent Bankers Association v Conover: nonbank banks are not in the business of banking" at 448
[41] Conjura, "Comment: Independent Bankers Association v Conover: nonbank banks are not in the business of banking" at 449
[42] Edward Symons (1983) 51 *George Washington Law Review* 676 at 677
[43] Final Report of the Financial System Inquiry, 1997 (http://fsi.treasury.gov.au)
[44] See below 'Purchased payment facilities' and 'Acquiring and issuing'
[45] For example, some debenture, cash management, stored value and other payment products. There are also characterisation issues for some hybrid debit / credit products, such as all-in-one

Regulating banking business

'Regular' banking business

A collection of federal and state bodies regulate Australian financial institutions.[46] This regulation relates mainly to prudential standards,[47] systemic stability, consumer protection and monetary policy. This is because, in the words of one academic, "banks act as financial intermediaries and protectors of the 'grocery money'".[48]

Following the Wallis report,[49] a new concept of an Authorised Deposit-taking Institution **(ADI)** was inserted into the *Banking Act 1959*.[50] An ADI is a company that has an authority to conduct "banking business" from the Australian Prudential Regulation Authority **(APRA)**.[51] Banking business is:

> "(a) a business that consists of banking within the meaning of paragraph 51(xiii) of the Constitution; or
>
> (b) a business that is carried on by a corporation to which paragraph 51(xx) of the Constitution applies and that consists, to any extent, of:
>
> (i) both taking money on deposit (otherwise than as part-payment for identified goods or services) and making advances of money; or
>
> (ii) other financial activities prescribed by the regulations for the purposes of this definition."[52]

An organisation must evaluate whether its operations consist of or include banking business. If banking business is identified the entity has a number of

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loans. Are they one single product, and if so are they a credit or debit product? Or are they two separate products, one being a deposit product and the other a loan or credit product?

[46] Australian financial institutions include banks, building societies, credit unions, friendly societies, managed funds, superannuation funds and finance companies. See Andrea Beatty *et al* "E-payments and Australian regulation" at 496-7

[47] The prudential standards relate to an institution's ability to repay its obligations to depositors when they are called upon.

[48] Theodore Schroeder, "Note: Nationsbank v Valic: Landmark or an illusion? The quest to define the business of banking continues" (1996) 57 *University of Pittsburg Law Review* 983 at 985. By grocery money, the commentator is referring to the fact that although the bank may not hold the customer's life savings, it holds the money from which they meet their week-to-week living expenses. Hence, the customer would be severely disadvantaged if the funds they hold with their bank were not available as and when the customer reasonably expected.

[49] The March 1997 Report of the Financial System Inquiry (chaired by Mr Stan Wallis).

[50] see section 5 and 9(3)

[51] section 9

[52] section 5

options. They may apply for an authority allowing them to carry on banking business. If such an authority is granted, the organisation becomes an ADI and is subject to the supervision of APRA.

An entity that conducts banking business may apply for an exemption from the application of the *Banking Act*.[53] These may be granted in limited circumstances where the organisation involved is supervised by another regime or where it is not considered appropriate to regulate them under the ADI scheme.[54] It is an offence to conduct banking business without an exemption or authority from APRA.[55]

Some organisations involved in the provision of electronic financial services may be uncertain whether their activities involve banking business. The statutory definition does not differ significantly from the understanding of banking business at general law.[56] As discussed above, in *Commissioners of the State Savings Bank of Victoria v Permewan Wright and Company Limited* the High Court held that banking business was characterised by taking money on deposit from customers and lending this to other people as required.[57]

The second limb of the statutory banking definition is "making advances of money". This is "distinguishe[d] . . from other dealings [by] the concept of *indebtedness*."[58] It is similar to a loan, although possibly broader.[59] Certain other forms of financial accommodation are also contemplated.[60]

The combination of the concepts of deposit taking and advance encompasses a wide range of financial services. This is much broader than the traditional notion of a bank and would include building societies, credit unions, friendly

[53] section 11
[54] Andrea Beatty *et al* "E-payments and Australian regulation" at 510-11
[55] section 7 and 8
[56] Andrea Beatty *et al* "E-payments and Australian regulation" at 507-8; Mallesons Stephen Jacques *Australian Finance Law*, Lawbook Co, 2002, chapter one
[57] (1915) 19 CLR 457 per Issacs, Gavan Duffy, Powers and Rich JJ at 471
[58] Andrea Beatty *et al* "E-payments and Australian regulation" at 509 [emphasis in original]
[59] *Handevel Pty Ltd v Commissioner of Stamps (Vic)* (1985) 157 CLR 177; *Lord Suffield v Inland Revenue Commissioners* [1908] 1 KB 865
[60] *Prime Wheat Association Ltd v Chief Commissioner of Stamp Duties* (NSWCA, 5 November 1997, Gleeson CJ, Handley JA, Sheppard AJA)

societies and the like.[61] It may also extend to the operators of some other payment systems, such as some credit and charge cards.

APRA has the power to grant[62] and revoke[63] an ADI's authority.[64] They may determine prudential standards that ADIs must comply with[65] and may issue various directions governing an ADI's operations and financial policies.[66] ADIs must maintain sufficient Australian assets to fulfil their obligations to Australian depositors and, in the event of financial trouble, the depositors' funds must be repaid first.[67]

Under the *Banking Act,* depositors have priority in the liquidation of an ADI.[68] They effectively have priority over both regular secured and unsecured creditors. While this is less than the depositor insurance and guarantee schemes existing in some countries, it does give deposit-holders substantive additional rights. These rights only apply to those holding deposits from ADIs. If the entity is not an ADI or the product is not a deposit, the protection does not apply. In theory, this means that non-deposit products held with ADIs are not covered.

Whether the entity is an ADI is clearly a matter of record. Whether a particular product is a deposit is less clear. However, for the reasons above, it a legal question – applying the definition to each product on a case-by-case basis.

Purchased payment facilities

A fairly recent addition to financial sector regulation in Australia is the *Payment Systems (Regulation) Act* 1998 **(the *PSR Act*)**. Under the *PSR Act* the Reserve Bank of Australia **(RBA)** has substantial powers to monitor, supervise and regulate a variety of payment systems. The *PSR Act* defines a payment system as a "funds transfer system that facilitates the circulation of money, and

[61] For example, there is no longer any differentiation based on whether the funds are only lent to members.
[62] section 9
[63] section 9A
[64] Andrea Beatty *et al* "E-payments and Australian regulation" at 506
[65] section 11A and 11AF
[66] section 11CA(2)
[67] section 13A(3) and (4)
[68] s13A

includes any instruments and procedures that relate to the system".[69] After formal designation,[70] the RBA may impose access regimes or standards upon a particular system.

Access is defined as "the entitlement or eligibility of a person to become a participant in the system, as a user of the system, on a commercial basis on terms that are fair and reasonable".[71] This is remarkably broad and could conceivably refer to institutional access to financial sector clearing systems,[72] consumer access to particular services or the use of financial sector infrastructure by new entrants into the field.[73]

The RBA has the power to determine standards that must be followed by designated payment systems.[74] "Standards" are not defined in the *PSR Act*. Possible standards could relate to interoperability,[75] security, authentication or accountability.[76]

A separate scheme has been established for the regulation of purchased payment facilities, being those:

> "purchased by a person from another person ... able to be used as a means of making payments up to the amount that, from time to time, is available for use under the conditions applying to the facility ... [and where] those payments are made by the provider of the facility or by a person acting under an arrangement with the provider of the facility (other than the user of the facility)"[77]

The holder of the stored value of such a facility, being the provider of the facility or another person who makes the payments referred to above, is regulated under the *PSR Act*. This is to ensure the stability of the facility itself and payment systems generally.[78] Before being permitted to be the holder of stored

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[69]section 7
[70]section 11
[71]section 7
[72]Ie the cheques clearing system established by the Australian Payments Clearing Association
[73]Ie access to the EFTPOS network. See Andrea Beatty *et al* "E-payments and Australian regulation" at 500-501
[74]section 18
[75] Interoperability refers to the capacity of a system to work with other systems based on different software and hardware.
[76]Andrea Beatty *et al* "E-payments and Australian regulation" at 501
[77]section 9
[78]House of Representatives Explanatory Memorandum, Chapter 5 (discussing Part 4 of the PSR); Andrea Beatty *et al* "E-payments and Australian regulation" at 502

value, a corporation must either have an authority from APRA to carry on banking business, or an authority or exemption granted by the RBA under the *PSR Act*.[79]

Many smart, debit and credit card systems will fall within the *PSR Act* provisions relating to purchased payment facilities. Where the issuer is a conventional ADI, the *PSR Act* requirements would not have any significant impact on their operations. However, for other organisations, an exemption or authority would be needed.

For greater certainty as a result of the Wallis Report reforms, a definition of banking business was inserted in the *Banking Act*. More recently, regulations under the *Banking Act* have been made to deem certain deposit-like activities[80] also to be banking business. The first of these, in 2000, was to deem the holder of stored value under certain purchased payment facilities to be banking business. It states

> "the provision of a purchased payment facility is banking business if APRA determines that the facility:
>
> (a) is of a type for which the purchaser of the facility is able to demand payment, in Australian currency, of all, or any part, of the balance of the amount held in the facility that is held by the holder of the stored value; and
>
> (b) is available, on a wide basis, as a means of payment, having regard to:
>
> > (i) any restrictions that limit the number or types of people who may purchase the facility; and
> >
> > (ii) any restrictions that limit the number or types of people to whom payments may be made using the facility."[81]

This definition does not cover all purchased payment facilities. It applies only to those available widely as a means of payment *and* under which the customer can demand repayment in Australian currency (ie make a cash withdrawal).

[79] see sections 9(3), 23 and 25; Andrea Beatty *et al* "E-payments and Australian regulation" at 502-4

[80] Activities that in the author's view are probably deposit-taking, but this has not be resolved by the courts.

[81] Reg 3, Banking Regulations 1966

Some commentators believe that these products were already deposits under the general law. Following the discussion and analysis above, this author would also agree that such stored value products are probably by definition already deposit products. However, providing such products as a stand-alone business would not constitute banking business under the general definition as the operator is not necessarily also making advances. For this reason, the regulation helpfully clarifies that such activities are banking business.

If the operator of such products were to also be in the business of making advances of money, a court may well come to the conclusion that they were in the business of banking and within the general statutory concept. That is, without the special deeming regulation, they would have been required to obtain an APRA authorisation. However, this has not been tested in court (to the author's knowledge) so the Government took the cautious approach of deeming this conduct to be banking business.

This regulation under the *Banking Act* was the result of a position agreed between APRA and the RBA. Following the Wallis reforms, responsibility for supervising banks was now with APRA. However, under the *PSR Act*, the RBA received a new role in supervising holders of stored value for purchased payment facilities. This slightly unusual position (separating the regulation of banks and holders of stored value) was what the 2000 Regulation aimed to address. The joint media release of the RBA and APRA at the time stated:

> "Purchased payment facilities, such as smart cards and electronic cash, are facilities which consumers pay for in advance and use to make various types of payments. Consumers rely on the holder of the stored value backing such a facility (that is, the entity receiving the proceeds from the sale of the facility) to subsequently redeem that value on demand. …
>
> The stored value backing a purchased payment facility represents a promise by the holder to repay in full. Where the customer is entitled, under the terms of the facility, to demand repayment in Australian currency of part or all of the balance of the stored value, the facility is akin to a deposit. For this reason, the Reserve Bank and APRA have agreed that it would make sense to have such purchased payment facilities, whether issued by an authorised deposit-taking institution or otherwise, regulated by APRA under a common regime. This will ensure consistency in regulatory treatment of these emerging payment

> instruments and is in line with the approach taken in a number of other countries. The Commonwealth Government has endorsed the revised arrangements."[82]

This can be contrasted with limited use, low circulation smart cards. Such cards, familiar in transport or educational settings (eg cards for use within a University) allow limited funds to be 'stored' on a card. Customers have some exposure on the card – they give the operator funds in advance and obviously hope that they will be available for use when the customer actually intends to make the relevant purchases. They will suffer some loss of the funds are not so available. However, customers are unlikely to view these products as a mainstream banking product (ie 'akin to a deposit' in the language of the APRA/RBA media release above).

As such, these products are probably not banking business under the deeming regulation.[83] Whether they are deposit products depends in part on their legal character – are they a pre-payment or a debt? Transport cards and similar products are better characterised as pre-payments for future services (eg, for future bus or train journeys) than debts to be repaid on demand. As such, they are probably not deposits under general law. This of course depends on the breadth of vendors and situations where the card can be used – the broader the range of uses and vendors, the greater the potential a court would find the legal relationship underlying the card is a debt and therefore a deposit, rather than a pre-payment for future goods and services. There is a spectrum, and the difficult cases are obviously the ones in the middle, where the product is able to be used with multiple unrelated vendors for a moderate range of transactions.

The use of the deeming regulation approach will probably mean that Australian courts are less likely to be asked to resolve the legal uncertainty about the definition of deposit. Most of the products that are close to the common law concept of deposit will probably be caught under the deeming regulation anyway. One would assume that APRA will take this into account in deciding when to exercise the determination power contained in the deeming provision.[84]

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[82] APRA/RBA Joint Media Release, 15 June 2000, (http://www.rba.gov.au/MediaReleases/2000/mr_joint_rba_apra.html)

[83] Regulation 3 discussed above.

[84] Regulation 3

This structure also gives APRA the ability to decide which products to drawn into the regulatory net, giving it some power to deal with perimeter issues.

Acquiring and issuing

The second area where a deeming regulation has been used is for card issuing and acquiring. The business of issuing and acquiring (that is, receiving) credit and debit card payments also involves elements of deposit taking. Again, the government has avoided the complex common law characterisation issue and deemed the following to be banking business:

> " …the activities of credit card acquiring and credit card issuing are banking business, if performed by a participant in a credit card scheme that was designated as a payment system under section 11 of the Payment Systems Act on 11 April 2001"[85]

As with the purchased payment facility deeming regulation, some credit acquiring and issuing services probably involved deposit-taking at general law. However, this is resolved by the new regulation, which simply deems such activities to be banking business (which the resulting consequences for the provider in terms of APRA licensing).

Corporations Act

The Australian Securities and Investments Commission (ASIC) regulates financial services and financial products (both widely defined) under the *Corporations Act 2001*. Services include advice and issuing, and products include non-cash payment facilities, investment facilities and deposit products.

A person makes a non-cash payment if they make a payment or cause a payment to be made otherwise than through the physical delivery of Australian or foreign currency. The facility through which, or through the acquisition of which, a person makes such a payment is the financial product regulated under the *Corporations Act* as a 'non-cash payment facility'.[86] Under the *Corporations Act* a deposit product is 'any deposit-taking facility made available by an ADI

[85] Regulation 4, Banking Regulations 1966

(within the meaning of the *Banking Act 1959*) in the course of its banking business'.[87]

Firms that provide financial services in relation to a financial product generally need an Australian financial services licence. This includes advice or dealing (eg arranging or issuing) in relation to a deposit product or a non-cash payment facility.

The *Corporations Act* also imposes a conduct and disclosure regime on those who issue or distribute non-cash payment facilities. For example, licensed issuers and distributors are obliged to train and supervise their representatives, take responsibility for losses caused by their representatives, maintain records and ensure their accounts are audited annually, and ensure any personal advice they give is based on reasonable grounds.

Mandatory product disclosure applies to issuers of non-cash payment facilities. This disclosure must be contained in a Product Disclosure Statement (PDS) and must include, inter alia, information about the product's cost, key features, risks and any dispute resolution processes. Advisers must also give a Financial Services Guide, and where personal advice is given, a Statement of Advice.

From time to time issues arise whether a particular facility is a deposit product under the *Corporations Act*. Whether an entity is an ADI is a matter of record – it is simply a question of their licensing status with APRA. Whether a facility is a 'deposit-taking facility' is more complicated and depends on the analysis above.

Practical implications of definition

While it is entertaining for some to have a fine academic debate about the meaning of concepts such as 'deposit', it helps to ground the discussion and look at its concrete application. It *does* matter how one defines deposit. And it is helpful to go beyond the simplistic position that *deposits are what deposit-takers 'take'.*

[86] s763D, s763A(1)(c), ASIC Policy Statement 185 *Non-cash payment facilities* at paras [185.57-185.58]
[87] s761A and 764A(1(i),

ASIC characterisation

One practical issue for payment products is whether a payment product is a non-cash payment facility and/or a deposit product under the *Corporations Act 2001*. The rules for each vary in some respects. For example basic deposit products do not require a Product Disclosure Statement but non-cash payment facilities do.[88] On the other hand non-cash payment products do not require periodic statement but deposit product do require them.[89]

APRA characterisation

Whether an entity is taking deposits in a legal sense also affects its regulation under the APRA regime. If the entity is already an ADI, it affects how the product is regulated. For example, how does the product fit within the capital adequacy regime? How do the funds underlying the facility affect the ADI's capital requirements? Do holders of the product have the benefit of the depositor-protection rules?

If the entity is not already an ADI, it affects whether the entity is conducting 'banking business' and requires APRA authorisation. For some products, the 'deeming' regulations already address this. For some purchased payment facilities and for credit card issuing and acquiring, Parliament has already deemed these activities to be banking business.[90]

Other similar activities, although not 'deemed' to be banking business under the regulations, may be taking deposits under general law. Products where the customer places funds with the issuer under a clear legal expectation of them being repaid or on-paid to third parties as directed by the customer are likely to be deposits under general law. An entity providing such a product, at the same time as 'making advances' is arguably conducting banking business under the general statutory definition. Such entities therefore need to consider and discuss authorisation with APRA.

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[88] reg 7.9.07FA, Corporations Regulations 2001
[89] s1017D
[90] See above

Conclusions

Deposit-taking has been regulated, but not rigorously defined, since ancient times. In the author's view, recent developments, both in the legislation and industry practice, means that the concept of a *deposit* needs to be reviewed and modernised.

A facility where the customer places funds with the provider for future use, either for future payments or to withdraw as cash, should be generally understood as a deposit. Rather than attempting to define deposit-taking in such as way that only catches those entities the community wants regulated as banks (or ADIs in Australia), a functional definition that recognises deposits for what they are is preferable. The legislation (and regulators) can then address which entities need to be prudentially regulated separately. Otherwise, the law creates anomalies by characterising a facility as a deposit or not purely on the basis of the status of the issuer. Such legal anomalies are not in the interest of the industry or community generally.